Michigan Law Review

Volume 54 | Issue 6

1956

Taxation - Liens -Priority of A Subsequent Federal Tax Lien Over an Antecedent Inchoate Lien

John B. Huck S.Ed.
University of Michigan Law School

TAXATION—LIENS—PRIORITY OF A SUBSEQUENT FEDERAL TAX LIEN OVER AN ANTECEDENT INCHOATE LIEN—The recent decision of the United States Supreme Court in *United States v. Liverpool and London & Globe Ins. Co.*[1] is representative of a line of Supreme Court cases since 1950 in which the Court has had to decide whether a statutory lien[2] that is prior in time to a federal tax

1 348 U.S. 215, 75 S.Ct. 247 (1955).

2 The term "statutory lien" is used here in a broad sense to include garnishment, attachment, distraint, mechanics' and state and local tax liens. These are non-consensual liens which are created by the ex parte action of the creditor. This comment concentrates on the garnishment lien, but what may be said of this type of lien generally applies to the other types.

lien[3] is also prior in right. These cases uniformly hold that a creditor, having an inchoate lien prior in right to most subsequent interests that may be acquired in the liened property, must make his lien specific and perfected before a federal tax lien comes into existence in order to protect and preserve its priority against the subsequent tax lien. Illustratively, in the *Liverpool* case, a creditor started an action against a solvent debtor (the taxpayer) and garnished a debt claim held by that debtor against an insurance company (the garnishee). The service of a writ of garnishment created a lien on the garnished debt giving the lienor, under state law,[4] a right to satisfaction from the garnished debt superior to the right of other interests which might subsequently be acquired in that property, even though acquired before the lienor had obtained a judgment.[5] Before the creditor could obtain a judgment in the *Liverpool* case, a federal tax lien arose and was recorded. The Court subordinated the earlier, but "inchoate," garnishment lien to the later tax lien.

The purpose of this comment is to analyze the rationale, in terms of both statutory construction and policy, of the theory that only a choate garnishment lien is superior to a subsequent tax lien.

I. DEVELOPMENT OF THE CHOATE LIEN DOCTRINE

To facilitate the collection of taxes, section 6321 of the Internal Revenue Code provides: "If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount . . . shall be a lien in favor of the United States upon all property and rights to property . . . belonging to such person."

The existence of a tax lien in no way depends upon the financial condition of a taxpayer. On the other hand, to assure the collection of debts of any type due the United States in the event that a debtor becomes insolvent, the priority statute, section 3466 of the Revised Statutes, provides: "Whenever any person indebted to the United States is insolvent . . . the debts due to the United States shall be first satisfied. . . ."[6]

[3] I.R.C. (1954), §6321, formerly I.R.C. (1939), §3670. It should be stressed that this comment is concerned solely with the situation where the statutory lien is created first and the tax lien afterward.

[4] Tex. Civ. Stat. (Vernon, 1951) art. 4084; United States v. Standard Brass & Mfg. Co., (Tex. Civ. App. 1954) 266 S.W. (2d) 407.

[5] The fiction that the lien "merges" in the judgment and "relates back" to the time of creation expresses the state policy that the priority of a lien must relate back beyond judgment if the lien is to be of any value. Anderson v. Ashford, 174 Ga. 660, 163 S.E. 741

For many years prior to 1950 the Government argued that the priority of a tax lien should be correlated with the priority statute, so that a tax lien would be prior to an antecedent "inchoate" lien even though the taxpayer was solvent. State and lower federal courts refused to correlate the two statutes on the basis that the language of the tax lien statute did not justify a correlative construction.[7] The first case involving this issue to come before the Supreme Court, *United States v. Security Trust & Savings Bank*,[8] decided that an antecedent statutory lien on the property of a solvent taxpayer must also be choate in order to prevail over a later federal tax lien. The opinion of that case clearly indicated that the Court adopted the choate lien doctrine as developed in the insolvency cases decided under the priority statute.[9] Because of this parallel construction, a profitable analysis of the choate lien doctrine as applied in the tax lien cases requires a preliminary consideration of its development in the insolvency cases arising under section 3466.

The early case of *Thelusson v. Smith*[10] was decided under the Act of 1799[11] (a predecessor to section 3466) which provided that " . . in all cases of insolvency . . . debts due to the United States . . . shall be first satisfied." The issue in that case was whether this act gave the United States a right to satisfy its claims from the land of the insolvent debtor prior to the right of a judgment creditor who had a general judgment lien upon all of the debtor's undescribed land, but who had not divested the debtor of his land by a levy prior to the debtor's insolvency. The decision in favor of the Government could have been based on the single sentence: "[T]he law makes no exception in favor of prior judgment creditors. . . ." The sweeping statement that the provisions of the

(1932); Board of Supervisors v. Hart, 210 La. 78, 26 S. (2d) 361 (1946); United States Fidelity & Guaranty Co. v. United States, (10th Cir. 1952) 201 F. (2d) 118.

6 R.S. §3466 (1875), 31 U.S.C. (1952) §191. "Debts" include taxes. Price v. United States, 269 U.S. 492, 46 S.Ct. 180 (1926). Insolvency must be manifested by an act of bankruptcy, a general assignment, or an attachment of the effects of an absconding debtor before the priority arises.

7 See Kennedy, "The Relative Priority of the Federal Government: The Pernicious Career of the Inchoate and General Lien," 63 YALE L.J. 905 at 924, n. 115 (1954). This construction is still rejected. United States v. White Bear Brewing Co., (7th Cir. 1955) 227 F. (2d) 359, revd. without majority opinion (U.S. 1956) 76 S.Ct. 646.

8 340 U.S. 47, 71 S.Ct. 111 (1950).

9 "In cases involving a kindred matter, i.e., the federal priority under R.S. §3466, it has never been held sufficient to defeat the federal priority merely to show a lien . . . contingent upon taking subsequent steps for enforcing it. . . . If the purpose of the federal tax lien statute to insure prompt and certain collection of taxes . . . is to be fulfilled, a similar rule must prevail here." Id. at 51.

10 2 Wheat. (15 U.S.) 396 (1817).

11 1 Stat. L. 676 (1799).

statute "exclude all debts due to individuals, whatever may be their dignity," was totally unnecessary under the facts of the case. The absolute priority implicit in this dictum caused the Court to add the further dictum that there were exceptions to the priority. Thus, if before the debtor becomes insolvent the property has been conveyed or mortgaged, "or if the property has been seized under a *fi. fa.*, the property is divested out of the debtor, and cannot be made liable to the United States."[12]

It was contended in *Conard v. Atlantic Ins. Co.*[13] that the *Thelusson* case meant that the priority granted by section 3466 was superior to any lien and that only an absolute conveyance could defeat the priority. The Court answered that "it has never yet been decided . . . that the priority of the United States will divest a specific lien . . . whether it be accompanied by possession or not."[14] The result of the *Thelusson* case was explained on the grounds that the judgment creditor, with an unexecuted general judgment lien on the debtor's land, had no interest in the land unless and until he perfected his lien by execution divesting the debtor of title. Because the debtor's title had not been divested before the Government's priority attached, the land was still a part of the insolvent's estate from which the Government was entitled to receive prior satisfaction. This explanation limited the broad dictum of the *Thelusson* case.[15] The *Conard* case was the beginning of a line of cases[16] which never mentioned the choate lien concept, but held that antecedent statutory liens prevailed over the priority provision of section 3466, even though the lienors had not levied on or otherwise divested the title from the debtor prior to his insolvency, a defect which would have been fatal under the broad language of the *Thelusson* case.

In *Spokane County v. United States*[17] the Government's unsecured debts against an insolvent's estate were given priority over

12 2 Wheat. (195 U.S.) 396 at 425 (1817).

13 1 Pet. (26 U.S.) 386 (1828).

14 Id. at 441.

15 The concurring opinion in Conard thought that this overruled Thelusson. The majority opinion in Conard also mentioned that the reasons for the Thelusson opinion were not fully reported due to "accidental circumstances." See 1 WARREN, THE SUPREME COURT IN UNITED STATES HISTORY 455 to 460 (1922).

16 See Kennedy, "The Relative Priority of the Federal Government: The Pernicious Career of the Inchoate and General Lien," 63 YALE L.J. 905 at 911 (1954); Rogge, "The Differences in the Priority of the United States in Bankruptcy and in Equity Receiverships," 43 HARV. L. REV. 251 at 268 (1929).

17 279 U.S. 80, 49 S.Ct. 321 (1929). The opinion made no mention of the contrary line of authority initiated by the Conard case. *Accord:* New York v. Maclay, 288 U.S. 290, 53 S.Ct. 323 (1933); United States v. Texas, 314 U.S. 480, 62 S.Ct. 350 (1941). These decisions questioned whether a prior mortgage would prevail over §3466, since under the

antecedent statutory liens because the lienor had failed to bring himself within the exception to the sweeping dictum of the *Thelusson* case: the lien had not been perfected by a seizure or execution sufficient to divest the insolvent debtor of title or possession in the property and legally sever that property from the general assets of the debtor at the time the United States priority arose. The earlier unperfected, and thus inchoate, lien was subordinated to the priority demanded by section 3466.

Although the Supreme Court has never found a "choate lien" in a section 3466 insolvency case, the decisions have crystallized four prerequisites to the existence of such a specific and perfected lien. The first three requirements are principally concerned with the specificity of all liens: identity of the lienor,[18] identity of the property subject to the lien,[19] and certainty of the amount secured by the lien.[20] The fourth requirement relates primarily to the perfection of a non-possessory lien by divesting the debtor of title or possession in the liened property, thus severing that property from his general assets.[21] The result reached in *United States v. Gilbert Associates, Inc.*,[22] indicates that despite the disjunctive in "title or possession," it may be insufficient to divest the debtor merely of his title. In the *Gilbert Associates* case, the city had foreclosed its own tax liens and purchased the tax titles at the foreclosure sale. The debtor, however, was left in possession of the property. The Court, holding that the priority of the United States was to be first satisfied, found that the lien of the city lacked perfection because the debtor had not been divested of possession.[23]

The reversion to the sweeping dictum of the *Thelusson* case has been accompanied by a change of emphasis in the relative superiority between the priority statute and choate liens. The *Conard* decision clearly implied the possibility that a choate lien would

lien theory the debtor is not divested of either title or possession. The Government's theory that everything short of payment must be done to perfect a lien makes even a mortgage inchoate as it must be foreclosed for payment. *Contra,* Savings & Loan Society v. Multnomah County, 169 U.S. 421, 18 S.Ct. 392 (1898).

18 United States v. Knott, 298 U.S. 544, 56 S.Ct. 902 (1936). [Dictum that a choate lien bars the priority of section 3466 was disapproved in United States v. Texas, 314 U.S. 480, 62 S.Ct. 350 (1941)].

19 United States v. Waddill, Holland & Flinn, Inc., 323 U.S. 353, 65 S.Ct. 304 (1945); Illinois v. Campbell, 329 U.S. 362, 67 S.Ct. 340 (1946).

20 United States v. Waddill, Holland & Flinn, Inc., 323 U.S. 353, 65 S.Ct. 304 (1945).

21 See the cases cited in note 19 supra. The requirement that the lienor divest the debtor of title creates a conceptual dilemma: when a lienor acquires title, his lien "merges into" the greater title interest and ceases to exist separately as a lien, and, as owner, he would no longer need the protection of a choate lien.

22 345 U.S. 361, 73 S.Ct. 701 (1953).

23 United States v. Gilbert Associates, Inc., 345 U.S. 361 at 366, 73 S.Ct. 689 (1953).

prevail over a "mere priority" of the United States.[24] More recently, however, the Court has stated, ". . . the Court has never decided whether the priority [of the United States] is overcome by a fully perfected and specific lien,"[25] thus implying the possibility of what Justice Minton has termed an "absolute priority"[26] for the Government in cases of insolvency. In the section 3466 cases thus far decided the Court has uniformly held that all the creditors' liens examined lacked the degree of specificity or perfection required in order to become choate. As a result, the Court has not yet had to decide whether or not a choate lien is in fact superior to the priority created by section 3466. Although an absolute priority construction would be supported by the statutory language, such a construction would mean that the entire development of the concept of a choate lien as a possible exception to the federal priority was unnecessary.

II. THE CHOATE LIEN AND THE TAX LIEN STATUTE

A. *Prerequisites for a Choate Lien.* The requirements of specificity and perfection which a lien must satisfy in order to become "choate," as developed in the insolvency cases arising under section 3466, have been watered down when transferred to the tax lien cases. Thus, in order to have the protection of choate lien priority as against a subsequent tax lien, the lienor need not divest the debtor-taxpayer of title or possession in the liened property. In the *Gilbert Associates* case the Government asserted priority under an unrecorded tax lien and the priority statute. The city claimed that it had become a judgment creditor by operation of a state statute relating to tax assessments and that it was, therefore, within the protection of section 6323 which declares that an unrecorded tax lien "shall not be valid as against any mortgagee, pledgee, purchaser, or judgment creditor until notice thereof has been filed. . . ."[27] The Supreme Court treated the general tax liens of both the town and the United States as equally perfected, but denied priority to the town's lien solely on the basis that the town

24 Conard v. Atlantic Ins. Co., 1 Pet. (26 U.S.) 386 at 441, 444 (1828).

25 Illinois v. Campbell, 329 U.S. 362 at 370, 67 S.Ct. 340 (1946). See also United States v. Texas, 314 U.S. 480 at 488, 62 S.Ct. 350 (1941); United States v. Waddill, Holland & Flinn, Inc., 323 U.S. 353 at 358, 65 S.Ct. 304 (1945).

26 See United States v. New Britain, 347 U.S. 81 at 85, 74 S.Ct. 367 (1954).

27 I.R.C. (1954), §6323, formerly I.R.C. (1939), §3672. Consistent parallel construction has led some courts to hold that §6323 impliedly amends the priority provision of §3466 so that a judgment creditor would prevail even though he had not levied on his judgment lien, thus modifying the result of the Thelusson case. See In re Meyer's Estate, 159 Pa. Super. 296, 48 A. (2d) 210 (1946); Bishop v. Black, 233 N.C. 333, 64 S.E. (2d) 167 (1951).

was not a judgment creditor in the conventional sense of the term, and thus was not within protection of section 6323. The Court did not decide whether the town had a choate lien superior to the tax lien, but considered only the Government's claim of priority under section 3466. Priority was awarded to the Government on the basis of section 3466 alone, because the town had not perfected its lien by divesting the debtor of title or possession before the priority of the Government attached. If the divestment requirement applied in the tax lien situation, the Court could have held for the Government on the basis of the tax lien alone.[28]

The implication that an antecedent lienor need not divest the taxpayer of title or possession in order to obtain a choate lien as against the subsequent tax lien was confirmed in *United States v. New Britain.*[29] In that case the city's tax liens were held to be choate from the date they attached to the realty, even though the taxpayer had not been divested of title or possession before the federal tax lien arose. The Court attempted to distinguish the *Gilbert Associates* case on the ground that personalty was involved in that case, whereas realty was involved in the *New Britain* case. This distinction is of doubtful soundness inasmuch as the New Hampshire Supreme Court in the *Gilbert Associates* case had held the property to be realty.[30] Moreover, in listing the characteristics of a choate lien (certainty of the amount of the lien, identity of the lienor, and the property subject to the lien) the Court was silent with regard to any requirement that the lienor must divest the debtor of title or possession in the liened property.[31] Entirely apart from the merits of the divestment requirement, it is clear that the prerequisites to the existence of a choate lien should be the same in both the tax lien and priority statute cases. The choate lien concept is judicial gloss resulting from the Court's interpretation and correlation of the two statutes. Having created the choate lien standard, the Court should apply an identical definition in the two types of cases.

Under existing decisions, however, the antecedent lien apparently need only be specific and perfected as to amount, lienor, and property at the time the tax lien is created in order to be within the Court-created "choate lien" exception to the priority of the tax lien. However, the Court, has relied on extremely

28 Kennedy, "The Relative Priority of the Federal Government: The Pernicious Career of the Inchoate and General Lien," 63 YALE L.J. 905 at 927 (1954).

29 347 U.S. 81, 74 S.Ct. 367 (1953).

30 Petition of Gilbert Associates, Inc., 97 N.H. 411 at 414, 90 A. (2d) 499 (1952).

31 347 U.S. 81 at 84, 74 S.Ct. 367 (1953).

speculative contingencies in order to find inchoate a lien that a state court has described as specific and perfected under state law.[32] The attachment lien in the *Security Trust* case was found to be inchoate because the lien would terminate under state law if three years elapsed without any judgment rendered in the cause. It was immaterial that the lienor in fact recovered judgment within three years, because the judgment came after the tax lien arose. In another case a landlord's distress lien was rendered contingent and inchoate because, at the time the tax lien arose, two days remained in which the tenant could have posted a bond and removed the lien from his property.[33] Again, it was immaterial that the tenant entered into an insolvency receivership the next day so that a bond was never posted.[34]

B. *The Choate Lien Mirage.* It is doubtful whether a creditor with a garnishment, or other statutory lien would be able to eliminate the contingent nature of his lien prior to judgment and thereby secure a choate lien before the tax lien comes into existence. In many states a lien is not even perfected by state standards until the lienor obtains judgment.[35] While perfection is a federal question and state standards are not controlling,[36] a garnishment lien followed by a judgment against the principal debtor before the tax lien arises on the property of that debtor, should be the latest stage at which the contingencies would be eliminated and the lien perfected for purposes of the Court's "choate lien" exception.[37] A judgment would fix the amount of the lien on the debt owed by the garnishee because the doctrine of res judicata would bar any later objection by the debtor to the amount awarded by the judgment. If a statute did not make the judgment itself a lien, the creditor would at least be a judgment creditor with a

32 Whether a lien is choate is a federal question. United States v. Acri, 348 U.S. 211, 75 S.Ct. 239 (1955). This was earlier classified as a question of state law in Spokane County v. United States, 279 U.S. 80 at 94, 49 S.Ct. 321 (1929). A state court's characterization of a lien as choate is not conclusive; but as inchoate, it is practically conclusive. Illinois v. Campbell, 329 U.S. 362 at 371, 67 S.Ct. 340 (1946).

33 United States v. Scovil, 348 U.S. 218, 75 S.Ct. 244 (1955).

34 In United States v. Waddill, Holland & Flinn, Inc., 323 U.S. 353 at 357-358, 65 S.Ct. 304 (1945), the possibilities that the rent might have been miscalculated, or already paid, or subject to set-offs made the landlord's distress lien inchoate. It was immaterial that none of these defenses were asserted by the tenant. The Court cited §3466 cases as authority for finding an inchoate lien in tax lien cases.

35 See note 70 infra.

36 See note 32 supra.

37 But see Miller v. Bank of America, (9th Cir. 1948) 166 F. (2d) 415, holding that a judgment creditor with an attachment lien must also have a prior execution lien on the attached asset in order to prevail over a subsequent tax lien. See also T.D. 6119, Int. Rev. Bul. No. 3, p. 7 at 26 (1955); H. Rep. 1337, 83d Cong., 2d sess., p. A407 (1954).

garnishment lien on the debt, thus identifying the specific property subject to the lien. Further perfection would require the creditor to divest the debtor of title or possession by a levy upon and sale of the garnished debt, thus discharging the lien and eliminating any question of priority.[38] It may be assumed, therefore, that the Court would find a garnishment lien perfected by judgment sufficient to be choate. In effect, then, a creditor who has an antecedent lien must also become a judgment creditor before the tax lien arises in order to be within the Court's "choate lien" exception to the priority of a subsequent tax lien. If this is so, the Court's exception in favor of a choate lien has, in substance, been equated with the exception of section 6323 in favor of a "judgment creditor" with a lien,[39] one of the four classes of interests protected by that section. As a practical result, no interests other than those expressly enumerated in section 6323, even though created before the tax lien arises, can prevail over the subsequent tax lien. Conversely, only those four classes of interests found in that section, whether arising before or after the tax lien comes into existence (but before the tax lien is recorded), can prevail over the tax lien. Such an interpretation gained its first judicial acceptance in the concurring opinion of Justice Jackson in the *Security Trust* case[40] in which the majority relied upon the failure of the earlier lien to be "choate" in order to sustain the priority of a subsequent tax lien. This interpretation may have been accepted by the entire Court in a recent decision where the Court said: "The landlord had a lien other than a mortgage, pledge, or judgment lien. As to all other liens . . . [section] 3672 . . . afforded no protection. *United States v. Security Trust Co.* . . . (concurring opinion)."[41] The quoted statement must be read in the context of the fact that the tax lien was the antecedent lien. The absolutism of the state-

[38] The divestment requirement applies only in the §3466 cases, not in the tax lien cases. See part II-A of this comment. Even if applicable in the tax lien cases, a garnishment deprives the principal debtor of many rights of ownership in his debt claim, thus substantially divesting him of title. See notes 69-73 infra. The requirement that the principal debtor be divested of possession was developed in reference to tangible property and is inappropriate in this context because an intangible debt is primarily a relationship between two parties and, thus, incapable of possession.

[39] Although §6323 literally protects a "judgment creditor," this has been construed to mean a judgment creditor with a lien. See note 37 supra.

[40] United States v. Security Trust & Savings Bank, 340 U.S. 47 at 51, 71 S.Ct. 111 (1950). This was anticipated in MacKenzie v. United States, (9th Cir. 1940) 109 F. (2d) 540 (dictum, since tax lien had priority anyway).

[41] United States v. Scovil, 348 U.S. 218 at 220. See also United States v. White Bear Brewing Co., (7th Cir. 1955) 227 F. (2d) 359 at 368-369, revd. without majority opinion (U.S. 1956) 76 S.Ct. 646. (See particularly the dissenting opinion of Justice Douglas in the latter case).

ment, plus the citation of Justice Jackson's concurring opinion, may possibly mean that the Court would have reached the same result (granting priority to the tax lien) for the same reason (landlord's lien not enumerated, and thus not protected by section 6323) had the creditor's lien been prior in time to the federal tax lien. Since the choate lien exception protects only a creditor with an earlier choate statutory lien as against a later tax lien, and since the tax lien was prior in time, the creditor could never have prevailed by merely having a choate lien, but only by becoming a judgment creditor within the protection of section 6323 before the tax lien was recorded. The further declaration that the lien was inchoate is thus superfluous except insofar as it may show that a creditor with an inchoate lien must necessarily become a judgment creditor in order to make his lien choate.

Justice Jackson's interpretation finds no support in the historical origin or in the subsequent history of the statutory exception. The tax lien statute as originally enacted[42] contained no exception provision. One of the first tax lien cases decided by the Supreme Court held that an antecedent secret tax lien prevailed over a subsequent purchaser without notice from the taxpayer.[43] To correct this harsh result, Congress enacted the exception provision, section 6323.[44] Section 6323 was thus initially designed to protect subsequent purchasers, mortgagees, and judgment creditors who acquired interests in the taxpayer's property after the tax lien had arisen but before it was recorded. There is no reason to believe that Congress intended that the 1913 amendment should also limit the antecedent interests which could have priority over subsequent tax liens only to those classes expressly enumerated in section 6323, because cases of this type were never litigated before the Supreme Court until the *Security Trust* case in 1950, nor before lower courts in any substantial number until the 1930's. The more logical conclusion is that both before and after the 1913 amendment, Congress believed that no provision was necessary to protect prior interests because they would be protected by the usual priority rule of first in time, first in right. This conclusion is supported by the House Report accompanying the 1913 amendment which stated, in part, that "[t]here is no reason why the government should not occupy the same position with reference to

42 14 Stat. L. 101 (1866).

43 United States v. Snyder, 149 U.S. 210, 13 S.Ct. 846 (1893). There was no implication of what the result would have been if the purchase preceded the tax lien.

44 That this was the purpose behind §6323, see United States v. Gilbert Associates, Inc., 345 U.S. 361 at 363, 73 S.Ct. 689 (1953).

liens on property as does the individual."[45] Moreover, in 1939 Congress added "pledgees"[46] to the class of interests protected by section 6323 in direct response to a decision holding an earlier unrecorded tax lien prior to a later pledge lien.[47] At this time, a substantial number of lower federal court decisions[48] had already held that an antecedent "inchoate" statutory lien had priority over a subsequent tax lien, the fact that the statutory lien was "inchoate" at the time the tax lien arose being immaterial. Congress did and said nothing about this interpretation of the tax lien statute. This indicates that Congress intended (1) the usual rule of priority—first in time, first in right—to continue to be applied as between statutory, though inchoate, liens and tax liens; and (2) the purpose of section 6323 to be the same as when passed in 1913, i.e., to reverse the usual rules of priority only when any one of the enumerated interests was acquired subsequent to the tax lien but before the tax lien was recorded.

Although this legislative history indicates that section 6323 should have no relation to the choate lien concept, the analysis immediately preceding that history concluded that the Court now follows Justice Jackson's view that only those four interests enumerated in section 6323 prevail over a later federal tax lien, and that therefore a lien is inchoate until it is reduced to judgment, thus making the lienor a "judgment creditor." The ambiguous per curiam decision in *United States v. White Bear Brewing Co.*[48a] raises the question of whether the Court has gone even farther in upholding the priority of a subsequent tax lien. The dissenting opinion indicates that there are two possible interpretations of the decision which gave a tax lien priority over a mechanic's lien which had been filed and was being foreclosed at the time the tax lien arose.

On the one hand, if the majority decided that the mechanic's lien was inchoate, then the decision is consistent with the basic principle that an inchoate lien has no priority over a subsequent tax lien. Since the lien could have been further perfected only by entry of a decree of foreclosure and sale, the decision supports the conclusion that a lien is inchoate until reduced to judgment by

45 H. Rep. 1018, 62d Cong., 2d sess., p. 2 (1912) (the quoted statement points to a broader policy than the specific situation before Congress).

46 I.R.C. (1939), §3672.

47 United States v. Rosenfield, (D.C. Mich. 1938) 26 F. Supp. 433.

48 See the cases cited in Kennedy, "The Relative Priority of the Federal Government: The Pernicious Career of the Inchoate and General Lien," 63 YALE L.J. 905 at 924, n. 115 (1954).

48a (U.S. 1956) 76 S.Ct. 646.

the lienor who thereby becomes a judgment creditor with a choate lien protected by section 6323.

On the other hand, as the dissent interpreted the per curiam decision, the majority may have decided that the lien was in fact choate but the lienor could not prevail against a subsequent tax lien because he was not yet a judgment creditor protected by section 6323. This is an extreme application of Justice Jackson's view that only the four classes of interests expressed in section 6323 (thus literally excluding a choate lien) have priority over a tax lien. If this is the rationale of the *White Bear* decision, what impact will this have on mortgage and pledge liens? As long as the Court adheres to Justice Jackson's interpretation of section 6323, antecedent mortgage and pledge liens will have priority over a subsequent tax lien because, and only because, they are expressly protected by section 6323. But if the Court should limit the protection of section 6323 to its original purpose so that it only gives a subsequent mortgage or pledge lien priority over an earlier but unrecorded tax lien, then antecedent choate mortgage and pledge liens would not have priority over a subsequent tax lien. If a tax lien has a prior right of satisfaction out of a taxpayer's property in which a creditor has an antecedent choate lien property interest, then the income tax itself has the same effect as a direct tax levied upon the creditor solely because of his ownership of that choate lien property interest. Thus the Court in effect allows a direct tax to be levied without apportionment. Moreover, to satisfy a tax lien ahead of an existing choate lien interest in the taxpayer's property is to deprive the lienor of his property without due process of law in order to satisfy the tax of the taxpayer.[48b]

C. *Correlation of Priority.* The parallel construction by which the priority of the tax lien is correlated with the priority statute, section 3466, is open to substantial criticism. The priority statute is a congressional determination that when all of the property of the debtor is involved in insolvency, the debts due the United States will be accorded priority. As a historical matter the priority language of section 3466 is derived from a similar provision in the Act of 1797[49] which was intended primarily to protect

[48b] The label "inchoate" means that tax-wise the lienor's interest in the taxpayer's property is so imperfect that priority of a tax lien does not give the income tax the effect of a direct tax upon that interest. To the extent that the Court may later admit to having been wrong in labeling as inchoate a lien interest which should be regarded as choate, it can be argued that there has been, in effect, a direct tax and a deprival of property without due process of law.

[49] 1 Stat. L. 515 (1797). This act was construed in United States v. Fisher, 2 Cranch

the revenues in the event of insolvency of a collector of customs duties.[50] Since the revenues in that era depended principally upon customs, and since there were relatively few collectors, the insolvency of any one collector could have substantially lessened the revenues. The historical purpose of section 3466 is in part responsible for the inconsistent priority policy whereby debts due the United States are accorded a higher priority in the insolvency cases controlled by section 3466 than in the bankruptcy cases governed by the Bankruptcy Act.[51] In bankruptcy liquidation Congress has decided that the prior satisfaction of certain other claims is more equitable and more in the public interest than the protection of revenues by an absolute priority,[52] and has deliberately subordinated protection of revenue as a matter of policy. Similarly, in order to facilitate the collection of taxes Congress created a general tax lien, but without any provision for priority or superiority over other interests. The absence of express legislation declaring that the tax lien is to have a special priority over other liens indicates that Congress probably intended the priority of the tax lien to be governed by the general principle that the lien prior in time is prior in right, without regard to the specificity or perfection of the competing liens. The collection of revenues would thus be subordinated to the satisfaction of the more equitable claim of a prior lien consistently with the policy expressed in the Bankruptcy Act. Under this analysis the Supreme Court in the *Security Trust* case overstated the purpose of the tax lien to be "*to insure* prompt and certain collection of taxes."[53] When the Court used this purpose as the rationale for its decision that the

(6 U.S.) 358 (1805), to apply whenever any person became insolvent. Prior statutes had limited the priority strictly to cases where the insolvent was indebted on a bond for payment of duties [1 Stat. L. 42 (1789), 1 Stat. L. 169 (1790), 1 Stat. L. 263 (1792)] as did a later statute [1 Stat. L. 676 (1799)].

50 If the insolvent collected the customs as agent for the Government, the use of the funds for his own purposes would be conversion. Under a theory of rightful withdrawal, the customs duties would be traced into the remaining assets of the insolvent. The United States as owner would have an absolute priority over other creditors of the insolvent.

51 30 Stat. L. 544 (1898), as amended, 11 U.S.C. (1952) §§1 et seq.

52 See, e.g., §64(a)(4) and (4) of the Bankruptcy Act, 30 Stat. L. 563 (1898), as amended, 11 U.S.C. (1952) §104(a)(4) and (4) [unsecured tax and debt claims of United States share a fourth and fifth rung priority respectively with other tax and debt claims]; and §67(c)(1) of the Bankruptcy Act, 30 Stat. L. 564 (1898), as amended, 11 U.S.C. (1952) §107(c)(1) [tax lien on personalty, without possession thereof, subordinated to priorities in §64(a)(1) and (2)]. An unrecorded tax lien has been held void as against the trustee as a judgment creditor under I.R.C. (1954), §6323. In re Sport Coal Co., (D.C. W.Va. 1954) 125 F. Supp. 517. *Contra:* In the Matter of Green, (D.C. Ala. 1954) 124 F. Supp. 481; In re Ann Arbor Brewing Co., (D.C. Mich. 1951) 110 F. Supp. 111.

53 340 U.S. 47 at 51, 71 S.Ct. 111 (1950) (italics added).

tax lien must be prior to an earlier "inchoate" lien, the Court gave greater priority to the tax lien than the statute would seem to justify.[54]

On the other hand, in both the Bankruptcy Act and in the priority statute, Congress has exercised its power[55] to declare that a claim for taxes and debts due the United States shall have a special priority over any other claim, without regard to the relative priority in time or secured nature of the competing claims. But in the tax lien statute, Congress created a general lien without so exercising that power. The conclusion reached in the preceding paragraph was that Congress intended the tax lien priority to be governed by the usual rule that the lien prior in time is prior in right, regardless of whether or not the prior lien is choate. A correlation of the priority of the tax lien with statutory priorities designed for the special insolvency or bankruptcy case would seem to defeat, rather than effectuate, the intent of Congress.

III. PRIORITY POLICY AND THE CHOATE LIEN

A. *Priority Premises.* All courts, litigants and writers are in complete accord with the basic assumption that priority is to be determined by the principle that the lien prior in time is prior in right. Opinion differs, however, on the premise of what kind of lien prior in time should be prior in right. Since the Court has adopted the premise that the lien first in time to become choate is first in right, the Court should require both a creditor's lien and a tax lien to meet the same standards of specificity and perfection in order to become choate. Applying the Court's definition of a "choate lien," a recorded tax lien, lacking both specificity and perfection[56] should be inchoate. The Court, however, treats an unrecorded tax lien as equivalent to a choate lien from the time it arises.[57] The failure of the Court to apply an identical definition

[54] The principle that a subsequent tax lien has priority over an antecedent statutory lien which is inchoate as of the time the tax lien arises, even though made choate thereafter, conflicts with the policy of the act which allows later perfection of certain statutory liens which are inchoate as of the initiation of proceedings, which is the analogous pivotal date line on which the priorities established by the act arise. These liens will then be valid against the trustee and hence superior to the priorities established by the act. Section 67 (b) of the Bankruptcy Act, 30 Stat. L. 564 (1898), as amended, 11 U.S.C. (1952) §107 (b).

[55] U.S. CONST., art. I, §8, art. VI. Spokane County v. United States, 279 U.S. 80 at 93, 49 S.Ct. 321 (1929). Since the United States does not succeed to the prerogatives of the Crown, priority is not an attribute of sovereignty, but must be created by statute. United States v. State Bank of North Carolina, 6 Pet. (31 U.S.) 29 (1832).

[56] Recording merely states that there is a lien on "all the property . . . belonging to the taxpayer," without describing such property. Besides lacking specificity, the tax lien also lacks perfection until a levy of distraint pursuant to I.R.C. (1954), §6331.

[57] United States v. City of Greenville, (4th Cir. 1941) 118 F. (2d) 963 at 965.

of what constitutes a choate lien has resulted in an inchoate federal tax lien having priority over both earlier inchoate and subsequent choate statutory liens. One writer has attempted to justify this result as a matter of policy on the assumption that revenue demands are more in the public interest than private claims.[58] This assumption begs the question of what constitutes "public interest." It is extremely doubtful whether the public interest is furthered by the unorthodox priority of tax liens. The loss of a disputed claim is more easily absorbed by the government, and, conversely, is harder on the financial position of an individual creditor.

Sounder results, policy-wise, would be reached if priority were based on the premise that the lien first in time to be created prevails even though inchoate. Not only would this set the same standard of priority for the competing tax and statutory liens in each case, but this would also make the principle of tax lien priority consistent with general principles of lien priority. When a creditor has done enough to obtain a lien which is preferred under state laws to subsequent liens, he should also prevail over a subsequent tax lien. It is submitted that this was the policy intended by Congress in expressly declaring that the Government should be in the same position as individuals with reference to liens on property.[59]

B. *A Threshold Issue.* Only after the initial decision has been made that both liens reach the same property of the taxpayer-debtor can the question arise as to which of the liens has a prior right to satisfaction. So far, this comment has proceeded upon the premise that both of the liens did reach the same property. This premise itself must now be examined.

The principle that a lien can reach only those rights which the debtor himself has in his property prevents the federal tax lien from attaching to any more or any greater property interests than the taxpayer has at the time the tax lien arises.[60] The statutory provision that the tax shall be a lien upon the taxpayer's "property

58 Sarner, "Correlation of Priority and Lien Rights in the Collection of Federal Taxes," 95 UNIV. PA. L. REV. 739 (1947).

59 See note 45 supra. Moreover, "floating liens" on after-acquired property would have priority as of the date the lien initially arises. This type of lien is inchoate under present law because the property subject to the lien is not sufficiently identified. Illinois v. Campbell, 329 U.S. 362, 67 S.Ct. 340 (1946).

60 United States v. Kaufman, 267 U.S. 408, 45 S.Ct. 322 (1925); Shaw v. United States, (D.C. Mich. 1939) 94 F. Supp. 245; United States v. Winnett, (9th Cir. 1947) 165 F. (2d) 149; In re Boylan, (D.C. Pa. 1946) 65 F. Supp. 105; Great American Indemnity Co. v. United States, (D.C. La. 1954) 120 F. Supp. 445; Kinart v. Churchill, 210 Iowa 72, 230 N.W. 349 (1930). 4 CASEY, FEDERAL TAX PRACTICE §14.27 (1955).

and rights to property" thus creates the threshold issue of determining the quantity of rights and interest that the taxpayer retains in his property after a creditor has obtained a garnishment lien upon it.

A preliminary question is whether the extent and quantity of the taxpayer's property interests and rights to be reached by the tax lien are to be determined under state law or federal law. Supreme Court decisions involving the tax lien have been silent on this entire problem. In cases involving the interpretation of other tax provisions the Supreme Court has held that where Congress has not expressly defined those interests which will be deemed to be included within the property concept used in a statute, the state law controls in determining the nature of legal interests and the rights of the taxpayer in the property sought to be reached by the taxing statute.[61] It should be remembered that the question is not whether Congress has the power to declare that the tax lien shall be a first lien,[62] but, rather, what Congress intended to include by the unqualified phrase "property and rights to property." Since Congress has not defined the content or scope of that phrase, the conclusion seems justified that Congress intended that state property law should determine the quantity and extent of the property rights and interests which the taxpayer actually owns, until it should specifically declare what other interests are to be included within the phrase "property and rights to property." Thus the scope of the tax lien, insofar as the extent of property attached is concerned, depends upon state property law for a determination of the property interests and rights actually owned by the taxpayer.[63] Once that determination is made, the tax lien attaches to all property interests and rights owned by the taxpayer. State law cannot thereafter restrict or affect the operation of the tax lien upon the property attached.[64] So long as state law is to

61 Morgan v. Commissioner, 309 U.S. 78, 60 S.Ct. 424 (1940); Tyler v. United States, 281 U.S. 497, 50 S.Ct. 356 (1930). Compare United States v. Robbins, 269 U.S. 315, 46 S.Ct. 148 (1926) with United States v. Malcolm, 282 U.S. 792, 51 S.Ct. 184 (1931) and Poe v. Seaborn, 282 U.S. 101, 51 S.Ct. 58 (1930). See also Erie R. Co. v. Tompkins, 304 U.S. 64 at 78, 58 S.Ct. 817 (1938); 4 CASEY, FEDERAL TAX PRACTICE §§13.33-13.40 (1955); 10A MERTENS, LAW OF FEDERAL INCOME TAXATION §§61.08, 61.09 (citing cases contra), 61.12 (1948).

62 See Morgan v. Commissioner, 309 U.S. 78, 60 S.Ct. 424 (1940); Tyler v. United States, 281 U.S. 497, 50 S.Ct. 356 (1930). See H. Rep. 1337, 83d Cong., 2d sess., p. A406 (1954); S. Rep. 1622, 83d Cong., 2d sess., p. 575 (1954). Cf. I.R.C. (1954), §5004(a)(1).

63 Burnet v. Harmel, 287 U.S. 103, 53 S.Ct. 74 (1932).

64 Michigan v. United States, 317 U.S. 338, 63 S.Ct. 302 (1943); United States v. City of Greenville, (4th Cir. 1941) 118 F. (2d) 963; Mercantile Trust Co. v. Hofferbert, (D.C. Md. 1944) 58 F. Supp. 701.

define the quantum of rights and interest remaining in the taxpayer's property, to allow the tax lien to reach greater interests is essentially to take the property of *A* to pay the tax of *B*.

This, then, raises the final question of what property interests or rights to property are retained by the debtor-taxpayer after the debt owing to him has been garnished. Since garnishment is entirely a statutory procedure, the effect of service of a writ on the rights of both the garnishor and the debtor-taxpayer depends upon a construction of the individual state statute.[65]

Under some statutes garnishment does not create a lien, but is a warning to the garnishee that if he voluntarily pays the debt to anyone else, he remains personally liable to the garnishor.[66] The creditor acquires no interest in the garnished debt, and the principal debtor's interest in his debt claim is unaffected, at least until the garnishor obtains an execution lien upon the debt. A tax lien arising after the garnishment but before the execution lien would be a first lien on the debt and entitled to priority.[67] The statutes involved in the tax lien cases under discussion provide that service of garnishment creates a lien on the garnished debt.[68] This lien may be construed by the state court to be vested[69] (perfected before judgment), or inchoate[70] (perfected by a judgment removing all contingencies and making it enforceable against the garnishee). Courts speak of garnishment liens as assignments of the debtor's rights in the property to the garnishor;[71] this, however, is only a conclusion. Of central importance are the rights which the principal debtor can still assert in his claim after the garnishment. It has been said that the principal debtor's rights are excluded or extinguished to the extent necessary to prevent interference with

[65] In re Marsters, (7th Cir. 1938) 101 F. (2d) 365. See the dissenting opinion in Sanders v. Armour Fertilizer Works, 292 U.S. 190 at 206, 54 S.Ct. 677 (1934).

[66] Bigelow v. Andress, 31 Ill. 322 (1863); Newberry v. Meadows Fertilizer Co., 203 N.C. 330, 166 S.E. 79 (1932).

[67] Relation back of the execution lien to the time of the garnishment would not affect the prior intervening tax lien. United States v. Security Trust & Savings Bank, 340 U.S. 47, 71 S.Ct. 111 (1950).

[68] See Mussman and Riesenfeld, "Garnishment and Bankruptcy," 27 MINN. L. REV. 1 at 17-55 (1942) for representative statutes.

[69] E.g., Winther v. Morrison, 93 Cal. App. (2d) 608, 209 P. (2d) 657 (1949), revd. sub nom. United States v. Security Trust & Savings Bank, 340 U.S. 47, 71 S.Ct. 111 (1950). See also the dissenting opinion and cases cited in Sanders v. Armour Fertilizer Works, 292 U.S. 190 at 208, 54 S.Ct. 677 (1934).

[70] Commercial State Bank v. Pierce, 176 Iowa 722, 158 N.W. 481 (1916); Anderson v. Ashford, 174 Ga. 660, 163 S.E. 741 (1932). See 29 N.C. L REV. 293 (1951).

[71] Farnoff v. Smith, 281 Ill. App. 232 (1935); United States v. Yates, (Tex. Civ. App. 1947) 204 S.W. (2d) 399. But this does not divest the principal debtor of title or possession. In re Marsters, (7th Cir. 1938) 101 F. (2d) 365.

payment of the garnishor's claim out of the garnished debt.[72] The debtor has no right to assign the garnished debt free from the lien so as to defeat the rights of the garnishor, his right to satisfaction from the claim remaining superior to that of the assignee.[73] A plea of the pending garnishment may bar or abate an action begun by the principal debtor against the garnishee.[74] Even when a plea of the pending garnishment does not abate or bar the action, the debtor cannot obtain judgment or satisfaction unless the garnishor fails to obtain a judgment against both the garnishee and the principal debtor, or unless the debtor satisfies the garnishor's claim before the garnishee pays pursuant to a judgment.[75]

In *Sanders v. Armour Fertilizer Works*,[76] the basic issue was whether a principal debtor could still assert any rights to the debt he held against a garnishee after the creditor had garnished the debt but before the creditor obtained judgment against the garnishee. On the ground that garnishment in Illinois created a lien on the debt, the majority of the Court held that the creditor had a superior right to pursue his garnishment proceeding to judgment and satisfaction free from the interference of any claim by the principal debtor.[77] Thus, if the creditor's garnishment creates at least an inchoate lien on the debtor's claim against the garnishee, then the most the debtor retains is a contingent right to receive the proceeds of his claim if (1) the debtor satisfies the creditor's claim before the garnishee pays under the compulsion of a judgment, or (2) the garnishor fails to obtain judgments against both the garnishee and the principal debtor. The tax lien, attaching only to those property interests and rights to property remaining in the taxpayer, would reach only this contingent right to satisfaction left after the prior garnishment. Under this analysis, since the tax and garnishment liens would reach entirely different interests in the taxpayer's property, there would be no need to resort to the rules of priority.

72 DRAKE, ATTACHMENT, 7th ed., §§453, 542 (1891).

73 Filipowicz v. Rothensies, (D.C. Pa. 1940) 31 F. Supp. 716; National Bank of America v. Indiana Banking Co., 114 Ill. 483, 2 N.E. 401 (1885); 2 SHINN, ATTACHMENT AND GARNISHMENT §613 (1896).

74 Grosslight v. Crisup, 58 Mich. 531 (1885).

75 Salomon v. Continental Ins. Co., 261 Mass. 360, 158 N.E. 774 (1927).

76 292 U.S. 190, 54 S.Ct. 677 (1934). A judgment by default had been entered against the principal debtor by the Illinois court in which the garnishment proceedings had been begun. A judgment is necessary to support a garnishment proceeding in Illinois, but does not make the lien choate.

77 The dissenting opinion argued only that garnishment did not create a lien in Illinois.

C. *The Purpose of Garnishment.* Ideally, a creditor who must sue for payment is entitled to receive immediate judgment and satisfaction. In practice, however, the delay in obtaining a judgment enables a debtor to waste his assets, create superior consensual liens on his assets, or so delay this action that another creditor starting a later action may obtain judgment first and be able to obtain prior execution liens, if not prior satisfaction. Statutory garnishment proceedings are designed to protect a creditor against these risks of delay by preserving the debtor's assets in the status quo as of the beginning of the action. The diligent creditor using these procedures obtains a valid statutory preference over subsequent claimants,[78] and is able to gain satisfaction of his judgment as quickly as if there had been no delay. The finish line in this race of diligence is the acquisition of a preferential lien by service of the writ of garnishment and not the perfection of the lien by judgment. The right to payment, but not the right of priority, is perfected by a judgment. To make perfection depend upon obtaining a judgment is to confuse perfection with collection. If a garnishment lien, however inchoate, is to be of any value, it must give the creditor priority over a subsequent lien intervening before the creditor obtains judgment.[79] A garnishment lien is intended to preserve certain assets pending trial, but no creditor wishes to incur the costs and risks of garnishment merely to preserve the asset for the satisfaction of a subsequent tax lien. When the possibility exists that a subsequent tax lien might nullify his inchoate lien priority, a creditor is forced to elect between taking this risk or foregoing garnishment, relying solely upon execution of judgment for protection. The latter course exposes the creditor to all the risks intended to be avoided by garnishment proceedings.

IV. CONCLUSION

The determination of when a lien is choate is a federal question. Only once, and then in the case of a municipality's tax lien, has this question been determined in favor of the holder of the antecedent lien.[80] Since a private creditor's lien has never been held to be choate, there is no concrete example of what may constitute a choate lien or how such a lien may be obtained. Moreover, the promised priority for a choate statutory lien will require

[78] In re Snitzer, (7th Cir. 1932) 62 F. (2d) 285.
[79] See 29 N.C. L. REV. 293 at 299 (1951).
[80] United States v. New Britain, 347 U.S. 81, 74 S.Ct. 367 (1953).

still more litigation in order to define precisely what is meant by a choate lien, and to determine whether a lien may become choate at some stage short of final judgment for the lienor. The adoption of a choate lien doctrine has introduced uncertainty as to priority of liens into the law of creditor's rights, an area of law where certainty is essential. The Supreme Court seems firmly committed to its position, and any reversal of priority policy is unlikely. It is extremely doubtful that Congress intended the plain language of the tax lien statute to import as esoteric a rule of priority as the Court has developed and applied in its decisions. A clear declaration by Congress on the priority status of the federal tax lien is necessary in order to clear away the wreckage produced by six years of judicial legislation.

John B. Huck, S.Ed.