Federal Tax Liens and Secured Transactions: Accommodation or Abdication

Barbara Ashley Phillips
FEDERAL TAX LIENS AND SECURED TRANSACTIONS: ACCOMMODATION OR ABDICATION?

Barbara Ashley Phillips*

INTRODUCTION

Since 1866, the federal tax lien has arisen in secret upon little more than an administrative signature. It attaches to all the taxpayer's property, real or personal, tangible or intangible, in existence or subsequently acquired. Three events create the lien:

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2 Int. Rev. Code of 1954, § 6321 provides as follows:

If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount (including any interest, additional amount, addition to tax, or assessable penalty, together with any costs that may accrue in addition thereto) shall be a lien in favor of the United States upon all property and rights to property, whether real or personal, belonging to such person.

One line of defense against the tax lien is that that taxpayer has "no property" in the asset in question, to which the tax lien can attach. See the discussion, infra, in notes 126 & 146.

8 Id. The lien attaches to personal property without necessity for levy, e.g., Glens Falls Ins. Co. v. Stoetzl, 67-1 U.S. Tax Cas. ¶ 9308 (E.D. Cal. 1966) [tax lien held superior without levy to subsequent judgment lien with respect to claim assigned to taxpayer]; Glass City Bank v. United States, 326 U.S. 265 (1945) [tax lien defeated subsequent attachment lien with respect to money coming due taxpayer for services, without necessity for prior distraint or levy].

4 E.g., Seaboard Sur. Co. v. United States, 306 F.2d 855 (9th Cir. 1962) [rights under a construction contract dependent on the contractor's performance]; United States v. Hubbell, 323 F.2d 197 (5th Cir. 1963) [unliquidated cause of action for tort]; Division of Labor Law Enforcement v. United States, 301 F.2d 82 (9th Cir. 1962) [liquor license]; Bensinger v. Davidson, 147 F. Supp. 240 (S.D. Cal. 1956) [contract purchaser's cause of action for restitution against vendor of real property]; United States v. McFaddin Express, 197 F. Supp. 289 (D. Conn. 1967) [franchise certificate of public convenience and necessity]; United States v. Rochelle, Jr., 384 F.2d 748 (5th Cir. 1967), cert. denied, 390 U.S. 946 [cache of swindler]; United States v. Wiltse, 68-1 U.S. Tax Cas. ¶ 9415 (C.D. Cal. 1968) [fraudulently conveyed real estate, on theory title constructively remained in taxpayer]. See also, cases cited in note 11 infra.

assessments, demand upon the taxpayer, and his failure to pay. Once these events occur, the lien attaches as of the assessment date. A filed notice of lien is required only to assure the United States' priority over a holder of a security interest, mechanic's lienor, purchaser, or judgment lien creditor.

Once the United States obtains a lien upon the taxpayer's property, no one can acquire an interest in it greater than what he holds at that moment, except by Congressional grace. In effect the property has two owners, the taxpayer and the United States. Once a federal tax lien has attached, the taxpayer cannot affect nor destroy the rights of the United States.

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6 INT. REV. CODE of 1954, § 6303(a), provides for notice and demand for the tax, and it has been held that the demand itself must be in proper form. United States v. Coson, 286 F.2d 453 (9th Cir. 1961).

7 North Gate Corp. v. North Gate Bowl, Inc., 194 N.W.2d 651 (Wis. 1967) [once notice and demand were made, the tax lien was held entitled to priority as of the earlier assessment date].

8 Unless another date is specifically fixed by law, the lien imposed by section 6321 shall arise at the time the assessment is made and shall continue until the liability for the amount so assessed (or a judgment against the taxpayer arising out of such liability) is satisfied or becomes unenforceable by reason of lapse of time. The lien is not itself subject to any diminution in status because of its general character or potentially related back perfection. The lien is perfect, under the law of its creator, from its inception. Glass City Bank v. United States, supra note 3; United States v. City of Greenville, 118 F.2d 963, 965 (4th Cir. 1941). See text, infra following note 26.

9 United States v. City of Greenville, supra note 7.

10 See, Anderson, Federal Tax Liens—Their Nature and Priority, 41 CALIF. L. REV. 241, 251 (1953). Even death of the taxpayer cannot decrease previously fixed rights under a federal tax lien. United States v. Bess, 357 U.S. 51, 56 (1958) [United States lien on cash surrender value of life insurance policy on life of taxpayer survived his demise, notwithstanding state law to the contrary, and were recovered from the proceeds]. See also, Seaboard Sur. Co. v. United States, supra note 4 [tax lien prevailed over subsequent trustee's lien for expense of administering taxpayer's contract proceeds]; Citizens Bank of Barstow, Tex. v. Vidal, 114 F.2d 380, 382 (10th Cir. 1940) [claim for work, labor and materials; tax lien defeated subsequent assign-
impair them by judgment unless the United States is a party to the proceeding.\textsuperscript{11}

Over the years Congress has protected a growing list of interests against this secret lien, but it has left it to the courts to define the scope of protection. In doing so, the courts developed a federal test for perfection of competing interests—"choateness."\textsuperscript{12}

Choateness may be illustrated by reviewing the problems of consensual lienholders before the Federal Tax Lien Act was enacted in 1966. Under prior law, a federal tax lien was invalid against mortgagees and pledgees until notice of the tax lien was filed. The courts required that interests be perfected under state law, that they be fixed and certain as to the amount of the obligation secured, and that the identity of the property subject to the lien and of the lienor be known.\textsuperscript{13} Furthermore, the creditor had to take all

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  \item Glass City Bank v. United States, \textit{supra} note 3; Bensinger v. Davidson, 147 F. Supp. 240, 245 (S.D. Cal. 1956) [cause of action for unjust enrichment; tax lien defeated subsequent release]; \textit{In re} Educational Equip., Inc., 21 Am. Fed. Tax R.2d 1508 (C.D. Cal. 1968) [residence; tax lien defeated conveyance for creditors].
  \item Choateness may be illustrated by reviewing the problems of consensual lienholders before the Federal Tax Lien Act was enacted in 1966. Under prior law, a federal tax lien was invalid against mortgagees and pledgees until notice of the tax lien was filed. The courts required that interests be perfected under state law, that they be fixed and certain as to the amount of the obligation secured, and that the identity of the property subject to the lien and of the lienor be known. Furthermore, the creditor had to take all
  \item Metropolitan Life Ins. Co. v. United States, 107 F.2d 311 (6th Cir. 1939) [judgment of foreclosure in suit by mortgagee senior to the tax lien held ineffective against tax lien; sale was required by federal law which controlled the manner in which tax liens might be removed]. All that is necessary is that the tax lien attach when the taxpayer has "property." See discussion \textit{supra} note 4 and \textit{infra} note 146. Carver v. Ferguson, 254 P.2d 44, \textit{case dismissed} (Cal. App. 1953) [cause of action for tort held to be property]. Cal. Civ. Code § 14(3) (West 1954) [chose in action is property]. United States v. Rentz, 213 F. Supp. 521 (N.D. Iowa 1962) [cause of action of contract held property subject to a federal tax lien]. Thereafter, the lien can only be removed according to the procedures prescribed by federal law. See, e.g., \textit{Int. Rev. Code} of 1954 § 7403 and 28 U.S.C. § 2410 (1964). United States v. Bluhm, 69-2 U.S. Tax Cas. § 9609 (1969) [tax lien survived foreclosure of junior real property tax lien where United States not served under 28 U.S.C. § 2410].
  \item The "choateness" test is generally traced to United States v. Security Trust & Sav. Bank, 340 U.S. 47 (1950) [attachment lien subordinated as "inchoate" to subsequent federal tax lien filed prior to the date the attaching creditor obtained judgment because attachment lien unenforceable under state law unless reduced to judgment within the statutory period. It may also be explained by the rule of sovereign immunity.].
  \item This federal concept of perfection was no innovation in the law. Rather, it reflected the static common law view that a security interest did not exist, at any given time, except and to the extent that value has been given and security subjected to lien. See a discussion of the departure from this concept in the chattel mortgage cases in \textit{1 G. Gilmore, Security Interests in Personal Property} § 2.3, at 27 (1965).
steps necessary to perfect his interest before the tax lien notice was filed.14

As it stood in 1966, the law appeared harsh and antiquated. Certain kinds of interest and expenses necessary to preserve a security interest were at the mercy of intervening federal tax liens. It was becoming difficult to fit modern security interests into the protected categories of "mortgagee, pledgee, judgment creditor, and purchaser" which were the only interests entitled to filed notice of the tax lien. And the law gave almost no protection whatever to after-acquired property or future advances, once the lien notice was filed, absent a well-defined purchase-money security interest. Thus, the prudent lender had to check the public records before each disbursement.

In 1966, at the urging of the Treasury, the American Bar Association, and numerous business associations,16 Congress enacted a new statutory scheme of priorities for liens and interests competing with federal tax liens.17 This law17 assumes the continued pre-eminence of the federal tax lien,18 but contains its own rules for perfection of certain competing interests.19 It does not affect many liens, such as certain liens of attorneys, attaching creditors and landlords, and other statutory liens.20 It affects most consensual

after tax lien filing, even though at one time the Treasury argued for a contrary rule. See United States v. Lord, 155 F. Supp. 105 (D.N.H. 1957).


16 See, the Act supra note 8.

17 INT REV. CODE of 1954, § 6323.

18 H.R. REP. No. 1884, 89th Cong., 2d Sess. 35 (1966) contains the following observation (emphasis supplied):

"Under decisions of the Supreme Court a mortgagee, pledgee or judgment creditor is protected at the time notice of the tax lien is filed if the identity of the lienor, the property subject to the lien, and the amount of the lien are all established at such time. See United States v. City of New Britain, 347 U.S. 81 (1954). Except as otherwise provided, subsection (a) of new section 6323 retains this basic rule of federal law."

19 H.R. REP. supra note 5. S. REP. supra note 5.

20 The amendments were immediately effective with few exceptions. See Pub. L. No. 89-719, § 114 (Nov. 2, 1966), 80 Stat. 1125. Under prior and presumably continuing law, attaching creditors who obtain judgment after tax lien filing will continue to be subordinate to an intervening tax lien. See United States v. Security Trust & Sav. Bank, 340 U.S. 47 (1950) [so held]. Landlord's liens, as in United States v. Scovil, 348 U.S. 218 (1955), and statutory or contractual attorneys' liens, as in United States v. Ringler, 166 F. Supp. 544 (N.D. Ohio 1958) [attorney holding mortgage on business assets to secure reasonable value of services in contesting tax liability] presumably will...
liens immediately however, and it is to them that this paper is addressed.\textsuperscript{21}

The game of lien priorities is rarely leap-frog, and great peace of mind usually attends being first across the finish line. The trophy in the winner's circle reads "First in time, first in right." But under the 1966 Act, as under prior law, one gains nothing by being first with an inchoate or imperfect lien. The subsequent federal tax lien will prevail. The question is, what is an inchoate or imperfect lien.

\textbf{A Guide to the Statute}\textsuperscript{22}

The 1966 tax lien priority statute cannot be interpreted without an understanding of prior federal tax lien law. We have considered

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  \item be cut off by the making of an assessment (or for consensual liens qualifying as "security interests" by tax lien filing) so that the rendition of services or occurrence of contingencies upon which the liens are predicated after that date will be ineffectual against the tax lien. \textit{See} Brooks, Jr. v. United States, 271 F. Supp. 671 (E.D. Ky. 1967) [lawyer's contingent fee rights held subordinate to intervening tax lien under exception to INT. REV. CODE of 1954 § 6323(b)(8)].
  \item \textsuperscript{21} INT. REV. CODE of 1954 § 6323(a), \textit{as amended}. \textit{See also} H.R. REP. and S. REP., \textit{supra} note 5. This paper does not address itself to INT. REV. CODE of 1954 § 6324, relating to estate and gift taxes and the exceptions to them, notably interest and expenses on prior liens and security interests, superpriority interests and mechanic's liens.
  \item \textsuperscript{22} The following is a brief outline of the tax lien priority statute, Pub. L. No. 89-719, § 101 (Nov. 2, 1966), 80 Stat. 1125, as it became effective on November 2, 1966:
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      \item Section 6323(a)—accords priority over unfiled tax liens to purchasers, mechanic's lienors, judgment lien creditors and holders of security interests. Prior law did as much for "mortgagors, pledgees, purchasers and judgment creditors."
      \item Section 6323(b)—accords priority over filed federal tax liens to various classes of persons without actual notice of the federal tax lien and to some with notice of the lien. Under prior law, only a purchaser, mortgagee or pledgee of a security and the purchaser of a motor vehicle were so protected. \textit{See} INT. REV. CODE of 1954 § 6323(a).
      \item H.R. REP., \textit{supra} note 5, at 2, 4, 36.
      \item Section 6323(c)—provides a limited priority with respect to property acquired by the taxpayer or otherwise becoming security after notice of the tax lien is filed. There was no provision in prior law for after-acquired property.
      \item Section 6323(d)—provides a limited priority for subsequent disbursements with respect to security existing when the tax lien is filed. Prior law contained no parallel to this provision for future advances.
      \item Section 6323(e)—is new and allows a priority for interest and expenses, provided these are allowed the same priority under local law as a lien or interest entitled to priority over a federal tax lien.
      \item Section 6323(f)—states where a notice of tax lien must be filed to lien real and personal property.
      \item Section 6323(g)—provides for the renewal of aging tax lien notices by refiling of the notice of lien, where because of a taxpayer's waiver or the suspension of the statute of limitations, the 6-year life of the tax lien has been extended.
      \item Section 6323(h)—defines the terms used in the statute.
      \item Section 6323(i)—defines actual notice, recognizes the right of subrogation and authorizes the District Director to disclose the amount of an outstanding tax obligation to interested persons.
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the evils which Congress intended to remedy and turn now to an analysis of the overall statutory scheme it adopted. An understanding of the statutory scheme is necessary to predict the outcome of litigation under the Act and to identify aberrational decisions which cannot be relied upon.

The statute defines the interests it protects, the extent of their protection, and tells how to perfect them. Competing interests do not exist for tax lien priority purposes unless they meet these federal statutory requirements. Federal law controls except where federal law makes state law definitions applicable.

The tax lien statute uses at least two techniques to obtain the results it seeks: (1) it sets out explicitly the requirements for perfection of the interests it protects; (2) it carves out exceptions to both statutory and judicial rules for perfection. The first technique is used to accommodate future advances and after-acquired security. The second is used to provide for interest, expenses, and the superpriorities (interests protected against filed tax liens). In both cases, the statute carefully defines qualifying interests.

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23 INT. REV. CODE of 1954 § 6323(c), (d). See also discussion infra notes 60 & 65 et seq.
24 The protection of any lien or security interest may extend to interest or carrying charges (including finance charges, service charges, and the like) upon the obligation secured, INT. REV. CODE of 1954 § 6323(e)(2)-(6). H.R. REP., supra note 5, at 46-47.

Priority by subrogation is also recognized by section 6323(i)(2). There is no requirement that amounts paid under this subsection be used to pay liens senior to the one held by the payor, nor that the payments be necessary to protect his security. If this section is read literally, it would be possible for a senior to increase the amount of his priority over a federal tax lien for redemption purposes by payments to an obstreperous, or for that matter, a friendly junior, whom he could foreclose out of the property, provided only that the junior was also senior to the federal tax lien. Where done in an effort to prevent the United States or other juniors from redeeming, non-redeeming lienors might not be held to be “entitled to priority over the lien imposed by section 6321.”

The United States even though notified of a private foreclosure sale, has 120 days within which to redeem the property, or such longer period as local law allows. INT. REV. CODE of 1954 § 6337(b).

The priority of interest and expenses under INT. REV. CODE of 1954 § 6323(c) is derivative, and exists regardless of when the interest accrues, or the expenses are incurred. No separate perfection of these items is necessary but they are dependent upon the establishment of a lien or interest which is prior to the tax lien of the United States. Security agreements should provide for the inclusion of all such items within the lien being created unless local law does so expressly; California law has not, since 1965. See Stats. 1965, 1379, page 3293, § 17, repealing CAL. COMM. CODE § 9312(7). See also 2 P. COOGAN, W. HOGAN & D. VAGTS, SECURED TRANSACTIONS UNDER THE U.C.C. § 2-105(2) (i) (1963).

25 The protection afforded the holder of a superpriority interest is similar to that afforded under prior law to purchasers, mortgagees or pledgees of securities and to purchasers of motor vehicles. The 1966 amendments enlarge the field of qualifying interests to include others where reliance is placed by the market on possession of the property or a tangible token of a property interest. INT. REV. CODE of 1954 § 6323(b). Also
A consensual lien must be perfected under local law against a judgment lien creditor in order to be recognized for tax lien priority purposes. Holders of "simple" security interests (good under the

protected are attorneys whose efforts create or procure property or funds, and de minimis sales involving too little money to justify an argument over lien priorities. In addition, the new protection of property tax liens in effect puts the United States in the same position as other creditors who are subordinated to these liens under state law.

The superpriorities break down into two categories: those protected whether or not the person secured has actual notice or knowledge of the tax lien and those who are protected only if they are without actual notice or knowledge of the federal tax lien at the time their liens or interests arise. Distinguish the notice of lien filing which is relevant to the priority of consensual lien-holders not qualifying for a superpriority. Int. Rev. Code of 1954 § 6323(a), (c), (d). See discussion in note 34 infra. Among those protected only if they are without actual notice or knowledge of the federal tax lien are

1. a purchaser of a security, a motor vehicle, or personal property at casual sale,
2. a person holding a security interest in a security,
3. an insurer lending on its life insurance,
4. or a passbook lender upon its own account.

A purchaser of personal property at retail will not be accorded his priority if by his purchase he intends to interfere with the collection of Federal taxes, or if he knows that his purchase will do so. However, actual notice of the tax lien is not, strictly speaking, sufficient to defeat him. A purchaser at casual sale will be similarly defeated by knowledge that the sale to him is one of a series of sales.

Also protected against previously-filed federal tax liens under section 6323(b) in spite of actual notice or knowledge of the tax lien are those qualifying as

1. a holder of a possessory lien on tangible personal property,
2. a holder of a mechanic's lien for small repairs to residential real estate,
3. an attorney holding a charging lien upon property or funds he procures or creates, as in Columbia Cas. Co. v. Consolidated Shipping Co., 276 F. Supp. 600 (E.D. La. 1967),
4. governmental bodies holding ad valorem and public improvements tax liens on real property, or public service or utility service liens.

The date of tax lien filing is a matter of indifference to the superpriority interest holders who meet the definitional requirements of Int. Rev. Code of 1954 § 6323(h). A superpriority purchaser must still have perfected his interest against a subsequent purchaser without actual notice. A holder of a security interest must still have perfected his interest against a judgment lien creditor. But there is no time limit within which they must do so. Only if the person must be without actual notice or knowledge of the tax lien, must he have satisfied the definitional requirements for a "purchaser" or "holder" of a security "interest" before such notice or knowledge is acquired.

Attorneys' liens, consensual or nonconsensual, are protected only with respect to judgments and amounts received in settlements, as against a previously filed federal tax lien, or a tax lien arising during the period when the attorney is still rendering services. This protection is broader than that allowed under the old creation of the fund rule, in that it covers settlements. However, it does not cover fees of a plaintiff in interpleader. See United States v. R. F. Ball Constr. Co., supra note 13.

26 H.R. Rep., supra note 5, at 11-12. S. Rep., supra note 5, at 13. See cases cited supra note 14, and Bebber v. Mills Lumber Co., 429 P.2d 92 (Wyo. 1967) [employees without artisan's or other lien inferior to United States as to goods produced]. See also Calvin & Co. v. United States, 264 Cal. App. 2d 571, 70 Cal. Rptr. 756 (1968) [United States tax lien held superior to lender's claim as to borrowed funds].

Int. Rev. Code of 1954 § 6323(h)(1) defines a security interest as one perfected against a subsequent judgment lien arising out of an unsecured obligation. The Uniform Commercial Code contains no statement of priorities between security interests within its purview (security interests in personal property) and a judgment lien. The perfection required must, therefore, be determined under general law defining and limiting
old "choateness" test) must take all steps necessary to that perfection before tax lien filing.\(^{27}\) And holders of commercial transactions security interests may take some steps necessary to it after tax lien filing.\(^{28}\) (Holders of superpriority interests are almost exempt from perfection rules, but must meet rigid definitional requirements. See discussion, supra, note 25.) The judgment lien creditor test is an initial perfection required of virtually all consensual liens for tax lien priority purposes. In this regard the House Report states that:

The priority granted a security interest over a Federal tax lien under any provision of section 6323 or section 6324 is never greater than the priority accorded such security interest, under local law, against a subsequent judgment lien arising out of an unsecured obligation.\(^{29}\)

The United States under its tax liens is not limited to the rights of a state-law judgment lien creditor. Under the 1966 law, as under its predecessor, the preeminence and pervasiveness of the federal tax lien is assumed. Once it exists, the federal tax lien is perfected both as to real and personal property.\(^{30}\) And it is immune from related-back perfection except as federal law provides.\(^{31}\)

\(^{27}\) See H.R. Rep., supra note 18 and infra note 66. See also text following note 44 infra; Glens Falls Ins. Co. v. Stoetzl and Glass City Bank v. United States, supra note 3. See contra, Peninsula State Bank v. United States, infra note 156.

\(^{28}\) See discussion in text following notes 54 and 69 and infra pp. 59 et seq. See also discussion in notes 126 and 146 infra. "Superpriority" interests which enjoy related-back perfection or escape perfection requirements entirely are defined primarily in Int. Rev. Code of 1954 § 6323(b). See discussion in note 25 supra.

\(^{29}\) H.R. Rep., supra note 5, at 49.

\(^{30}\) Id.; see also Federal Tax Lien Act of 1966, supra note 8.

\(^{31}\) See H.R. Rep., supra note 5, at 35, 49. See also supra note 18 supra, and text follow-
The lien priority provisions are essentially an accommodation, not an abdication. The United States is still a competing creditor with a statutory edge, but the edge has become easier to live with for the commercial lenders, manufacturers, and sellers who are the chief beneficiaries of the 1966 amendments. By contrast, Congress granted few concessions to innocent bystanders, other than purchasers and repairmen of Lilliputian proportions, and contract purchasers.

In many ways the new statute is akin to the Uniform Commercial Code, but it is folly to assume that the same terms have the same meaning in both contexts. A security interest under section 6323(h)(1) of the Internal Revenue Code includes real property, whereas a Uniform Commercial Code security interest is limited to personal property and fixtures. A purchaser under section 6323(h)(6) must have given "adequate and full consideration," not merely valuable consideration. The requirements for perfection of an Internal Revenue Code-qualified security interest are stricter than for a Uniform Commercial Code interest because related-back perfection is not generally recognized. Future advances and after-acquired property are provided for only in a limited way. But see Carco Acceptance Corp. v. Kunze, 69-2 U.S. Tax Cas. F1 9607 (D.C. Neb. 1969) [purchase money security interest prevailed against prior tax lien in spite of 7-day gap between release of security interest refiling in county. The case concurs with the purchase money security cases but is wrongly explained on the theory that the tax lien could not prevail because a judgment creditor could not do so under state law. This theory wholly ignores Congressional limitations upon related back perfection.].

UNIFORM COMMERCIAL CODE § 1-201 (37) (1958). A "purchaser" may now include a holder of "(A) a lease of property, (B) a written executory contract to purchase or lease property, (C) an option to purchase or lease property or any interest therein, or (D) an option to renew or extend a lease of property, which is not a lien or security interest. . . . ." H.R. REP., supra note 5, at 50. INT. REV. CODE of 1954 § 6323(h)(6). United States v. Mitchell, 69-2 U.S. Tax Cas. F1 9524 (7th Cir. 1969) [allowing United States to set aside transfer of taxpayer's interest in his home to his spouse in exchange for a mortgage on both interests to pay taxes of lien on the property].

The statute defines a protected "agreement" as one providing for disbursements made before actual notice of tax lien filing. Int. Rev. Code of 1954 § 6323(c)(2)(A), (d). This allows the lender to protect himself immediately upon actual notice by ceasing to make further disbursements. If he comes within the commercial financing priority, he may then act in a more leisurely fashion to terminate substitution of collateral and prevent dissipation of collateral acquired for a period up to 45 days following the tax lien filing.

This approach presupposes that the secured party has power under the security agreement to discontinue disbursements or extensions of credit, once the filing of a federal tax lien has been discovered. In the absence of such a contractual provision, the secured party may be hard pressed indeed, as no provision will be made for his protection against a filed federal tax lien, unless he comes within the relatively narrow confines of the obligatory disbursements provisions, Int. Rev. Code of 1954 § 6323(c)(4), which are inapplicable unless the obligation required by reason of the intervention of the rights of a person other than the taxpayer. The burden is on the
tion 6323(i)(1) defines "actual notice or knowledge" for purposes of application to organizations in the language of the 1962 amendment to section 1-201(27) of the Uniform Commercial Code.35

WHERE TO FIND NOTICE OF A FEDERAL TAX LIEN

The 1966 amendments36 greatly simplified the search for a tax lien in advance of extending credit or lending money. Notices of federal tax liens affecting the taxpayer's personal property are filed in only one place as are notices of liens affecting any given piece of his real property. As before, to lien real property, notice of a federal tax lien must be filed in the one office designated by the state in which the property is located.37 To lien personal property, notice of lien must be filed in the one office designated by local law for the filing of such notices to lien all the taxpayer's personal property, whether or not within the state.38 This is generally the recorder's office in the county where the taxpayer resides or where a corporation or partnership has its principal executive office.39 In states not providing one and only one such office, notice will be filed with the clerk of the United States District Court for the district in which the taxpayer resides.40

government to show the existence of actual notice or knowledge, according to the Committee reports. H.R. Rep., supra note 5, at 12, 50. S. Rep., supra note 5, at 14.
36 INT. REV. CODE of 1954 § 6323(f).
37 INT. REV. CODE of 1954 §§ 6323(f)(1)(A)(i), (2)(A). As in California, this is usually the office of the recorder for the county in which the property is located. CAL. GOV'T CODE § 7200(a) (West Supp. 1968). State law will apparently control the definition of "real property." In a footnote to the discussion of the Act's definition of "security interest," the Committee Reports state that "it is intended that what becomes a part of realty is to be determined under local law." H.R. Rep., supra note 5, at 11. S. Rep., supra note 5, at 13. As to fixtures, see the cases cited infra note 97 et seq. See also, Elliott v. Sioux Oil Co., 191 F. Supp. 847 (D. Wyo. 1960) [same, as to the beneficial interest in a trust consisting of real property].
38 INT. REV. CODE of 1954 § 6323(f)(1)(A)(ii). INT. REV. CODE of 1954 § 6323(f)(2)(B) governs the situs of personal property. See discussion of residence, infra note 41. State law is apparently intended to govern what constitutes personal as well as real property. Thus debts secured by a mortgage or trust deed on realty will be personal property, in "lien theory" states. United States v. Goldberg, 362 F.2d 575 (3d Cir. 1966) [so held; federal tax liens of which notice was filed in the county of the corporation's principal place of business took priority with respect to a note and mortgage over subsequent assignee]; CAL. CIV. CODE § 2888 (West 1954); Martin v. Becker, 169 Cal. 301, 146 P. 665 (1915); Hilliard v. Bank of America, 102 Cal. App. 2d 730, 225 F.2d 327 (1951); United States v. Cohen, 389 F.2d 689 (5th Cir. 1969). Contra, Harman v. Fairview Associates, 69-1 U.S. Tax Cas. ¶ 9187 (1969). [This is not good law under the 1966 Act. The state must designate only one place for filing to lien all personal property belonging to a taxpayer.]
39 In the case of a corporation or partnership, notices of federal tax liens are to be filed with the Secretary of State to lien personal property. CAL. GOV'T CODE § 7200(b)(1) (West Supp. 1968).
40 INT. REV. CODE of 1954 § 6323(f)(1)(B). A notice of tax lien against tax-
The 1966 Act is tricky however, in that it contains its own definitions and relevant periods. For example, the situs of all personal property for tax lien notice filing purposes is deemed to be the taxpayer’s residence. Furthermore, the time when the situs of personal property is determined is the time when the notice of lien is filed, not the time when the property is acquired. Thus, a lien filed January 1, 1965, in State A where the taxpayer then resided, would lien a piece of equipment acquired by him prior to January 31, 1971, in any state, regardless of his residence at the time of acquisition. A refiling of notice of a tax lien would have to be both in the place of original filing and where the taxpayer then resides provided the Commissioner knows of the new residence (either through written notice or a filed return) more than 90 days before refiling. Accordingly, a prospective encumbrancer or purchaser of personal property should verify the absence of tax lien filings wherever the taxpayer (borrower or seller) resided over the preceding six years and thirty days to virtually assure the priority of his interest over a federal tax lien.

**Basic Priorities**

Assuming that credit has been extended or a loan made in ignorance of a filed tax lien, what is the relative strength of the security interest and the federal tax lien? Analysis of the priority problems of the holder of a security interest begins with an exam-
ination of the state of affairs existing when the notice of tax lien is filed. This date of "tax lien filing" is the key to determining whether and to what extent a consensual lien is prior in time to a federal tax lien. This is the first cut-off point for determining the perfection and extent of the security interest, and also of judgment liens, purchasers' interests, and to a lesser extent, mechanic's liens.

Specifically, we must answer the following questions:

1. At the date of tax lien filing, was there a written agreement covering this transaction in existence?

If no written agreement existed when the tax lien was filed, there can be no priority for future advances or after-acquired property since these are identified on the date of tax lien filing, absent a superpriority.

2. At the date of tax lien filing, had the holder of the security interest taken all steps necessary to the perfection of his interest against a judgment lien creditor under state law?

If all steps necessary to the perfection of a security interest under state law have not been taken when the tax lien is filed, only...

46 Id. § 6323(a),(h) (6).
47 A mechanic's lien is perfected with respect to real property for tax lien priority purposes whenever it becomes perfected under local law against subsequent purchasers without actual notice, but no earlier than the date on which the lienor first begins to supply labor, services, or materials. Int. Rev. Code of 1954, § 6323 (h)(2). Unlike the security interest, there is no requirement that the "consideration" for the lien be supplied before notice of the tax lien is filed. In other words, the statute accepts an otherwise inchoate lien for purposes of determining priority as against the federal tax lien. A bonded stop notice lienor is protected by this rule, with respect to construction loan funds. Shore Block v. Lakeview Apts., 377 F.2d 835 (3d Cir. 1967). For cases finding priority on an "equitable lien" theory, see discussion in notes 126 & 153 infra.


49 See note 25 supra.
a commercial financing security interest or superpriority is entitled to any priority whatever for after-acquired property and future advances. For example, assume that a security interest is perfected against another security interest in the same manner as it is perfected against a judgment lien. As a simple security interest it could not be perfected against a federal tax lien in accounts receivable or contract rights until a financing statement had been filed. And while a similar filing or possession would accord protection to a security interest in goods, chattel paper or documents, possession would be necessary to the perfection of a simple security interest in an instrument.

A commercial transactions security interest may enjoy temporary perfection as provided for by the Commercial Code, if the temporary perfection does not jeopardize the interest's immunity against a judgment creditor obtaining a lien on the date of tax lien filing. However, this is only true if perfection is achieved within the 45-day or other period provided by the tax lien statute, and does not prevent the interest from meeting the law's other conditions.

3. What disbursements were made prior to the time of filing of the notice of federal tax lien?

While these disbursements may be secured without question for tax lien priority purposes, priority for post-tax lien filing disbursements generally depends upon lack of actual notice of the tax lien filing.

4. What security was in existence and had been acquired by the taxpayer prior to the time of tax lien filing?

Late perfection of the security interest in specific property because of delay in the debtor's acquisition of rights in the collateral is provided for only in the commercial transactions (or superpriority) provisions. The commercial transactions exceptions allow priority in collateral acquired within 45 days after tax lien filing for certain interests created by commercial transactions financing agreements. And an even longer acquisition period is allowed certain

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50 See text following note 25 supra and notes 64 & 154 infra.
52 Cal. Com. Code §§ 9304(1), 9305 (West 1964). With respect to instruments, this is true because there is no temporary or related-back perfection. However, security interests in securities are entitled to superpriority treatment. See note 25 supra.
54 See Int. Rev. Code of 1954 § 6323(d) and text following note 66 infra; see also discussion in notes 25 (superpriorities) and 24 (interest and expenses) supra; and following note 24.
obligatory disbursements agreements and real property construction or improvement agreements (including crop and livestock loans).\(^{56}\) However, a *simple* security interest does not extend to property not in existence when the notice of tax lien is filed.\(^{57}\)

**THE CONCEPT OF A "SECURITY INTEREST" UNDER THE INTERNAL REVENUE CODE**

*In General*

The Tax Lien Act of 1966 codifies the prior judicial test of choateness for competing liens. Under this test, a "simple" security interest is protected to the same extent as a mortgage or pledge under prior law.\(^{58}\) Statutory exceptions to the "choateness" test include the superpriorities and the commercial transactions provisions.\(^{59}\)

A "simple" security interest\(^{60}\) exists only in existing property in which has been created a security interest good under local law against a subsequent judgment lien creditor.\(^{61}\) The *existence* of the security interest refers to the perfection required, the disbursements made, and the property claimed as security. A similar test for perfection is applied under the Internal Revenue Code (all references herein to IRC refer to the Internal Revenue Code of 1954, 1968 edition) to judgment lien creditors, who must have acquired their *judgment* liens prior to the date of tax lien filing.\(^{62}\)

An IRC-qualified security interest does not always include many types of interests—notably rights not yet earned or conditioned upon an event which has not occurred—which would be sub-

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\(^{56}\) INT. REV. CODE of 1954 § 6323(c)(3) and (4), discussed *infra* note 94 and following note 134.

\(^{57}\) INT. REV. CODE of 1954 § 6323(h)(1). See *infra* pp. 59 et seq. for a discussion of the Internal Revenue Code limitations on qualifying property.

\(^{58}\) INT. REV. CODE of 1954 § 6323(b),(c).

\(^{59}\) INT. REV. CODE of 1954 § 6323(a),(h)(1). See discussion following note 25 *supra.*

\(^{60}\) INT. REV. CODE of 1954 § 6323(a),(h)(1).

\(^{61}\) INT. REV. CODE of 1954 § 6323(h)(1)—"Security Interest. The term 'security interest' means any interest in property acquired by contract for the purpose of securing payment or performance of an obligation or indemnifying against loss or liability. A security interest exists at any time (A) if, at such time, the property is in existence and the interest has become protected under local law against a subsequent judgment lien arising out of an unsecured obligation, and (B) to the extent that, at such time, the holder has parted with money or money's worth." (emphasis supplied). Note that only *consensual* interests are protected as security interests.

\(^{62}\) The perfection required of a judgment lien is implicit in the phrase “judgment lien creditor” which replaces the appellation under prior law, “judgment creditor.” H.R. Rep., *supra* note 5, at 36; see also discussion, *supra* note 26.
ject to Article 9 of the Uniform Commercial Code.\textsuperscript{63} And the IRC security interest does not generally exist until all events necessary to its perfection have occurred, unlike the Commercial Code.\textsuperscript{64} These are the most important differences between the two statutes.\textsuperscript{65}

The test for perfection of a "simple" security interest and a judgment lien might be called an "all events" test, since after tax lien filing nothing the lienor can do will increase the amount of his security nor the extent of disbursements secured against the tax lien, nor the perfection of the security interest or judgment lien except as provided in section 6323.\textsuperscript{66} The chart on the following pages illustrates the point that a simple security interest encompasses pre-tax-lien-filing—i.e., Time 1—disbursements and security only. See example "A."

Under the so-called 45-day exception,\textsuperscript{67} this interest is stretched to include protection for disbursements made before the 46th day after tax lien filing and before actual notice of that filing.\textsuperscript{68} The chart refers to this as "Time 3." See example "D." Under this exception,

\textsuperscript{63} The limitations upon property which can be the subject of an Internal Revenue Code security interest are discussed infra p. 59. However, most vulnerable is "any interest of a buyer of accounts, chattel paper, or contract rights" (Uniform Commercial Code § 1-201 (37)) to the extent these are not in existence at the critical time. Rights in proceeds which are different from the property which gives rise to them, such as proceeds from the sale of inventory, unless and until these come into existence are likewise unsatisfactory. However, for a novel approach to the "qualified property" problem, see Harter v. District Director, 22 Am. Fed. Tax R.2d 593 (E.D. Wash. 1968) [assignment of amounts falling due (on unstaeted dates) from lumber purchaser by mill operator to log supplier held superior to prior tax liens on theory the taxpayer had no property in the account. See discussion note 146 infra].

\textsuperscript{64} See text, supra notes 27 & 50, and H.R. Rep., infra note 66.

\textsuperscript{65} See also discussion note 32 supra.

\textsuperscript{66} The House and Senate Reports contain the following statement:

\textquotedblleft... Various types of secured creditor interests already having, or given, priority status over tax liens are specifically defined, and it is provided that where those interests qualify under the definitions they are to be accorded this priority status whether or not they are in all other respects definite and complete at the time notice of the tax lien is filed. H.R. Rep., supra note 5. S. Rep., supra note 5. (Emphasis supplied.)\textquotedblright

It is submitted that where an interest does not qualify under the statutory definitions, there can be no priority unless it is in all respects definite and complete at the time notice of the tax lien is filed.

\textsuperscript{67} Int. Rev. Code of 1954 § 6323(d).

\textsuperscript{68} Int. Rev. Code of 1954 § 6323(d). It is of course necessary that a written security agreement precede tax lien filing, and that the agreement protect the interest in question under local law against a judgment lien creditor.

Note that this is a departure from the pre-1966 rule which viewed each advance as a separate security interest when actually made. See Comment, Nonconsensual Liens Under Article 9, 76 Yale L.J. 1649, 1665 (1967). See also, United States v. Pay-O-Matic Corp. 162 F. Supp. 154 (D.N.Y. 1958), aff'd, 256 F.2d 581 (2d Cir. 1958), cert. denied, 358 U.S. 830 (1958) [attorney's lien in condemnation suit held inchoate under federal law until services fully performed]; and H.R. Rep., supra note 5, at 10, 45.
<table>
<thead>
<tr>
<th>Example</th>
<th>Written security agreement entered into and security interest perfect under state law under which nothing remains to be done to establish perfection</th>
<th>Time 1</th>
<th>Time 2</th>
<th>Time 3</th>
<th>Time 4</th>
<th>Result</th>
</tr>
</thead>
<tbody>
<tr>
<td>A.</td>
<td>✓</td>
<td>*</td>
<td>X</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>B.</td>
<td>✓</td>
<td>X</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>C.</td>
<td>✓</td>
<td>X</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>D.</td>
<td>✓</td>
<td>*</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
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</tr>
<tr>
<td>E.</td>
<td>✓</td>
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<td>*</td>
<td>X</td>
<td>✓</td>
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</tr>
<tr>
<td>F.</td>
<td>✓</td>
<td>✓</td>
<td>X</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>G.</td>
<td>✓</td>
<td>*</td>
<td>✓</td>
<td>✓</td>
<td>X</td>
<td>✓</td>
</tr>
<tr>
<td>H.</td>
<td>✓</td>
<td>✓</td>
<td>*</td>
<td>X</td>
<td>✓</td>
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</tr>
<tr>
<td>I.</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>X</td>
<td>✓</td>
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</tr>
<tr>
<td>J.</td>
<td>✓</td>
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<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
</tbody>
</table>

**Time 1:** Before notice of tax lien is filed.  
**Time 2:** The date of tax lien filing.  
**Time 3:** The 45-day period following Time 2.  
**Time 4:** 46 or more days after Time 2.  
"X" denotes protected interests.  
* denotes extent of protection (see Result).
it is immaterial whether there was any disbursement made within
Time 1 (before tax lien filing), but it is critical that there be Time 1 security. No provision is made under the 45-day exception of
section 6323(d) for after-acquired security. See examples “E” and
“F.”

There is no requirement that these post-tax-lien-filing disburse-
ments be obligatory and no advantage under this provision merely
because they are. Obligatory or not, priority under section 6323(d)
is cut off for disbursements made more than 45 days after tax lien
filing or after earlier actual notice of this filing.60

A qualifying disbursement under the Internal Revenue Code
is defined as a parting with money or money’s worth.70 Past con-
sideration is sufficient in all cases where it is sufficient under local
law.71 A promise to extend credit or to make a loan is not a “part-
ing with money’s worth” under the Internal Revenue Code.72 Only
where a disbursement is required by the intervention of rights of a
third party (other than the taxpayer-debtor), does the Internal
Revenue Code accord additional protection to a secured party.73

The “Commercial Transactions” Security Interest and the
Protection of After-acquired Property74

The commercial transactions exceptions provide for after-ac-
quired security.75 Disbursements under the commercial financing
subdivision of this section (whether as loan or purchase) must be

60 Some protection is accorded disbursements made obligatory by the intervention
of rights of a third party. See text following note 114 et seq. infra.
70 H.R. REP., supra note 5, at 45; INT. REV. CODE of 1954 § 6323(b)(1)(B).
72 Note the contrary rule of the UNIFORM COMMERCIAL CODE § 1-201(44)(a),
where a promise to extend credit constitutes value sufficient to permit attachment of
a security interest. UNIFORM COMMERCIAL CODE § 9-204.
73 See following note 134 infra, for discussion of specialized obligatory dis-
bursements.
74 INT. REV. CODE of 1954 § 6323(c).
75 A filed tax lien is not good against certain security interests coming into
existence after tax lien filing (because of post-tax-lien filing disbursements or acquisi-
tions) if the following conditions are met:
a. There must be a security interest protected under local law against a judgment
lien arising at the time of tax lien filing in
b. qualified property, as defined, covered by
   c. a written agreement entered into before tax lien filing. INT. REV. CODE of 1954
   § 6323(c)(1)(B).
In addition, the agreement must constitute
   a. a commercial transactions financing agreement,
   b. a real property construction or improvement financing agreement, or
   c. an obligatory disbursement agreement, all of which are defined. INT. REV.
   CODE of 1954 § 6323(c)(1)(A)(i),(ii),(iii).
made before actual notice or knowledge of tax lien filing and not later than 45 days afterwards, as under the 45-day exception of section 6323(d). Commercial financing security may be acquired by the taxpayer or otherwise become security only within 45 days after the tax lien filing—Time 3 security on the accompanying chart. See example "E."

Under the obligatory disbursements and crop, livestock, or construction loan provisions, priority is recognized in property becoming security more than 45 days after tax lien filing. The priority accorded this (Time 4) security is illustrated by examples “C,” “F” and “I” on the accompanying chart. In addition, these provisions are the only ones affording protection to (Time 4) disbursements after actual notice of tax lien filing or 46 or more days after tax lien filing (Time 2), except for interest and certain expenses, and the superpriorities. See examples “G,” “H” and “I.”

1. The Commercial Transactions Financing Exception. The purposes of the commercial transactions financing exception are to permit the roll-over of inventory and accounts receivable for 45 days after notice of the tax lien is filed, and to protect the lender or purchaser’s security in after-acquired property for the same period. As a result of this provision, the lender need only check the records every 45 days, rather than before each disbursement as prudence would have counselled under prior law. However, the agreement to make loans or to purchase commercial financing security must have been made in the course of the lender’s trade or business. Accordingly, although manufacturers’ or distributors’ financing on a customer’s accounts receivable may be protected, a family lender is not. The result is that his security must have come into existence as such prior to tax lien filing.

Another qualification upon the availability of the commercial financing exception to protect after-acquired security is that the

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76 Limitations on the kind of property which may secure a holder against a federal tax lien are discussed infra p. 59; see also Continental Fin. Inc. v. Cambridge Lee Metal Co., 100 N.J. Super. 327, 241 A.2d 853 (1968), discussed in note 146 infra.
77 INT. REV. CODE of 1954 § 6323(c)(2).
79 One other alternative to consider in the family secured loan area is to set up the transaction as a gift. If the otherwise-debtor gives property to a donee prior to the attachment of a federal tax lien, the “debtor” has no longer any property to which the lien can attach. Zeddies v. United States, 357 F.2d 897 (7th Cir. 1966) [so held, in absence of evidence that conveyance was fraudulent]. However, where a taxpayer acquires property presumptively by gift, that property is subject to federal tax liens filed against him. United States v. Trilling, 328 F.2d 699 (7th Cir. 1964). However, the price of a gift instead of a loan is loss of any interest deductions on payments made by the donor, who would otherwise be entitled to them as a borrower, INT. REV. CODE of 1954 § 163.
security must be acquired by the taxpayer-debtor in the ordinary course of his trade or business. Ordinary business assets and non-depreciable personal property held for investment or speculation are frequently distinguished in federal tax law and it is possible that some significance will be attached to the use of the word "ordinary" in the tax lien priority context. However, the impact of this qualification is minimized by the creation of a superpriority (protection against a filed tax lien) for security interests in securities. This is the one class of property most likely to be found a capital asset held for investment or speculation rather than an ordinary business asset which qualifies as commercial financing security. Real property and depreciable personal property used in a trade or business are almost always considered ordinary business assets, and thus could qualify as commercial financing (Time 3) security for tax lien priority purposes. However, the circumstances of the taxpayer's acquisition and holding of the asset would be relevant in a close case, and intangible personal property is to be suspect.

The commercial financing definitions must, of course, be satisfied: Is the financing agreement in question written? Does it assure priority as to the security in question against a judgment lien creditor under local law? Under its provisions, does the person claiming priority agree to make loans (no binding commitment is necessary) to the taxpayer to be secured by commercial financing security or to purchase such security (other than inventory)?

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80 Int. Rev. Code of 1954 § 6323(c) (2) (A) (i), (ii).
81 The Code has long distinguished between capital assets and real or depreciable personal property used in a trade or business. Int. Rev. Code of 1954 § 1221(2). The latter were not initially qualified for capital gains treatment. In 1942 because of income distortions arising from government requisition of property and war losses overseas, Congress allowed real and depreciable personal property to receive capital gain treatment where the disposition created a gain and ordinary loss treatment if a loss were created. Involuntary conversions of long-term capital assets and tangible business property were lumped together and a net gain (capital) or loss (ordinary) reported, under what is now Int. Rev. Code of 1954 § 1231.

Unaffected by any of these distinctions was intangible personal property used or acquired by a business: stocks, bonds, commodity futures, contract rights, and so on. See, e.g., Corn Prod. Ref. Co. v. Commissioner, 350 U.S. 46 (1955) [corn futures held ordinary assets in the hands of corn products manufacturer]; Pridemark, Inc. v. Commissioner, 345 F.2d 35 (4th Cir. 1965) [uncompleted contracts for prefabricated houses in hands of dealer in such houses held ordinary assets].

82 Int. Rev. Code § 6323(b) (1) (A), (B), discussed in note 25 supra.
84 Int. Rev. Code of 1954 § 6323(c) (2) (A) (i). Commercial financing security is defined in Int. Rev. Code of 1954 § 6323(c) (2) (C) to include "(i) paper of a kind ordinarily arising in commercial transactions, (ii) accounts receivable, (iii) mortgages on real property, and (iv) inventory." H.R. Rep., supra note 5, at 8, 41; S. Rep., supra note 5, at 708.
85 Int. Rev. Code of 1954 § 6323(c) (2) (A) (ii).
If the financing agreement does not meet these requirements at the time of tax lien filing, there can be no protection for after-acquired property (security) under this exception. Protection can only be found elsewhere, such as in construction, crop and livestock loans and obligatory disbursements, or as superpriorities.

Under this section purchasers of commercial financing security other than inventory are treated as lenders as they are in the case of accounts, contract rights, and chattel paper under the Uniform Commercial Code. The characteristic use of recourse provisions in the factoring context makes the segregation of sales from secured transactions hopelessly complex. Nevertheless, in the lien priority context, it is desirable to mitigate the effect of unexpectedly being treated as a secured party as a result of what was thought to be a sale.

The tax lien priority statute provides purchasers (in substance or form) a choice of priorities. Take for example a purchaser of accounts receivable at the going discount rate. Such a simple purchaser must perfect his interest against a subsequent purchaser without actual notice, but having done so, he is protected to the extent of the entire property covered by the purchase agreement, regardless of when he is required to pay the price. As a lender, he need only perfect his interest against a judgment lien arising at the time of tax lien filing and otherwise qualify his interest under the commercial financing exception's definitional requirements. However, his resultant priority will extend only to the "purchase price" paid, plus interest and expenses as for all other lenders. If his priority is that of a lender, his protection is that of a lender also. If he accepts the general priority rights accorded other purchasers, his protection is that of other purchasers. The choice is his.

2. Real Property Construction and Improvement Loans. The
purpose of this second type of commercial transaction is to permit the completion of real property construction projects. The theory is that the completed structure will be worth more to the United States, as well as to the lender, after completion.94 For this reason, the construction lender's protection is limited to cash disbursements applied to the construction project.

The construction lender has priority over filed tax liens for two kinds of Time 3 security: the first is "real property as to which the construction or improvement has been or is to be made," or the proceeds of the contract for such construction or improvement.95 The term "property" is nowhere defined in the 1966 amendments nor in the Reports accompanying them. It is not clear whether "property" includes fixtures which become a part of the property under state law, as some have suggested.96 California law relating to the priority of a security interest in a fixture as against a security interest in the real property was unaffected by the enactment of the California Commercial Code,97 and prior law afforded no priority to the holder of the security interest in the fixture over the holder of a security interest in the realty,98 absent a waiver by the senior secured party.99 In other words, fixtures do become a part of the

95 Int. Rev. Code of 1954 § 6323(c) (3) (B) (i), (ii). A footnote to the House Report on the Act states that "As to what constitutes property, it is intended that what becomes a part of realty is to be determined by local law." H.R. Rep., supra note 5, at 11, note 2. However, "property" under the Act must have been that "with respect to which the construction or improvement has been or is to be made," Int. Rev. Code of 1954 § 6323(c) (3) (B) (i).
97 The official text of the Uniform Commercial Code contains provisions defining security interest in fixtures (Uniform Commercial Code § 9-102(1) (a)), determining priorities between competing security interests in fixtures (Uniform Commercial Code § 9-313) and providing special rules for the place of filing financing statements covering security interests in fixtures (Uniform Commercial Code § 9-401(1) (b)). The California version contains none of this. It makes Division 9 applicable "to any transaction (regardless of its form) which is intended to create a security interest in goods which are or later became 'fixtures' under the law of this state," and goes on to leave the priority of an interest in the fixture vis-à-vis an interest in the real property to California real property law, Cal. COMM. CODE § 9102(1) (c) (West 1964). The term fixtures is defined in Cal. CIV. CODE §§ 658, 660 (West 1954). See generally, Warren, Coverage of Division 9, 3 California Commercial Law, Cont. Ed. of Bar § 1.9 et seq. (1966).
99 Such waivers are suggested and described in Robinson, Consumer and Equip-
property under California law. Nevertheless, the construction lender's priority under new section 6323 over filed tax liens should not be recognized with respect to fixtures, because "qualified property" includes only the constructed property which the lender is making cash disbursements to finance.\textsuperscript{100} It should not, therefore, include property, neither constructed nor improved, which the lender did not finance.\textsuperscript{101}

The long-range priority accorded the lender's security in the constructed or improved property (or contract proceeds) does not extend to other (Time 3) security already owned or subsequently acquired by the taxpayer. As to Time 3 security and disbursements, the construction lender may have the same protections accorded the holder of a simple security interest\textsuperscript{102} and the commercial lender\textsuperscript{103} providing the requirements of the applicable code sections are met. If this additional security is itself being constructed or manufactured, its value at the critical time of tax lien filing\textsuperscript{104} or 45 days thereafter\textsuperscript{105} will determine the extent of the lender's priority over the tax lien.\textsuperscript{106}

This subsection protects only cash disbursements.\textsuperscript{107} Thus, suppliers of goods and services must look to other parts of the stat-
ute for their priority unless they can secure payment from the construction lender whose priority will thereby be expanded.\textsuperscript{108} Protected cash disbursements may be optional, and they may be made \textit{with actual notice} of the tax lien filing.\textsuperscript{109} They need not even be made to creditors holding liens which prime the federal tax lien. They may be made indefinitely—there is no 45-day limit—so long as they are made to finance the construction of real property.\textsuperscript{110} Therefore, it is unlikely that construction funds diverted to the taxpayer or shareholders of a corporate taxpayer will qualify under this exception.

The construction lender must, of course, qualify his interest under the definitional requirements of the statute.\textsuperscript{111} He must have entered into a written agreement to make loans \textit{before} the date of tax lien filing, and the agreement must encompass the construction, improvement, or demolition of real property.\textsuperscript{112} The security interest claimed must be protected under local law against any judgment lien arising at the time of tax lien filing.\textsuperscript{113} However, unlike the commercial lending priority, neither borrower nor lender must be acting in the course of its trade or business to secure priority for construction loans over filed tax liens.

The construction lender's priority is a generous one, particularly since the failing-contractor scenario usually involves trust fund taxes collected from the contractor's employees. Frequently, the United States has been forced to look to the 100 percent penalty against persons responsible for the nonpayment of these collected taxes as a means of effecting collection.\textsuperscript{114}

\textsuperscript{108} For example, there is a priority accorded holders of mechanic's and stop notice liens. \textit{Id.} \S 6323(a),(h)(2). In addition, a superpriority (\textit{i.e.} priority over previously filed federal tax liens) is accorded persons holding liens on residential property for small repairs. \textit{Id.} \S 6323(b)(7). \textit{See note 25 supra. See also} Harman \textit{v. Fairview Assoc.}, 69-1 U.S. Tax Cas. \S 9187 (App. Div. 1969).

\textsuperscript{109} This is not expressly stated in the bill or in the Committee Reports. Nevertheless it is implicit in this subsection. \textit{See W. PLUMB \& L. WRIGHT, FEDERAL TAX LIENS, 85, at note 81 (2d ed. 1967).}

\textsuperscript{110} Funds not applied to the construction—such as excess funds pocketed by the borrower—may not be accorded priority in repayment by virtue of \textit{Int. Rev. Code} of 1954 \S 6323(c)(3), in light of the purpose of this section. If such disbursements were made, the lender might still be able to obtain priority in repayment to the same extent as a holder of a security interest or as a commercial lender.

\textsuperscript{111} \textit{H.R. Rep., supra} note 66; \textit{S. Rep., supra} note 66.

\textsuperscript{112} \textit{Int. Rev. Code} of 1954 \S 6323(c)(3)(A)(i),(ii); \textit{Int. Rev. Code} 6323(c)(1)(A); \textit{H.R. Rep., supra} note 5, at 43. Hereafter, the terms "constructed" or "construction" will be used in place of "construction, improvement, or demolition."

\textsuperscript{113} \textit{Int. Rev. Code} of 1954 \S 6323(c)(1)(A)(ii),(B); \textit{see discussion on note 26 supra.}

\textsuperscript{114} \textit{Cf. in re} Halo Metal Prods. Co., 69-1 U.S. Tax Cas. \S 9202 (N.D. Ill. 1969). \textit{See Pacific Nat'l Ins. Co. v. United States}, 270 F. Supp. 165 (N.D. Cal. 1967) [holding a surety in control of the taxpayer-contractor's funds and paying net pay-
It is not surprising then, that when Congress opened the door for priority of the construction lender, it required at the same time that payroll financing include the contingent obligation to meet withheld taxes. The employer remains, of course, primarily liable for all payroll taxes, so that only on his failure to pay will the payroll financier be liable under this new law.\textsuperscript{115}

3. Crop and Livestock Loans.\textsuperscript{116} Loans made to finance the harvesting of a farm crop or the raising of such a crop or of livestock or other animals are also accorded priority over filed federal tax liens, regardless of when disbursements are made.\textsuperscript{117} This priority is accorded all disbursements to finance the raising or harvesting, regardless of tax lien filing, or of actual notice of the filing. It is necessary, however, that the written loan agreement be entered into before tax lien filing, and that it create an interest protected under local law against the lien of a judgment creditor arising when the tax lien is filed.\textsuperscript{118} In this instance, the disbursements need not be made in cash, but may be made by furnishing goods and ser-

\textsuperscript{115} The statutory liability of persons paying or providing for wages is found in INT. REV. CODE of 1954 § 3505, which provides in part as follows:

(a) Direct Payment by Third Parties.—For purposes of sections 3102, 3202, 3402, and 3403, if a lender, surety, or other person, who is not an employer under such sections with respect to an employee or group of employees, pays wages directly to such an employee or group of employees, employed by one or more employers, or to an agent on behalf of such employee or employees, such lender, surety or other person shall be liable in his own person and estate to the United States in a sum equal to the taxes (together with interest) required to be deducted and withheld from such wages by such employer.

(b) Personal Liability Where Funds Are Supplied.—If a lender, surety, or other person supplies funds to or for the account of an employer for the specific purpose of paying wages of the employees of such employer, with actual notice or knowledge (within the meaning of section 6323(i)(1)) that such employer does not intend to or will not be able to make timely payment or deposit of the amounts of tax required by this subtitle to be deducted and withheld by such employer from such wages, such lender, surety or other person shall be liable in his own person and estate to the United States in a sum equal to the taxes (together with interest) which are not paid over to the United States by such employer with respect to such wages. However, the liability of such lender, surety, or other person shall be limited to an amount equal to 25 percent of the amount so supplied to or for the account of such employer for such purpose.

Subsection (c) provides for the crediting of amounts collected under this subsection to the employer's liability.

Note that the burden of proving actual notice or knowledge is not specifically placed upon the United States in proceedings under this section, as was done where the issue involved is "the priority of a federal tax lien versus a competing lien or interest." H.R. REP., supra note 5, at 14, 12. S. REP. supra note 5, at 14, 12.

\textsuperscript{116} INT. REV. CODE of 1954 § 6323(c)(3).


\textsuperscript{118} Id. § 6323(c)(1)(A)(ii),(B).
Where disbursements are made by the furnishing of goods and services—such as the provision of seed or the use of a combine—the priority extends to the reasonable value of these items.120

Crop or livestock loans are secured to the extent of the crop or livestock whose production or harvesting is being financed and the proceeds of their sale; they may also be satisfied from any other property qualifying for a simple security interest, if the agreement provides.121 In terms of the chart, they may also be secured with respect to Time 3 security under the commercial financing exception, to the extent they qualify.122

4. Financing the Production of Other Personal Property Not Provided For. There is no exception under the Internal Revenue Code from the priority of a filed federal tax lien which expressly allows the completion of inanimate personal property in the process of manufacture or production. The only repair or improvement lien recognized in the code with respect to personal property is an uninterrupted possessory lien.123 However, in competing with tax liens against the manufacturer, a lender financing production on the security of the goods in process and proceeds of a contract of sale may make disbursements under the 45-day rule124 and look to security produced within 45 days after tax lien filing for disbursements made within the same period and prior to actual notice of the filing,125 to the extent the relevant code sections are satisfied.

Under prior law, a purchase-money mortgagee was accorded priority against a filed tax lien, on the theory that the taxpayer's only "property" in the goods was the equity above that amount owing the purchase money financier.126 However, maintaining suc-

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119 Id. § 6323(c)(3)(A)(iii).
120 H.R. REP., supra note 5, at 43; see contra, W. PLUMB & L. WRIGHT, FEDERAL TAX LIENS 86, 87 (2d ed. 1967) that disbursements in kind are protected to the extent of their price.
121 INT. REV. CODE of 1954 § 6323(c)(3)(B)(iii); see also discussion following note 57 supra; H.R. REP., supra note 5, at 44.
122 INT. REV. CODE of 1954 § 6323(c)(2); see also discussion following note 78 supra.
123 See discussion note 26 supra.
124 INT. REV. CODE of 1954 § 6323(d).
125 INT. REV. CODE of 1954 § 6323(c) [commercial financing exception].
126 In re Halprin, 280 F.2d 407, 410 (3d Cir. 1960) [on purchase-money theory, priority accorded financier of manufacturer as to proceeds of contract of sale where the assignment was made before work was performed]; Monroe Banking & Trust Co. v. Allen, 285 F. Supp. 201 (N.D. Miss. 1968), infra note 146, contra, Parlane Sportswear Co. v. United States, 359 F.2d 974, 977 (1st Cir. 1966) [where assignment of buyer's contract was made after work was completed]; cf. Fine Fashions, Inc. v. United States, 328 F.2d 419, 421 (2d Cir. 1964) [assignment of government contract proceeds as additional security for payment of cost of material used in production held ineffective against federal tax lien and levy on those funds in the hands of
cessfully the position of a purchase-money mortgagee was not always easy. Such claims were frequently rejected where the assignment of contract proceeds was only additional security, and where it followed completion of the manufacture of the goods. Nevertheless the purchase-money theory is still available and is helpful to the lender or purchaser financing production.

When the taxpayer is the purchaser instead of the manufacturer, the lender financing production should be entitled to protection under the commercial financing exception outlined above. There appears to be no further protection unless the lender can become subrogated to the manufacturer’s possessory lien under local law. Subrogation is expressly acknowledged by the code as a valid method of establishing a priority, but this may prove small consolation where the goods have been delivered to the taxpayer.

In cases where the tax lien is filed prior to the completion of manufacture, one further resort is the District Director. Under the Internal Revenue Code as amended in 1966, he has authority to subordinate a federal tax lien in order to increase the government’s recovery under its lien. He also can discharge property subject to a federal tax lien if the government’s interest in the property has no value, if partial payment is made, or if the fair market value of property which remains subject to the lien is at least double the amount of the unsatisfied liability secured by the lien, plus prior liens. Thus, a lender may find it advantageous to negotiate with

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127 Fine Fashions, Inc. v. United States, supra note 126; Parlane Sportswear Co. v. United States, supra note 126; cf., Seaboard Sur. Co. v. United States, 306 F.2d 855 (9th Cir. 1962), supra note 4 [interest of non-purchase money assignee of government contract held subordinate to subsequent federal tax lien]; but see United States v. Toys of the World Club, Inc., 288 F.2d 89, 93 (2d Cir. 1961) [dictum]; H.R. Rep., supra note 5, at 4 [priority of purchase money mortgagees undisturbed by the Act]. See also, United States v. Morrison, 247 F.2d 285, 287 (5th Cir. 1957) [equitable vendor's lien held ineffective against federal tax lien].

UNIFORM COMMERCIAL CODE § 9.107(b) and Comment (2) identify the purchase money security interest of a lender by the fact that present consideration is given to enable the debtor to acquire the collateral. See WARREN, PRIORITIES, 3 CAL. COMM. CODE, CONT. ED. OF BAR (1966) §§ 4.32, 4.33, 4.34.

128 INT. REV. CODE of 1954 § 6323(c)(2).


130 INT. REV. CODE of 1954 § 6323(d)(2).

131 Id. § 6325(b)(2)(B).

132 Id. § 6325(b)(2)(A).

133 Id. § 6325(b)(1).
the District Director for a subordination or discharge, where a junior federal tax lien would prevent the lender from being secured with respect to disbursements made more than 45 days after notice of the tax lien has been filed, or after actual notice. Otherwise, his security may be limited to the value of the goods in process at the end of the 45-day grace period, for only to the extent of its then-value is this security in existence for tax lien priority purposes.134

5. Obligatory Disbursements.135 Certain persons obligated to make future disbursements under an agreement entered into before tax lien filing are accorded additional protection for disbursements made after that date. The agreement must be in writing136 and the obligor must have entered into it in the course of his trade or business,137 and his security interest in the property subject to his lien must have been perfected at the time of tax lien filing against a judgment lien creditor.138 The agreement is not limited to ensuring performance with respect to real property and may thus encompass the manufacture or production of goods or the furnishing of services, as well as the bare obligation to make payment.

The disbursements protected under this section are only those required to be made by reason of the intervention of the rights of a person other than the taxpayer.139 There is no requirement that they be made in cash. Examples of such disbursements are those required under a letter of credit, or a bonding agreement.140 An endorser's

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134 See authorities cited note 106 supra.
136 Id. § 6323(c)(1)(A).
137 Id. § 6323(c)(4)(A).
138 Id. § 6323(c)(1)(B).
139 Id. § 6323(c)(4)(A).

The requirement that disbursements be made must arise on the happening of an event beyond the obligor's control. This requirement must, therefore, be triggered by the intervention of the rights of a third party, such as the good faith reliance of a supplier of goods or a bank authorized to honor a letter of credit on an issuing bank's obligation under a letter of credit. H.R. Rep., supra note 5, at 44.

Accordingly, an obligation to the taxpayer-debtor alone would be insufficient to bring a lender within the protections of Int. Rev. Code of 1954 § 6323(c)(4).

An analogy may be drawn from the equitable lien cases to establish the good faith reliance of a supplier of goods or services. E.g., cf., see under prior law McBain v. Santa Clara Sav. & Loan Ass'n, 241 Cal. App. 2d 829, 51 Cal. Rptr. 78 (1966) [suppliers of labor and materials held to have priority over borrower and lender, with respect to unexpended construction loan funds]. A third party beneficiary theory might also be helpful; cf., Cal. Civ. Code § 1559 (West 1954); Ralph C. Sutro Co. v. Paramount Plastering, Inc., 216 Cal. App. 2d 433, 31 Cal. Rptr. 174 (1963) [construction loan agreement conditioning payment to contractor on proof of payment of laborers and materialmen]. Note that real property construction lenders, however, need not rely on the obligatory disbursements priority except to the extent their disbursements
or guarantor's obligation would also come within the scope of this section provided the endorsement or guarantee were made in the course of that person's trade or business. There is no 45-day limit on the time within which the obligatory disbursements must be made to achieve priority under section 6323(c)(4). All qualified disbursements may achieve priority over federal tax liens, regardless of when the latter are filed.

The property which may secure these priority obligatory disbursements includes property which may be security under the general priority rule of section 6323(a). Also recognized is a security interest in property acquired by the taxpayer at any time after tax lien filing to the extent this property is directly traceable to the obligatory disbursement.

Sureties receive the same protection as others making obligatory disbursements except that additional property is available to satisfy the sureties' priority. The protected sureties are those ensuring the performance of a contract between the taxpayer and another person. Their priority may be satisfied additionally from the proceeds of the ensured contract, and in the case of contracts to construct or improve real property, or to produce goods or to furnish services, any tangible personal property used by the taxpayer in the performance of the ensured contract. The sureties' agreement need only qualify as an "obligatory disbursements agreement."

The additional security afforded sureties under this subsection leaves undisturbed their rights of subrogation through an owner or mechanic. However, subrogation is available only through one other than the taxpayer, and is helpful only to the extent that per-

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141 H.R. REP., supra note 5, at 44.
142 INT. REV. CODE of 1954 § 6323(c)(4).
143 Id. § 6323(c)(4)(B).
144 INT. REV. CODE of 1954 § 6323(c)(4)(C). Sureties of performance under contracts between the taxpayer and another person may look to tangible personal property which is used by the taxpayer in the performance of the ensured contract regardless of when the taxpayer acquired the property, provided the surety holds a simply perfected security interest in it. This provision thus dispenses with the 45-day acquisition rules of the commercial lender priority provisions, INT. REV. CODE of 1954 § 6323(c)(2), a benefit not accorded others required to make obligatory disbursements, who must trace their disbursements into the property it was used to acquire, and who are not accorded special priority as to proceeds of the ensured contract, INT. REV. CODE of 1954 § 6323(c)(4)(B).
145 INT. REV. CODE of 1954 § 6323(i)(2).
son either (1) prevents the taxpayer from acquiring any "property" in the security in dispute\(^\text{146}\) or (2) holds an interest which itself


The so-called "property" problem relates to a line of cases in which a direct confrontation of liens competing with federal tax liens was avoided upon the theory that the federal tax lien could attach only where the taxpayer had "property," and where it could be successfully argued that the competing liens deprived the taxpayer of any property right in the disputed property. The theory has been applied almost exclusively in the mechanic's lien area, and in purchase-money security cases. \textit{See, e.g., In re Halprin, supra note 126; Gauvey v. United States, 291 F.2d 42, 47 (8th Cir. 1961) [conditional vendor under contract of sale antedating filing of notice of tax lien, but recorded thereafter]; General Motors Acceptance Corp. v. Wall, 239 F. Supp. 433, 435 (W.D. N.C. 1965) [same, as to vehicle where Government could not bring itself within the recording acts by detrimental change in position].} \textit{But see, Smith v. Hamilton, 54-1 U.S. Tax Cas. \textsuperscript{f}f 9292 (S.D. Cal. 1954) [secret lien of unpaid vendor found purely equitable in California and therefore too insubstantial to prevail over subsequent federal tax liens].} Note that purchasers have not always been able to bring themselves within the "no property" rule, United States v. Cramer Indus. Inc., 349 F.2d 625 (5th Cir. 1965) [erroneous property description in deed allowed subsequently-filed federal tax lien to prevail over pre-tax-lien-filing purchaser, under recording acts]. Post-tax-lien-filing purchasers are protected, if at all, under the superpriority exceptions, In\textit{t. REV. CODE of 1954 § 6323(b).} And if a purchaser perfects his interest against a subsequent purchaser without actual notice, he is now protected against the tax lien. Engel v. Tinker Nat'l Bank, 269 F. Supp. 199 (E.D.N.Y. 1967). The purchase-money security interest was recognized as unimpaired by the Act in H.R. \textit{Rep., supra note 5}, at 4; S. \textit{Rep., supra note 5, at 4.}

An equitable lien has never been considered equivalent to a purchase money security interest. \textit{See discussion supra note 127. See also United States v. Masonry Contractors, 68-1 U.S. Tax Cas. \textsuperscript{f}f 9184 (S.D. Tex. 1968) [materialman's claim to unused materials held subordinate to federal tax lien on theory that state law only afforded a right of repossession]; Continental Fin. Inc. v. Cambridge Lee Metal Co., Inc., \textit{supra note 127 [In re Halprin distinguished; court found that if United States had no lien on the proceeds of an unperformed contract, neither did the assignee of the embargo account receivable, and when the account ripened more than 45 days after tax lien filing, the United States was entitled to priority]; Harbert Constr. Co. v. United Iron Works Inc., \textit{supra note 126; Bethlehem Steel Corp. v. Foley, supra note 26. \textit{See contra, a group of recent cases which have seized upon the \textquotedblleft no property\textquotedblright{} concept to avoid deciding the priorities issues: Morrison Flying Serv. v. Deming Nat'l Bank, 340 F.2d 430 (10th Cir. 1968) [assurance by paying agent to taxpayer's subcontractor hold to create equitable interest valid against contract proceeds as against subsequent tax liens]; Harter v. District Dir., 22 Am. Fed. Tax R.2d \textsuperscript{f}f 5091 (E.D. Wash. 1968) [assignment to supplier of logs of amounts falling due lumber mill (on unspecified dates) from purchasers held to deprive taxpayer mill of property in the debt to which prior tax liens could attach]; In re Swan-Finch Oil Corp., 279 F. Supp. 385 (S.D.N.Y. 1967) [creditor's suit to set aside fraudulent conveyance held to deprive taxpayer of the property, so that tax liens could not attach to it]; Creditor's Exch. Serv. Inc. v. United States, 277 F. Supp. 885 (S.D. Tex. 1967) [assignment of account receivable (maturity dates not given) held to effect disposition of the taxpayer's property, for purposes of the application of United States' insolvency priority]; Monroe Banking & Trust Co. v. Allen, \textit{supra} note 126 [assignment of proceeds of subcontract for building construction to financing bank held to deprive taxpayer of any interest in the contract. Tax liens filed after assignment and advances but before completion of performance were held subordinate to the bank's assignment, even though the bank wasn't a pledgee and had no mortgage lien]. The above cases generally misuse the "no property" concept. The result in \textit{Monroe Banking} is probably justified under the con-}
primes the federal tax liens. Thus, the additional protection afforded the consensual security interest under the obligatory disbursements and securities' exceptions is substantial.

**IN WHAT PROPERTY WILL A SECURITY INTEREST BE RECOGNIZED?**

*In General*

The new statute itself is of little help in deciding what property may be the subject of a security interest for tax lien priority purposes. It refers alternately to "property in existence" and "property subject to the lien imposed by section 6321" (the federal tax lien). Assistance must be sought from commercial and bankruptcy law, and prior decisions concerning federal liens and priorities.

Property recognized as such under state law will fail to secure an interest against a federal tax lien in certain circumstances. First,
it may fail if the holder's right to look to the security is contingent upon an event, such as taxpayer-debtor's default, or his acquisition of rights in the property, if this event has not occurred at the time of tax lien filing.\textsuperscript{151} In terms of the chart, \textit{supra}, such property cannot be Time 1 security, because the security interest is executory.\textsuperscript{152} The proceeds of certain property may thus fail to secure an interest against a federal tax lien.\textsuperscript{153} Can property be commercial financing (Time 3) security if the contingency occurs within 45 days after the date of tax lien filing? Under the commercial transactions exceptions, the filed federal tax lien is invalid unless the contingency would defeat the interest under state law as against a judgment lien arising at the time of tax lien filing or cause the definitional requirements of section 6323(c) not to be met.\textsuperscript{154}

Second, property will fail to secure a \textit{simple} interest against a federal tax lien if the holder must take any steps to perfect his interest against a judgment lien under state law after the notice of tax lien is filed. All events necessary to perfection must have occurred prior to tax lien filing, in the case of a simple security interest, which requires existing (Time 1) security.\textsuperscript{155} Whether or not the holder can perfect his interest in such property under the commerc-

\textsuperscript{151} See discussion in text following note 54 \textit{supra}, and note 152 \textit{infra}.

\textsuperscript{152} The same rule is applied outside of the tax lien priority context, as well as within it. \textit{Compare}, Kinnison v. Guaranty Liquidating Corp., 18 Cal. 2d 266, 115 P.2d 450 (1941) [assignment of rents as additional security] \textit{with} Beeghly v. Wilson, 152 F. Supp. 726 (N.D. Iowa 1957) [insurance company's right to set-off, against renewal commissions of agent, costs incurred in garnishment proceeding held inchoate until garnishment had been made]. \textit{See also} Bank of America v. United States, 345 F.2d 624 (9th Cir. 1965). That subsequently acquired inventory is after-acquired property under the \textit{UNIFORM COMMERCIAL CODE}, see Gordon, \textit{The Security Interest in Inventory under Article 9 of the Uniform Commercial Code}, 62 COLUM. L. REV. 49, 53-56 (1962). Note also that accounts do not come into existence until a debt is created. \textit{UNIFORM COMMERCIAL CODE} §§ 9-204(2)(d) and 9-106; \textit{CAL. COMM. CODE} §§ 9204(2)(d) and 9106. \textit{See also} P. Coogan, W. Hogan, \& D. Vagts, \textit{SECURED TRANSACTIONS UNDER THE U.C.C.}, Ch. 11 (1963). \textit{See contra}, 2 G. Gilmore, \textit{SECURITY INTERESTS IN PERSONAL PROPERTY}, § 45.5, at 1307 (1965). \textit{See also} Continental Fin. Inc. v. Cambridge Lee Metal Co., \textit{supra} note 76 [federal tax liens prevailed over prior assignors of accounts receivable as to accounts coming into existence more than 45 days after tax lien filing. Only contract rights maturing into accounts within the 45-day period were accorded priority]. Apparently \textit{contra}, on facts not clearly stated, is \textit{Creditor's Exch. Serv. Inc. v. United States}, \textit{supra} note 146.

\textsuperscript{153} \textit{Home Ins. Co. v. Rider Corp.}, \textit{supra} note 150; \textit{but see} Chrysler Corp. v. Long & Long, Inc., 171 F. Supp. 541 (E.D. Mich. 1958) [ chattel mortgage for present consideration held inchoate with respect to property returned after tax lien filing but arising out of assigned accounts receivable]. That returned goods are "acquired" when they are returned, \textit{see UNIFORM COMMERCIAL CODE} § 9-306(5)(a). And \textit{see} Andrello v. Nationwide Fire Ins. Co., 68-1 U.S. Tax Cas. § 9332 (App. Div. 2d 1968) [holding mortgagee, as pledgee of fire insurance proceeds under agreement with no loss payable clause, entitled to priority over United States under prior, but unfiled, tax liens].

\textsuperscript{154} Cases note 48 \textit{supra}.

\textsuperscript{155} \textit{INT. REV. CODE} of 1954 § 6323(h)(1),(d); \textit{H.R. REP.}, \textit{supra} note 5, at 49.
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cial transactions exceptions depends upon whether the interest was otherwise valid against a judgment lien creditor at the time of tax lien filing. There is some room here for argument that perfection within the 45-day period is sufficient if such perfection would protect the security interest under local law against a judgment lien creditor obtaining a lien on the date of tax lien filing. The bare statutory language supports the view that the "all events" test is not imposed under the commercial financing exception until the 46th day after tax lien filing, and the Reports do not specifically dispel this inference. But the conditions (discussed in the following paragraph) for establishing a commercial financing security interest must have been met prior to tax lien filing.

Third, property will fail to secure an interest against a federal tax lien if the definitional requirements of the Internal Revenue Code are not met on the date of tax lien filing. Thus, as to commercial financing (Time 3) security, the requisite written agreement must have been entered into before tax lien filing. In addition, the security interest must come into existence within 45 days after tax lien filing, unless some statutory exception is applicable. Furthermore, property becoming security after tax lien filing under the commercial financing exception must be either accounts receivable (not just accounts), inventory, real property mortgages, or commercial paper acquired in the ordinary course of the taxpayer-debtor’s trade or business. Intangible rights other than accounts receivable must be embodied in "paper" within 45 days after tax lien filing to secure an interest against the federal tax lien.

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156 This relaxation of the "all events" test appears to have been intended by Congress. The House Report provides that:

For purposes of subparagraph (A) of section 6323(c)(1), the written agreement must be entered into before notice of the tax lien is filed, although such agreement need not be recorded prior to that time. However, recordation in accordance with the provisions of local law may be necessary prior to the filing of the notice of lien in order to satisfy other provisions of subsection (c). H.R. Rep., supra note 5, at 41; Int. Rev. Code of 1954 § 6323(c)(2)(B).


158 The agreement must have been entered into, and it must have created a security interest protected against a judgment lien arising on the date of tax lien filing. The contrary decision in Peninsula State Bank v. United States, 201 So. 2d 466 (Fla. 1968), holding an assignee under a contract entered into within the 45-day period following tax lien filing had priority over the tax lien, is submitted to be erroneous. See contra United States v. Masonry Contractors, Inc., supra note 26 (dictum) and Int. Rev. Code of 1954 § 6323(c)(1).

159 Cases supra, notes 81 & 150, regarding the time within which security must have come into existence. Statutory exceptions to the time rules might be Int. Rev. Code of 1954 §§ 6323(c)(3) (crop, livestock, or construction loans), 6323(c)(4) (obligatory disbursements), 6323(e) (interest or expenses) or 6323(b) (superpriorities).

160 Int. Rev. Code of 1954 § 6323(c)(2)(A)(i), (ii), and (c)(2)(C).

161 Id. § 6323(c)(2)(C)(i).
Fourth, an interest not yet earned by performance is not property which secures a simple security interest (Time 1) unless earned prior to tax lien filing.\textsuperscript{162} It cannot be commercial financing security unless earned within 45 days after tax lien filing under the commercial financing exception, unless coming within some other exception.\textsuperscript{163} Although it is property under state law, it lacks the requisite existence which is the hallmark of perfection under federal law. The onus of this rule should not be too great in view of the exceptions created for real property construction and improvements, the superpriorities, and obligatory disbursements. In other cases, a provision in the security agreement making the filing of a notice of tax lien a default by the taxpayer-debtor will protect the holder of a security interest, except in the case of the production of personal property.\textsuperscript{164}

\textbf{The Californian's Dilemma}

One problem of particular concern in California is Congress' intended exclusion of general intangibles such as patents and copyrights from the definition of commercial financing paper. This exclusion is not apparent from a reading of the statute, but instead appears in the House Report.\textsuperscript{165} Its potential significance is enormous, because "general intangibles" is defined by reference to the Uniform Commercial Code in which it is a residual classification from which "contract rights" and "accounts" have been distinguished by rather narrow definitions. Hence, the list of assets so classified is an ever-growing one. In addition, although the draftsmen may have thought (with California's Commercial Code draftsmen) that relatively little financing was done on the strength of this kind of security, in fact the opposite is true. Licensing agreements

\textsuperscript{162} Under prior law, see Seaboard Sur. Co. v. United States, 306 F.2d 855 (9th Cir. 1962) [rights under unperformed construction contract]; United States v. Pay-O-Matic Corp., 162 F. Supp. 154 (S.D.N.Y. 1958), aff'd, 256 F.2d 581 (2d Cir. 1958), cert. denied, 358 U.S. 830 (1958) [attorney's lien in condemnation suit held inchoate under federal law governing priority of federal tax liens until the services were fully performed]; Walker v. Paramount Eng'r Co., 353 F.2d 445, 449-50 (6th Cir. 1965) [garnishment lien held inferior to subsequent federal tax lien with respect to a debt arising from partially completed construction contract]; United States v. Phillips, 198 F.2d 634 (5th Cir. 1952) (dictum); Randall v. Colby, \textit{supra} note 150.

\textsuperscript{163} See, under current law, Continental Fin. Inc. v. Cambridge Lee Metal Co., \textit{supra} note 76 [holding contract right inchoate until matured into an account receivable]; United States v. Masonry Contractors, \textit{supra} note 26; references note 159 \textit{supra}.

\textsuperscript{164} See discussion \textit{supra}.

\textsuperscript{165} The House Report provides:

Paper of a kind ordinarily arising in commercial transactions ... does not include general intangibles (for example, patents or copyrights), as such intangibles are defined in article 9-106 of the \textit{Uniform Commercial Code}. H.R. Rep., \textit{supra} note 5, at 42.
and royalty contracts are common security in this state. Nevertheless, such security is vulnerable to attack by the government because it was not intended to be commercial financing security.

An additional problem in establishing California security interests in intangibles as "paper of a kind ordinarily arising in commercial transactions" is raised by California's broad exclusion of general intangibles and certain insurance claims from the Uniform Commercial Code requirements of perfection by possession or filing. It may well be that "paper of a kind ordinarily arising..." will be limited to paper in which a security interest is perfected by possession or filing. Without possession or filing, a lien is secret. It defeats creditors' expectations which are presumed shared by the United States under the judgment lien creditor test. For this reason, California's Commercial Code as it now stands may disqualify this type of security as against a federal tax lien, unless the security interest is fully perfected (a simple security interest in Time 1 security only) prior to tax lien filing.167

CONCLUSION

It may well be that the newly-established certainty of consensual lienors as respects their priorities may lead them to take a greater interest in whether the United States is being paid its taxes, as these become due. While consensual lienors may not be certain of enjoying a priority for x-number of days, they must be equally certain that thereafter, the priority will be cut off. This certainty should encourage additional policing by the creditor of his debtor's tax status. If the courts interpret section 6323 of the Internal Revenue Code in this spirit, the new law will have well-served the interests of the self-enforcing system of taxation of which we often boast.

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166 See California State Bankers' Committee Statement approving exemption of general intangibles from the filing requirements of Article 9 on the ground that such assets rarely served as commercial security. CAL. SENATE FACT FINDING COMM. ON JUDICIARY, 6TH PROGRESS REPORT, PART 1, 568 (1959-1961) and Professor Marsh's comment thereon at 643.

167 To the UNIFORM COMMERCIAL CODE definition of general intangibles, the California version adds "any interest or claim in or under any policy of insurance is a general intangible." CAL. COMM. CODE § 9106 (West 1964). Compare UNIFORM COMMERCIAL CODE 9-301 to 9-306 with comparable CAL. COMM. CODE sections. The insurance exclusion in the UNIFORM COMMERCIAL CODE allowed a federal tax lien to prime a prior assignment in Aetna Cas. & Sur. Co. v. Roller, 69-1 U.S. Tax Cas. ¶ 9214 (D. Ariz. 1969).