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THE-UNSOLVED PROBLEMS IN PRIORITY FOR FEDERAL TAX CLAIMS

As the Federal Government's tax program has increased in scope the status of the Government's claim for taxes has taken on greater importance. The right of the United States to priority does not arise from the common law but depends entirely on three statutes:¹ The Bank-

69. See note 63 *supra*.

1. "The right of priority of payment of debts due to the government, is a prerogative of the crown well known to the common law. . . . The claim of the United States, however, does not stand upon any sovereign prerogative but is exclusively founded upon the actual provisions of their own statutes." *United States v. State Bank of North Carolina*, 31 U.S. (6 Pet.) 308, 310 (1832). See 9 MERTENS, FEDERAL INCOME TAXATION § 54.20 (1943) questioning this view.

ruptcy Act, Section 3466 of the Revised Statutes² and Sections 3670-3672 of the Internal Revenue Code.³

The Bankruptcy Act, in Section 67(b),⁴ makes provision for the priority of statutory liens over unsecured claims.⁵ If there is a tax claim and a competing lien the question of priority is governed by the applicable lien law, that is, Section 3670.⁶ Section 64(a) of the Bankruptcy Act⁷ sets up its own system of priorities for unsecured creditors under which federal, state, and local tax claims are fourth and the priority created by Section 3466 is fifth. Under the Act federal tax claims are thus subsequent to secured creditors and to three classes of unsecured creditors.⁸

When the debtor is insolvent rather than bankrupt,⁹ there is a marked difference in the treatment of creditors.¹⁰ Section 3466, the

2. "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 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 the cases in which an act of bankruptcy is committed." REV. STAT. § 3466 (1875), 31 U.S.C. § 191 (1952). Hereafter referred to in this Note as Section 3466.

3. "If any person liable to pay any taxes neglects or refuses to pay the same after demand, the amount . . . shall be a lien in favor of the United States upon all property . . . belonging to such person." INT. REV. CODE OF 1939, § 3670, 53 STAT. 448 (now INT. REV. CODE OF 1954, § 6321). This shall hereafter be referred to as Section 3670.

"Unless another date is specifically fixed by law, the lien shall arise at the time the assessment list was received by the collector. . . ." INT. REV. CODE OF 1939, § 3671, 53 STAT. 449 (now INT. REV. CODE OF 1954, § 6322).

"Such lien shall not be valid as against any mortgagee, pledgee, purchaser, or judgment creditor until notice thereof has been filed by the collector. . . ." INT. REV. CODE OF 1939, § 3672(a), 53 STAT. 882 (now INT. REV. CODE OF 1954, § 6323(a)). This shall be referred to as Section 3672.

Section 3670-72 of the Code of 1939 are §§ 6321-323 in the 1954 Code; the sections are substantially the same.

4. 52 STAT. 876 (1938) as amended, 11 U.S.C. § 107(b) (1952).

5. 4 COLLIER, BANKRUPTCY ¶ 67.20 (14th ed. 1942).

6. 4 *id.* ¶ 67.24.

7. 52 STAT. 874 (1938), as amended, 11 U.S.C. § 104(a) (1952).

8. Section 3466 has been held inapplicable in bankruptcy proceedings. *Adams v. O'Malley*, 182 F.2d 925 (8th Cir. 1950); *United States v. Sampson*, 153 F.2d 731 (9th Cir. 1946); *In re Knox-Powell-Stockton Co.*, 100 F.2d 979 (9th Cir. 1939); *In re Jacobson*, 263 Fed. 883 (7th Cir. 1920). See 3 COLLIER, BANKRUPTCY ¶ 64.502 (14th ed. 1941).

9. For a discussion of what constitutes insolvency see 9 MERTENS, FEDERAL INCOME TAXATION §§ 54.14-18.

10. See Kennedy, *The Relative Priority of the Federal Government: The Pernicious Career of the Inchoate and General Lien*, 63 YALE L.J. 905 (1954); Rogge, *The Differences in the Priority of the United States in Bankruptcy and in Equity Receiver-ships*, 43 HARV. L. REV. 251 (1929); Notes, 30 N.C.L. REV. 442 (1952); 56 YALE L.J. 1258 (1947).

basic provisions of which were enacted in 1797,¹¹ provides that in this event the debts owed the United States¹² take priority; the section does not create a lien.¹³ This act seems to give absolute priority to the United States' claims since on its face it contains no exceptions.¹⁴ Some writers indicate that Congress did not intend federal priority over antecedent liens,¹⁵ but the courts have interpreted the statute in such manner so that federal claims will defeat such liens if the latter are general and inchoate; only creditors who have taken steps to "perfect" their lien before the federal claim inheres are protected.¹⁶ The problem becomes one of defining specificity and perfection, and this has been termed a federal question.¹⁷ By the device of finding that the lien lacked one or more of the qualities of specificity, the Supreme Court has consistently denied creditors priority over United States tax claims, and through the years has avoided directly facing the question whether a specific and perfected lien is superior to federal priority.¹⁸ The result of all this is that although equity receiverships and bankruptcy proceedings both deal with the distribution of an insolvent's estate, the mere filing of a petition in bankruptcy may, under the present system, radically change the creditor's

11. 1 STAT. 515 (1797).

12. Tax claims of the United States have been held to be debts within this provision. *Price v. United States*, 269 U.S. 492 (1926).

13. See cases cited in Annot., 77 L. Ed. 757, 772 (1932).

14. *United States v. Waddill, Holland & Flinn, Inc.*, 323 U.S. 353, 355 (1945).

15. Kennedy, *supra* note 10, at 907; Note, 29 N.C.L. REV. 293, 300 (1951); 68 HARV. L. REV. 722, 723 (1955).

16. *United States v. Gilbert Associates, Inc.*, 345 U.S. 361 (1953); *Illinois ex rel. Gordon v. Campbell*, 329 U.S. 362 (1946); *United States v. Waddill, Holland & Flinn, Inc.*, 323 U.S. 353 (1945); *United States v. Texas*, 314 U.S. 480 (1941); *Spokane County v. United States*, 279 U.S. 80 (1929); *Conard v. Atlantic Insurance Co.*, 26 U.S. (1 Pet.) 189 (1828); *Thelsson v. Smith*, 15 U.S. (2 Wheat.) 271 (1817).

17. A state court's characterization, although entitled to weight, is always subject to reexamination by the Supreme Court. If the state characterizes its lien as inchoate, then this is practically conclusive. *United States v. Security Trust & Savings Bank*, 340 U.S. 47, 49 (1950).

But see *Spokane County v. United States*, 279 U.S. 80, 94 (1929); *United States v. Reese*, 131 F.2d 466, 468 (7th Cir. 1942). One court stated: "In the interest of orderly administration of justice in matters of concurrent jurisdiction, this court should respect the state court's characterization. . . ." *United States v. Acri*, 109 F. Supp. 943, 945 (N.D. Ohio 1952).

18. *Illinois ex rel. Gordon v. Campbell*, 329 U.S. 362, 370 (1946); *United States v. Waddill, Holland & Flinn*, 323 U.S. 353, 355 (1945); *Bank of Wrangell v. Alaska Asiatic Lumber Mills*, 84 F. Supp. 1, 2 (D. Alaska 1949).

Lower courts have given priority to liens which they have found specific and perfected. See, e.g., *United States v. Atlantic Municipal Corp.*, 212 F.2d 709 (5th Cir. 1954), commented on in 68 HARV. L. REV. 722 (1955), 41 VA. L. REV. 107 (1955); *Bank of Wrangell v. Alaska Asiatic Lumber Mills, supra*; *Evans v. Stewart*, 66 N.W.2d 442 (Iowa 1954).

For a further discussion of § 3466 see Blair, *The Priority of the United States in Equity Receivership*, 38 HARV. L. REV. 1 (1925); Holman, *The United States—Creditor*, 9 FED. B.J. 261 (1948); Note, 20 U. CIN. L. REV. 274 (1951).

rights.¹⁹ There is no adequate reason for this divergent treatment, and it is argued that Section 3466 should be brought into conformity with the policy of the Bankruptcy Act.²⁰

Section 3670 creates a federal lien which attaches to all property²¹ belonging to a delinquent taxpayer. This statute,²² unlike Section 3466, establishes a lien but does not create federal priority.²³ Section 3672, in order to protect certain prior interests against a secret lien,²⁴ was amended to provide that the federal lien shall not be valid as against a mortgagee, purchaser, judgment creditor,²⁵ or pledgee²⁶ until notice is filed by the collector in the district in which the property subject to the lien is situated.²⁷ The standing of those liens which arose prior to the tax lien and those which do not fall into the categories of Section 3672, for example, attachments, garnishments, and mechanics and state tax liens, are not dealt with in this statute, and the question is raised whether the act should be read as if it contained a provision that federal tax liens take precedence over creditors not mentioned, irrespective of whether their rights came into existence prior to, or subsequent to, the time when

19. In nonbankruptcy proceedings a tax claim of the United States is entitled to priority over state and municipal taxes which are not specific and perfected. See, *e.g.*, *United States v. Gilbert Associates, Inc.*, 345 U.S. 361 (1953); *United States v. Texas*, 314 U.S. 480 (1941); *Spokane County v. United States*, 279 U.S. 80 (1929).

In bankruptcy proceedings under § 64 (a) the United States' tax claims have no priority over a claim for taxes due to the state but both must share equally. 3 COLLIER, *BANKRUPTCY* §§ 64.02, 64.401; Rogge, *supra* note 10, at 252; Annot., 62 A.L.R. 146, 149 (1929); Annot., 97 L. Ed. 32, 47 (1952). For a comparison of treatment of wage claims under § 3466 and the Bankruptcy Act see Note, 30 N.C.L. REV. 442 (1952).

20. "[D]ifferences in priority have grown up around virtually independent statutory provisions enacted with little or no thought to comparison. There is no sufficient reason for such divergencies to continue to exist. . . ." Rogge, *supra* note 10, at 252. See Kennedy, *supra* note 10, at 930-32; Note, 29 N.C.L. REV. 293, 301 (1951); 68 HARV. L. REV. 722, 723 (1955).

21. State law has been applied to determine what constitutes property of the taxpayer when the federal lien attaches. *United States v. Cox*, 119 F. Supp. 147, 150 (N.D. Ga. 1953); *United States v. Anders Contracting Co.*, 111 F. Supp. 700 (W.D.S.C. 1953).

For a general discussion as to what property the federal lien attaches see 9 MERTENS, *FEDERAL INCOME TAXATION* § 54.47-50; Anderson, *Federal Tax Liens—Their Nature and Priority*, 41 CALIF. L. REV. 241, 245-56 (1953); Annot., 174 A.L.R. 1373, 1378-386 (1948); Annot., 105 A.L.R. 1244, 1247-250 (1936).

22. The United States has had a statutory lien for unpaid taxes since 1866. 14 STAT. 107 (1866), REV. STAT. § 3186 (1875).

23. *United States v. The Pomare*, 92 F. Supp. 185, 188 (D. Hawaii 1950).

24. Originally the federal tax lien was valid against subsequent purchasers or creditors although they had no notice of the federal lien. *United States v. Snyder*, 149 U.S. 210 (1893).

25. 37 STAT. 1016 (1913).

26. 53 STAT. 882 (1939).

27. As to others § 3671 provided that the lien attach at the time the assessment list was received by the collector. This has been changed so that under Section 6322 of the 1954 Code the lien arises from the making of the assessment.

the tax lien attached under Section 3670.²⁸ Cases have generally agreed that if the federal lien is prior in time it will be prior in right.²⁹ The real problem of priority arises if the competing lien is prior in time and the cases though in conflict applied the rule "first in time, first in right," and treated the federal lien as any other lien having no special priority.³⁰ The result reached in many of these cases, which gave priority to the competing creditors of the Government, was that an inchoate lien prior in time was superior in rank to a federal tax lien. The Supreme Court in *United States v. Security Trust & Savings Bank*³¹ departed from these cases and made the doctrine of the general and inchoate lien, which was applied earlier to Section 3466, equally applicable to Section 3670.³²

28. "No more here than in § 3466 is there any indication that Congress intended the federal right to supercede an antecedent lien." Kennedy, *supra* note 10, at 922. Note, 29 N.C.L. Rev. 293, 300 (1951). *But see* Mr. Justice Jackson's concurring opinion in *United States v. Security Trust & Savings Bank*, 340 U.S. 47, 51 (1950).

29. *Macatee, Inc. v. United States*, 214 F.2d 717 (5th Cir. 1954); *Cobb v. United States*, 172 F.2d 277 (D.C. Cir. 1949); *United States v. City of Greenville*, 118 F.2d 963 (4th Cir. 1941); *MacKenzie v. United States*, 109 F.2d 540 (9th Cir. 1940); *United States v. Maddas*, 109 F. Supp. 607 (W.D. Pa. 1953); *Samms v. Chicago Title & Trust Co.*, 349 Ill. App. 413, 111 N.E.2d 172 (1953); *United States v. Standard Brass & Mfg. Co.*, 266 S.W.2d 407 (Tex. Civ. App. 1954). *Contra*, *United States v. Woodside*, 34 F. Supp. 281 (W.D.S.C. 1940); *Winston-Salem v. Powell Paving Co.*, 7 F. Supp. 424 (M.D. N.C. 1934); *Berrymont Land Co. v. Davis Creek Land & Coal Co.*, 119 W. Va. 186, 192 S.E. 577 (1937).

30. Kennedy, *supra* note 10, at 924; Annot., 95 L. Ed. 59, 67 (1951); 26 N.Y.U.L. Rev. 373 (1951). "There is nothing in the Internal Revenue Code, §§ 3670-3672 . . . providing for government priority over inchoate liens which antedate its own liens." *United States v. Sampsell*, 153 F.2d 731, 735 (9th Cir. 1946).

"It would seem, however, that the [federal] lien was intended to attach to the property of the taxpayer subject to existing encumbrances; and this is borne out by the provision that it shall not be valid as against mortgagees, purchasers, or judgement creditors until notice thereof is duly filed as provided by the act. This interpretation places liens of the federal government and liens of the states on an equal basis for the application of the principle first in time, first in right . . . which is the principle ordinarily applied with respect to priority of liens. . . ." *United States v. City of Greenville*, 118 F.2d 963, 966 (4th Cir. 1941).

For cases granting the competing lien priority see, *e.g.*, *United States v. Winnett*, 165 F.2d 149 (9th Cir. 1947); *United States v. Sampsell*, 153 F.2d 731 (9th Cir. 1946); *United States v. 52.11 Acres of Land*, 73 F. Supp. 820 (E.D. Mo. 1947); *New York Casualty Co. v. Zwerner*, 58 F. Supp. 473 (N.D. Ill. 1944); *Board of Supervisors v. Hart*, 210 La. 78, 26 So.2d 361 (1946); *United States v. Yates*, 204 S.W.2d 399 (Tex. Civ. App. 1947).

For cases granting the federal lien priority see *Miller v. Bank of America, Nat'l Trust & Sav. Ass'n*, 166 F.2d 415 (9th Cir. 1948), *affirming*, *Bank of America v. United States*, 73 F. Supp. 303 (N.D. Cal. 1946); *United States v. Fisher*, 93 F. Supp. 73 (N.D. Cal. 1948).

31. 340 U.S. 47 (1950). For a discussion of this case see 39 GEO. L.J. 496 (1951); 35 MINN. L. REV. 580 (1951); 26 N.Y.U.L. REV. 373 (1951).

32. "In cases involving a kindred matter, *i.e.*, the federal priority under Rev. Stat. § 3466, it has never been held sufficient to defeat the federal priority merely to show a lien effective to protect the lienor against others than the Government, but contingent upon taking subsequent steps for enforcing it. . . . If the purpose of the federal tax lien statute to insure prompt and certain collection of the taxes due the United States from tax delinquents is to be fulfilled, a similar rule must prevail here." *United*

A federal tax lien will be held superior to a contingent and inchoate attachment lien even though the latter is prior in time.

The historical argument for priority of federal claims is that they must be protected in order to secure adequate revenue for the public benefit.³³ The Government cannot exist or function properly and efficiently unless taxes are collectable with speed and certainty. When the debtor is insolvent, some of his creditors are going to suffer in any event, and it is contended that other claims, even those of states and their local subdivisions, should be subordinate to the claims of the United States which involve a wider public interest.³⁴ The Court's concept that federal claims must be given priority for the purpose of securing an adequate public revenue is questionable in light of the Bankruptcy Act in which Congress has given tax claims a low priority.³⁵

The Government has met great resistance in its efforts to gain the benefits of the *Security Trust* doctrine.³⁶ There are noticeable efforts on the part of both the state and federal courts to avoid this stringent rule which frequently results in federal priority. At the same time the Supreme Court has evidenced its determination to abide by and continue its announced rule.³⁷

One obvious way for the lower courts to attempt to circumvent the *Security Trust* doctrine is to be very liberal as to what constitutes a specific and perfected lien. The Supreme Court has established three criteria for determining whether or not a lien is sufficiently specific and

States v. Security Trust & Saving Bank, 340 U.S. 47, 51 (1950).

33. "It [the right of priority of payment of debts due to the government] is founded not so much upon any personal advantage to the sovereign as upon motives of public policy, in order to secure an adequate revenue to sustain the public burdens, and discharge the public debts." United States v. State Bank of North Carolina, 31 U.S. (6 Pet.) 308, 310 (1832).

34. Sarnar, *Correlation of Priority and Lien Rights in the Collection of Federal Taxes*, 95 U. PA. L. REV. 739, 747 (1947).

35. See Note, 56 YALE L.J. 1258, 1263 (1947).

36. In *Brown v. General Laundry Service, Inc.*, 139 Conn. 363, 371, 94 A.2d 10, 14 (1952), *rev'd sub nom.* United States v. New Britain, 347 U.S. 81 (1954), the court refused to acknowledge that the *Security Trust* case gave no significance to the difference between § 3466, a priority statute, and § 3670, a lien statute.

37. Some doubt was cast on the *Security Trust* doctrine when in *United States v. Gilbert Associates, Inc.*, 345 U.S. 361 (1953), the Supreme Court based its decision of federal priority solely on Section 3466 rather than holding for the government on both Section 3466 and Section 3670. Since the debtor was in receivership, the government had asserted priority under both sections. For the view that Section 3670 is not limited to cases where the debtor is solvent see *Evans v. Stewart*, 66 N.W. 2d 442, 445 (Iowa 1954); *In re Decker's Estate*, 355 Pa. 331, 341, 49 A.2d 714, 717 (1947); *In re Meyer's Estate*, 159 Pa. Super. 296, 300, 48 A.2d 210, 213 (1946).

But in subsequent decisions the Supreme Court has reaffirmed the *Security Trust* doctrine. See *United States v. Acri*, 75 Sup. Ct. 239 (1955); *United States v. Liverpool & London & Globe Ins. Co.*, 75 Sup. Ct. 247 (1955); *United States v. New Britain*, 347 U.S. 81 (1954).

perfected for federal purposes under Section 3466:³⁸ The lienor must be identified,³⁹ the amount of the lien must be certain,⁴⁰ and the property to which the lien attaches must be definite.⁴¹ In addition to these tests the court has suggested that a transfer of title or possession is necessary to make the lien specific and perfected.⁴²

A Florida court in *U.S. v. Griffin Moore Lumber Co.*,⁴³ while making no mention of the *Security Trust* doctrine, gave an antecedent materialman's lien priority. The labor and material supplied to the debtor had, said the court, enhanced the value of his property and it would be unjust enrichment if another claimant could now take advantage of this increased value of the land. The court held that to give the federal claim priority would be "contrary to equity and would contravene every natural impulse."⁴⁴ This case relied heavily on cases prior to *Security Trust*, especially *In re Taylorcraft Aviation Corp.*⁴⁵ which had held that the federal tax lien which was filed first was subordinate to a mechanic's lien which under state law related back to the date the work began. This relation-back doctrine had been expressly repudiated in the *Security Trust* case.⁴⁶

In a suit arising in Alaska,⁴⁷ in which the facts were similar to those of the *Taylorcraft* case, the court, while recognizing the reason and

38. *Illinois ex rel. Gordon v. Campbell*, 329 U.S. 362, 375 (1946).

39. *United States v. Knott*, 298 U.S. 544, 550 (1936).

40. *United States v. Waddill, Holland & Flinn, Inc.* 323 U.S. 353, 357 (1945).

41. *United States v. Texas*, 314 U.S. 480, 487 (1941); *In re Lane's Estate*, 244 Iowa 1076, 1081, 59 N.W.2d 593, 596 (1953).

42. *United States v. Gilbert Associates, Inc.*, 345 U.S. 361, 366 (1953); *Illinois ex rel. Gordon v. Campbell*, 329 U.S. 362, 375 (1946). See discussion of this requirement in Note, 56 YALE L.J. 1258, 1262 (1947).

43. 62 So.2d 589 (Fla. 1953). For a criticism of this case see 7 MIAMI L.Q. 588 (1953).

44. "Furnishing labor and material not only results in unjust enrichment of the lands but it is the very source of the laborer and materialman's bread and butter. This of itself was reason enough why the Federal Statute did not give the Federal tax lien priority over the laborer or materialman's lien. *United States v. Griffin Moore Lumber Co.*, 62 So.2d 589, 590 (Fla. 1953).

45. 168 F.2d 808 (6th Cir. 1948).

46. "Nor can the doctrine of relation back—which by process of judicial reasoning merges the attachment lien in the judgment and relates the judgment lien back to the date of attachment—operate to destroy the realities of the situation." *United States v. Security Trust & Saving Bank*, 340 U.S. 47, 50 (1950).

Several cases have sustained a surety's equitable lien over a government's lien using the relation-back doctrine. Before *Security Trust*: *American Surety Co. v. Louisville Municipal Housing Comm'n*, 63 F. Supp. 486 (W.D. Ky. 1945); *In re Van Winkle*, 49 F. Supp. 711 (W.D. Ky. 1943). After *Security Trust*: *United States Fidelity & Guaranty Co. v. United States*, 201 F.2d 118 (10th Cir. 1952); *Alabama-Tennessee Natural Gas Co. v. Lehman-Hoge & Scott*, 122 F. Supp. 314 (N.D. Ala. (1954)); *United States v. Crosland Constr. Co.*, 120 F. Supp. 792 (E.D.S.C. 1954); *Am. Fidelity Co. v. Delany*, 114 F. Supp. 702 (D. Vt. 1953).

47. *Kel Weatherstrip, Inc. v. Rankin*, 124 F. Supp. 555 (D. Alaska 1954).

justice of the latter decision, held that the *Security Trust* doctrine had to be followed. Under federal law the mechanic's lien could not be considered perfected on the date the federal lien attached, and therefore the United States was entitled to priority.⁴⁸ In two other cases recently decided in the federal courts⁴⁹ the question whether or not antecedent mechanic's liens were specific and perfected was considered; both courts held that the liens satisfied the three requirements and were thus entitled to priority. The Government's contention that the mechanic's liens were not perfected until reduced to judgment was not accepted. In neither of these cases did the lienor divest the debtor of title or possession.

The controversy between the United States and state and local governments as to priority has a long history. The decisions have upheld the power of Congress to give priority to debts due the Federal Government although the debts subordinated were prior claims due the state or its political subdivisions;⁵⁰ the hardship to the state, if any, is said to be the result of federal supremacy.⁵¹ There have been several recent cases in which the courts through the *Security Trust* doctrine have held that particular state and local tax liens were specific and perfected and thus entitled to priority.⁵² In *United States v. Gilbert Associates, Inc.*,⁵³ the Supreme Court refused to reach that result holding that local tax liens were subordinate to federal tax liens since the owner had not been divested of title or possession of the property. This strict interpretation of specificity was made under Section 3466. In a later case decided under Section 3670 the Supreme Court⁵⁴ for the first time

48. Cf. *United States v. Eisinger Mill & Lumber Co.*, 202 Md. 613, 98 A.2d 81 (1953).

49. *United States v. Albert Holman Lumber Co.*, 206 F.2d 685, *petition for rehearing denied*, 208 F.2d 113 (5th Cir. 1953); *United States v. Frederick's Brewing Co.*, 4 P-H 1954 FED. TAX. SERV. ¶ 72889 (N.D. Ill.). Cf. *Great Am. Indemnity Co. v. United States*, 120 F. Supp. 445 (W.D. La. 1954).

50. See note 19 *supra*.

51. If there is any hardship to the state it "is the necessary consequence of the supremacy of the laws of the United States on all subjects to which the legislative power of Congress extends." *United States v. Fisher*, 6 U.S. (2 Cranch) 304, 317 (1804). *But see United States v. Nicholls*, 4 Pa. 251 (1805), *writ of error dismissed*, 17 U.S. (4 Wheat.) 378 (1819).

52. *United States v. New Britain*, 347 U.S. 81 (1954); *United States v. Canadian American Co.*, 108 F. Supp. 206 (E.D.N.Y. 1952), *aff'd per curiam*, 202 F.2d 751 (2d Cir. 1953).

See *In re Ann Arbor Brewing Co.*, 110 F. Supp. 111 (E.D. Mich. 1951) where assets were distributed among the federal and state governments under general equity doctrines rather than under *Security Trust*.

See *Smith v. United States*, 113 F. Supp. 702 (D. Hawaii 1953), where priority is given the territorial lien on the doctrine of first in time, first in right, without discussing *Security Trust*.

53. 345 U.S. 361 (1953).

54. *United States v. New Britain*, 347 U.S. 81 (1954).

found that a lien was specific and perfected.⁵⁵ The local lien here was not accompanied by title or possession, and the *Gilbert* case was distinguished on the ground that it involved personal property, an insolvent taxpayer, and a general lien.⁵⁶

The courts have also attempted to avoid the stringency of federal priority by characterizing the competing lien as one falling within the four protected categories provided in Section 3672. In *Hawkins v. Savage*⁵⁷ the federal lien arose prior to the attachment lien but was filed subsequent to it. The district court held that the competing lienor prevailed since the statute put him in the position of a purchaser. This approach can be criticized on several grounds. In the first place it is contrary to the accepted construction of Section 3672 as is borne out in a New Hampshire case⁵⁸ in which that state's supreme court held that through the assessment of taxes the town was given the status of judgment creditor, and that, consequently, a filing of the federal lien was necessary to establish federal priority. The United States Supreme Court reversed the decision on the ground that pursuant to the cardinal principle of uniformity in taxation Congress used the words "judgment creditor" in their "usual, conventional sense as a judgment of a court of

55. This case raised the complex problem of "circuitry of priority." There were two mortgages and a judgment lien prior in time to the federal lien; there were town liens, some of which arose prior to and some subsequent to the federal lien. Under federal law the mortgages and judgment liens concededly had priority over the federal lien; the federal lien was clearly entitled to priority over the subsequent town liens. As to those liens arising prior to the federal lien, under *Security Trust* the question of priority turned on the issue of specificity. Under state law the town liens had priority over the mortgages and judgment lien. The problem was how to distribute the funds so that neither federal nor state law would be violated. This problem has been dealt with by several courts with varying solutions.

The state court in *Brown v. General Laundry Service*, 139 Conn. 363, 373, 94 A.2d 10, 15 (1952), found that "the only reasonable interpretation of § 3672 is that the Congress, in enacting it, expressed the intention that federal liens should be subordinated to such mortgages and judgment liens as are described therein, and, consequently, subordinated to such other incumbrances as have priority over those mortgages and judgment liens." See also *Ferris v. Chic-Mint Gum Co.*, 14 Del. Ch. 232, 124 Atl. 577 (1924). For cases following a different line of reasoning see *Smith v. United States*, 113 F. Supp. 702 (D. Hawaii 1953); *Samms v. Chicago Title & Trust Co.*, 349 Ill. App. 413, 111 N.E.2d 172 (1953).

The United States Supreme Court only settled the question of which liens had priority over the federal government. The court refused to concern itself with the question of whether the state and its subdivisions received its revenue prior to creditors preferred under Section 3672. *United States v. New Britain*, 347 U.S. 81, 88 (1954).

For further discussion of this problem see Anderson, *supra* note 21, at 269; Kennedy, *supra* note 10, at 927; 67 HARV. L. REV. 358 (1953).

56. This has led some to believe that the requirements for specificity and perfection under Section 3670 are not as strict as under Section 3466. *Kel Weatherstrip, Inc. v. Rankin*, 124 F. Supp. 555, 560 (D. Alaska 1954); Kennedy, *supra* note 10, at 929.

57. 110 F. Supp. 615 (D. Alaska 1953).

58. *Petition of Gilbert Associates, Inc.*, 97 N.H. 411, 90 A.2d 499 (1952).

record. . . ."⁵⁹ Analogously, the word "purchaser" should be construed to have its usual meaning. Secondly, it is questionable whether the state statute is susceptible of such construction.⁶⁰ Finally, it should be noted that in this case the attachment lien was not prior in time and therefore should not be prior in rank.⁶¹

Implicit in these cases which strive to grant priority to the competing lien are two problems: Is there in reality a public benefit in granting federal priority over preceding liens, and should priority of liens depend on specificity and perfection? The cases involving mechanic's liens indicate that the amount gained by the government in any particular case may be comparatively small while at the same time a substantial loss may result to the competing creditor. Of course, it may be pointed out that, although in each particular case the sum may be rather insignificant, the total amount of lost revenue, resulting from a large number of cases, could create a very serious problem for the Federal Government.

If the argument in favor of federal priority is accepted, it still does not seem sound that priority of competing liens should depend on specificity. It is difficult to see why the Federal Government should be given priority over certain secured creditors and not over others.⁶² The doctrine of the general and inchoate lien, besides being a questionable policy, is also undesirable because of the conflict and uncertainty it has produced. Creditors competing with federal claims are unable to predict, with any degree of success, whether the lower courts will follow the United States Supreme Court cases or attempt to circumvent them. Statutes which have been in existence so long and construed so often should not give rise to so much costly, frustrating, and time consuming

59. *United States v. Gilbert Associates, Inc.*, 345 U.S. 361, 364 (1953). See also *United States v. Security Trust & Savings Bank*, 340 U.S. 47, 51-52 (1950) (concurring opinion); *Macatee, Inc. v. United States*, 214 F.2d 717 (5th Cir. 1954); *In re Litt*, 128 F. Supp. 34 (E.D. Pa. 1955); *In re Green*, 124 F. Supp. 481 (N.D. Ala. 1954); *State ex rel. Okla. Employment Security Comm'n v. United States*, 266 P.2d 973 (Okla. 1953); *In re Capitol Cleaners & Dyers*, 233 P.2d 377 (Utah 1951). But *cf.* *United States v. Preferred Contractors*, 122 F. Supp. 219 (E.D.N.Y. 1954); *Evans v. Stewart*, 66 N.W.2d 442, 449 (Iowa 1954).

60. The Alaska statute said that the attachment lienor's rights against third persons shall be deemed the same as those of a bona fide purchaser. The statute did not make the lien holder a purchaser. See *Kel Weatherstrip, Inc. v. Rankin*, 124 F. Supp. 555, 560 (D. Alaska 1954).

61. See note 29 *supra*.

62. "No reason appears why the standing of a lien against federal priority should be made to depend on the specificity of the subject property or upon a technical divestment of title. Although liens having specificity and title divestment should be protected inasmuch as they usually represent security transactions upon which there has been reliance, reliance may also be present where the lien is general, like one upon fluctuating inventory, or where there has been no title divestment as in a lien-theory mortgage." 68 HARV. L. REV. 722, 723 (1955).

litigation.⁶³

The Court recently handed down three decisions overruling the opinions of two federal courts and one state court which had used one or more of the above methods of circumventing the stringency of federal priority. In *United States v. Scovil* the state court⁶⁴ held that a landlord's claim protected by distress (after the Collector of Internal Revenue received the assessments but prior to the filing) was entitled to protection against the unfiled tax lien. The Supreme Court⁶⁵ reversed and ruled that the Government must prevail since the distress lien did not fall within any of the four categories provided in section 3672, thus making filing unnecessary to protect the Government lien.⁶⁶ The Court went on to say that in any event the distress lien was not perfected; it was merely a "caveat of a more perfect lien to come" and therefore could not defeat federal priority. Since the distress lien was subsequent to the date of the federal lien and was not within the conventional definition of the four categories, the result of the case seems sound.

Two cases presented similar problems for the Court's consideration. In one there was an attachment, a federal tax lien, and then a judgment;⁶⁷ in the other there was a garnishment lien and then a federal tax lien.⁶⁸ Although these cases presented the same fact situation and legal question as the *Security Trust* case,⁶⁹ the lower court⁷⁰ distinguished them from that decision with the statement that in *Security Trust* the state law granted no effectiveness to the attachment proceedings while in these cases the competing creditor acquired a valid lien under state law.⁷¹ On this basis, priority was granted to the antecedent private creditor. The Supreme Court reversed stating that its answer "was the same as in

63. Note, 22 GEO. WASH. L. REV. 583, 591 (1954).

64. *United States v. Scovil*, 224 S.C. 233, 78 S.E.2d 277 (1953).

65. *United States v. Scovil*, 75 Sup. Ct. 244 (1955).

66. For a subsequent court following the Supreme Court reasoning in the *Scovil* case see *In re Litt*, 128 F. Supp. 34 (E.D. Pa. 1955).

67. *United States v. Acri*, 75 Sup. Ct. 239 (1955).

68. *United States v. Liverpool & London & Globe Ins. Co.*, 75 Sup. Ct. 247 (1955).

69. "The question presented here is whether a tax lien of the United States is prior in right to an attachment lien where the federal tax lien was recorded subsequent to the date of the attachment lien but prior to the date the attaching creditor obtained judgment." *United States v. Security Trust & Savings Bank*, 340 U.S. 47, 48 (1950).

70. *Sunnyland Wholesale Furniture Co. v. Liverpool & London & Globe Ins. Co.*, 107 F. Supp. 405 (N.D. Tex. 1952), *aff'd sub. nom. United States v. Liverpool & London & Globe Ins. Co.*, 209 F.2d 684 (5th Cir. 1953); *United States v. Acri*, 109 F. Supp. 943 (N.D. Ohio 1952).

71. For other cases using the same device to distinguish away *Security Trust* see *United States v. Albert Holman Lumber Co.*, 206 F.2d 685, *aff'd*, 208 F.2d 113 (5th Cir. 1953); *United States Fidelity & Guaranty Co. v. United States*, 201 F.2d 118 (10th Cir. 1952); *Ferbro Trading Corp. v. Jo-Mar Dress Corp.*, 78 Pa. Dist. & Co. 337 (1951).

the *Security Trust* case and for the same reasons.”⁷² The Supreme Court found the cases indistinguishable from *Security Trust* and from each other,⁷³ and ruled that the state’s characterization of its liens was not binding on the federal court; the competing liens were, for federal purposes, inchoate. The Supreme Court, although thus given the opportunity to review and perhaps alter its decision, in no uncertain or vague language, affirmed the *Security Trust* case.

The various writers have differed as to whether or not the federal tax claims should be given absolute priority⁷⁴ and have presented sound arguments in support of both positions. No matter which course is favored, there is a need for congressional clarification in this area. Congress should review the system of priorities in the various statutory provisions and establish precise and uniform standards to control the courts in the determination of the priorities of federal tax claims and competing liens.

EMBEZZLEMENT AND INCOME UNDER THE INTERNAL REVENUE CODE

The federal income tax, primary source of revenue for the National Government, is levied upon “all income from any source whatever.”¹ This broad definition encompasses income from illegal business opera-

72. *United States v. Aciri*, 75 Sup. Ct. 239, 241 (1955).

73. *United States v. Liverpool & London & Globe Ins. Co.*, 75 Sup. Ct. 247, 248 (1955).

74. For arguments favoring federal priority see Sarnier, *supra* note 34, at 746 (1947). For those opposing federal priority see Kennedy, *supra* note 10; Note, 29 N.C.L. REV. 293, 300 (1951).

1. INT. REV. CODE OF 1954, § 61(a). This section replaces Int. Rev. Code of 1939, § 22(a), 52 STAT. 457, but does not appreciably alter its interpretation. 1 CCH 1955 STAND. FED. TAX REP., ¶ 636.

2. Bootlegging: *United States v. Sullivan*, 274 U.S. 259 (1927); *Maddas v. Commissioner*, 114 F.2d 548 (3rd Cir. 1940); *Steinberg v. United States*, 14 F.2d 564 (2nd Cir. 1926). Black market operations: *United States v. Chapman*, 168 F.2d 997 (7th Cir. 1948), *cert. denied* 335 U.S. 853 (1948); *Wallace H. Petit*, 10 T.C. 1253 (1948). Lotteries: *Droge v. Commissioner*, 35 B.T.A. 829 (1937); *Huntington v. Commissioner*, 35 B.T.A. 835 (1937). Bookmaking: *James P. McKenna*, 1 B.T.A. 326 (1925). Usurious loans: *Barker v. Magruder*, 95 F.2d 122 (D.C. Cir. 1938); *Mitchell M. Frey*, 1 B.T.A. 338 (1925); *Terrell v. Commissioner*, 7 B.T.A. 773 (1927). Unlawful insurance policies: *Patterson v. Anderson*, 20 F. Supp. 799 (D.C. Cir. 1937). Fraudulent land sales: *Briggs v. United States*, 214 F.2d 699 (4th Cir. 1954). Illegal movie transportation: *George L. Rickard*, 15 B.T.A. 316 (1929). Income from abortion: *Mary Luginbuhl*, 8 CCH Tax Ct. Mem. 968 (1949).