NOTES

BANKRUPTCY: SECTION 70 (c) OF BANKRUPTCY ACT APPLIED TO EMPOWER TRUSTEE TO SET ASIDE UNFILED FEDERAL TAX LIEN

UNDER SECTION 6323 (a) of the Internal Revenue Code, a federal tax lien is not valid against a "judgment creditor" unless notice of the lien has been filed.[1] The courts have consistently rejected the contention that section 70c of the Bankruptcy Act[2] confers upon a trustee in bankruptcy the rights of a "judgment creditor" within the meaning of section 6323 (a).[3] In the case of *In re Kurtz Roofing Co.*,[4] however, the Court of Appeals for the Sixth Circuit held to the contrary, thereby enabling the trustee to invalidate an unfiled antecedent federal tax lien.

Although the federal tax lien asserted in *Kurtz* was established both by assessment and demand,[5] it was not filed prior to the date of bankruptcy. Because section 70c confers upon the trustee all the rights, remedies, and powers of a creditor holding a lien by

[1] "The lien imposed by section 6321 shall not be valid as against any mortgagee, pledgee, purchaser, or judgment creditor until notice thereof has been filed by the Secretary or his delegate . . . ." INT. REV. CODE OF 1954, § 6323 (a). Notice is filed in the office designated by the law of the state in which the property subject to the lien is located or, in the absence of this designation, with the clerk of the United States district court. *Ibid.* § 6323 (a) (1)-(2). The form of the notice may not be unduly complicated by state law. *Ibid.* § 6323 (b).

[2] "The trustee, as to all property, whether or not coming into possession or control of the court, upon which a creditor of the bankrupt could have obtained a *lien by legal or equitable proceedings* at the date of bankruptcy, shall be deemed vested as of such date with all the *rights, remedies, and powers of a creditor then holding a lien thereon by such proceedings,* whether or not such a creditor actually exists." 66 Stat. 430 (1952), 11 U.S.C. § 110c (1958). (Emphasis added.)

[3] Simonson v. Granquist, 287 F.2d 489 (9th Cir. 1961), *rev'd on other grounds,* 369 U.S. 38 (1962); In the Matter of Fidelity Tube Corp., 278 F.2d 776 (3d Cir.), *cert. denied,* 364 U.S. 828 (1960); Brust v. Sturr, 237 F.2d 135 (2d Cir. 1956); United States v. England, 226 F.2d 205 (9th Cir. 1955); In the Matter of Babcock Printing Press Co., 63-1 U.S. Tax Cas. 88321 (N.D. Ohio 1962); In the Matter of Gale Dorothea Mechanisms, Inc., 59-2 U.S. Tax Cas. 73421 (E.D.N.Y. 1959); In the Matter of Green, 124 F. Supp. 481 (N.D. Ala. 1954); *In re* Ann Arbor Brewing Co., 110 F. Supp. 111 (E.D. Mich. 1951). *Contra,* In the Matter of Sport Coal Co., 125 F. Supp. 517 (S.D.W. Va. 1954), *rev'd on other grounds sub nom.,* United States v. Eiland, 223 F.2d 118 (4th Cir. 1955).

[4] 335 F.2d 311 (6th Cir. 1964).

[5] *Id.* at 312. See INT. REV. CODE OF 1954, §§ 6321-22.

legal or equitable proceedings as of the date of bankruptcy,[6] the court reasoned that he possesses the rights of a judgment creditor holding a lien.[7] Finding no convincing reasons of policy or precedent to preclude an equation of these rights to those of the "judgment creditor" of section 6323 (a), the court held the trustee entitled to that section's protection against the unfiled tax lien.[8]

One of the primary objectives of the Bankruptcy Act is the equitable distribution of an insolvent debtor's estate.[9] In order to achieve this objective the trustee should have the power to obtain assets which creditors might reach by proceeding against third parties with unrecorded liens or similarly voidable interests.[10] After the act was passed in 1898, the courts construed section 70a (5)[11] so that it gave the trustee this power.[12] In 1906, however, the Supreme Court limited the effectiveness of this interpretation by withdrawing from the trustee the power to attack an encumbrance which, although voidable under state law, could not have been set aside because no creditor existed at the time of bankruptcy who could have availed himself of this right.[13] The predecessor to section 70c was, therefore, added in 1910[14] to negate the effect of that decision. Under this amendment, the trustee was accorded the status (1) of a creditor holding a lien by legal or equitable proceedings as to property coming into the custody of the bankruptcy court and (2) the somewhat weaker position of a *judgment creditor* holding an unsatisfied execution[15] as to all other property. In 1950 Congress deleted the second provision and gave the trustee the status of a creditor holding a lien by legal or equitable proceeding as to both types of property,

[6] "Date of bankruptcy" refers to the date when the petition was filed. Bankruptcy Act § 1 (13), 52 Stat. 840 (1938), 11 U.S.C. § 1 (13) (1952).

[7] A judgment creditor without a lien is not protected by § 6323 (a). Miller v. Bank of America, 166 F.2d 415, 417 (9th Cir. 1948) (decided under predecessor to § 6323 (a)).

[8] 335 F.2d at 314.

[9] 3 COLLIER, BANKRUPTCY ¶ 64.02, at 2058 (14th ed. 1964) [hereinafter cited as COLLIER].

[10] See MacLachlan, *The Title and Rights of the Trustee in Bankruptcy*, 14 RUTGERS L. REV. 653, 667 (1960).

[11] 30 Stat. 565 (1898), as amended, 66 Stat. 429 (1952), 11 U.S.C. § 110 (a) (5) (1958).

[12] 4 COLLIER ¶ 70.47, at 1338, ¶ 70.48.

[13] York Mfg. Co. v. Cassell, 201 U.S. 344 (1906). See 4 COLLIER ¶ 70.47; MACLACHLAN, BANKRUPTCY § 183, at 187 (1956) [hereinafter cited as MACLACHLAN]; 3 REMINGTON, BANKRUPTCY § 1600 (1957).

[14] Act of Jnne 25, 1910, ch. 412, 36 Stat. 838.

[15] A judgment creditor does not necessarily have a lien. See 4 COLLIER ¶ 67.08; MACLACHLAN § 183, at 187. See also note 7 *supra*.

whether or not such a creditor actually exists.[16] Although this change was intended to simplify and expand the rights of the trustee,[17] prior to *Kurtz* it was held that the deletion of the words "judgment creditor" in section 70c prevented the trustee from acquiring the protection of section 6323 (a).[18]

A more compelling basis for these decisions was found in *United States v. Gilbert Associates.*[19] In that case the Supreme Court held that a municipality holding a lien could not be accorded the protection of section 6323 (a) as a "judgment creditor." The Court reasoned that since uniformity of application among the states is a cardinal principle of the congressional tax scheme, the "judgment creditor" of section 6323 (a) should be restrictively defined as one "in the usual, conventional sense of a judgment of a court of record, since all states have such courts."[20] Subsequent lower court decisions have held that the trustee in bankruptcy cannot satisfy the *Gilbert* formula because he does not actually derive his status from a judgment of a court of record.[21]

In *Kurtz,* therefore, the court found it necessary either to distinguish or reconcile its decision with the *Gilbert* definition of a section 6323 (a) judgment creditor. In this respect *Kurtz* reflects the virtually unanimous criticism by legal commentators of the application of *Gilbert* by previous cases.[22] The court reasoned that since *Gilbert* dealt only with the relative priority of lienholders outside bankruptcy, its restrictive definition should not be literally applied in determining the congressionally conferred powers of a trustee in bankruptcy.[23] The problem of uniformity which prompted the *Gilbert* definition, moreover, is not present with respect to

[16] Act of March 18, 1950, ch. 70, § 2, 64 Stat. 26.

[17] H.R. REP. No. 1293, 81st Cong., 1st Sess. 7 (1949); see 4 COLLIER ¶ 70-47.

[18] In the Matter of Fidelity Tube Corp., 278 F.2d 776, 781-82 (3d Cir.), *cert. denied,* 364 U.S. 828 (1960).

[19] 345 U.S. 361 (1953).

[20] *Id.* at 364.

[21] Simonson v. Granquist, 287 F.2d 489, 490 (9th Cir. 1961), *rev'd on other grounds,* 369 U.S. 38 (1962); In the Matter of Fidelity Tube Corp., 278 F.2d 776, 781 (3d Cir.), *cert. denied,* 364 U.S. 828 (1960); Brust v. Sturr, 237 F.2d 135, 136 (2d Cir. 1956); United States v. England, 226 F.2d 205, 206 (9th Cir. 1955). This reasoning suggests it would be necessary to amend either § 6323 (a) or § 70c in order for the trustee to prevail. See In the Matter of Green, 124 F. Supp. 481, 482 (N.D. Ala. 1954).

[22] *E.g.,* 4 COLLIER ¶ 70.49 n.3c; MACLACHLAN § 183, at 192; Loiseaux, *Federal Tax Liens in Bankruptcy,* 15 VAND. L. REV. 137, 138-42 (1961); Seligson, *Creditors Rights,* 32 N.Y.U.L. REV. 708-11 (1961).

[23] 335 F.2d at 314; *accord,* In the Matter of Fidelity Tube Corp., 278 F.2d 776, 785 (3d Cir.) (dissenting opinion), *cert. denied,* 364 U.S. 828 (1960).

applying section 6323 (a) in bankruptcy because the trustee's position is congressionally established and not subject to variation from state to state.[24] Furthermore, the *Kurtz* court indicated that even if the *Gilbert* definition were applicable, the trustee in bankruptcy should nevertheless fall within its scope. Conceding that the trustee is obviously not in fact a judgment creditor, the court relied upon the legislative development[25] and judicial interpretation[26] of section 70c in determining that he is deemed under that provision to possess *all* the rights, remedies, and powers of a judgment creditor. To say that the trustee should be denied the protection of section 6323 (a) merely because his rights as a judgment creditor are conferred by congressional rather than judicial authority, the court concluded, is to rely upon a wholly superficial distinction and one which the Supreme Court could not have intended to establish in *Gilbert*.[27]

Although both sections 70c and 6323 (a) were specifically directed against the harsh effects of secret liens,[28] *Kurtz* represents a choice between two broader considerations of policy. On the one hand is the attempt by Congress through the Bankruptcy Act to confer on the trustee powers extensive enough for the equitable and efficient distribution of the debtor's estate.[29] To effectuate this objective Congress has continually extended the trustee's power to invalidate pre-bankruptcy encumbrances.[30] In cases where these

[24] See Loiseaux, *supra* note 22, at 140.

[25] 335 F.2d at 312-13. "[T]he [1950] amendment to section 70c . . . has been placed in the bill . . . *to simplify and to some extent expand*, the general expression of the rights of trustees in bankruptcy." H.R. REP. No. 1293, 81st Cong., 1st Sess. 7 (1949). (Emphasis added.) See 4 COLLIER ¶ 70.47. The court reasoned that the legislative intention to expand the trustee's power under § 70c included the lesser rights of a judgment creditor. 335 F.2d at 312-13. See 4 COLLIER ¶ 70.49 n.3c; MACLACHLAN § 1602 (1957); Loiseaux, *supra* note 22, at 139; Seligson, *supra* note 22, at 709; note 14 *supra*.

[26] The trustee has frequently been described as a judgment creditor under § 70c as against pre-bankruptcy encumbrances other than tax liens. See, *e.g.*, *In re* Ripp, 242 F.2d 849, 852 (7th Cir. 1957); B. F. Avery & Sons v. Davis, 226 F.2d 942, 945 (5th Cir. 1955); Sampsell v. Straub, 194 F.2d 228 (9th Cir. 1951), *cert. denied*, 343 U.S. 927 (1952).

[27] 335 F.2d at 314.

[28] See United States v. Gilbert Associates, 345 U.S. 361, 363-64 (1953); Sampsell v. Straub, 194 F.2d 228, 231 (9th Cir. 1951), *cert. denied*, 343 U.S. 927 (1952).

[29] See 3 COLLIER ¶ 60.01.

[30] Bankruptcy Act § 60, 64 Stat. 24 (1950), as amended, 11 U.S.C. § 96 (Supp. V, 1964) (preferential transfers); § 67a, 52 Stat. 875 (1938), as amended, 11 U.S.C. § 107a (1958) (judicial liens); § 67c, 66 Stat. 427 (1952), 11 U.S.C. § 107c (1958) (statutory liens); § 67d, 66 Stat. 428 (1952), 11 U.S.C. § 107d (1958) (fraudulent transfers); § 70e, 52 Stat. 882 (1938), as amended, 11 U.S.C. § 110e (1958) (transfers voidable under any nonbankruptcy law). Under none of these provisions, however,

specific extensions are inadequate, the lienholder status given the trustee under section 70c enables him to challenge the particular encumbrance.[31]

Confronting these extensive provisions for efficient bankruptcy administration is the federal tax lien created to insure the prompt and certain collection of overdue taxes.[32] This lien arises automatically at the time of assessment[33] and is perfected by demand, after which it relates back to the assessment date.[34] With the exception of those secured creditors protected by section 6323 (a),[35] the federal lien, whether or not it is filed, prevails over any subsequent interest.[36] Furthermore, the inchoate lien doctrine, originally developed in insolvency liquidations outside federal bankruptcy, has been judicially incorporated into the federal tax lien provisions, rendering the lien practically invulnerable to any other antecedent interest.[37] Outside bankruptcy, therefore, both congressional and judicial treatment has placed the federal tax lien in an overwhelmingly advantageous position.

The joint construction of federal statutes should not result in the subversion of basic policies unless unavoidable. The result obtained by the *Kurtz* decision does not amount to a significant frustration of the purposes of the federal tax lien provisions. All that *Kurtz* requires is that the government follow the

can the trustee normally challenge the federal tax lien effectively. See Comment, *Avoiding Federal Tax Liens in Bankruptcy*, 39 TEXAS L. REV. 616 (1961); 35 IND. L.J. 351, 353-57 (1960).

[31] 4 COLLIER ¶ 70.45, at 1383; MACLACHLAN § 183, at 186-87.

[32] The primary purpose of these provisions is to insure prompt and certain collection from delinquent taxpayers. *E.g.*, United States v. Security Trust & Sav. Bank, 340 U.S. 47, 51 (1950); United States v. Bond, 279 F.2d 837, 847 (4th Cir.), *cert. denied*, 364 U.S. 895 (1960).

[33] INT. REV. CODE OF 1954, § 6322.

[34] See In the Matter of Fidelity Tube Corp., 278 F.2d 776, 780 (3d Cir.), *cert. denied*, 364 U.S. 828 (1960). Unless the lien is filed for record there is no practicable way of discovering it. See Walker, *What Protection Against the Secret Federal Tax Lien*, 9 J. TAXATION 8 (1958).

[35] Mortgagees, pledgees, purchasers, judgment creditors. INT. REV. CODE OF 1954, § 6323 (a). The history of the federal tax lien shows that exemptions from the lien are strictly construed. See United States v. Security Trust & Sav. Bank, 340 U.S. 47, 53 (1950) (concurring opinion).

[36] See INT. REV. CODE OF 1954, § 6323.

[37] Under the inchoate lien doctrine the government lien prevails over any antecedent lien which is not "perfected." The standard of "perfection" requires certainty as to the identity of the lienor, the amount of the lien, and the property to which it attaches. Illinois *ex rel.* Gordon v. Campbell, 329 U.S. 362, 375 (1946). For a complete discussion of the development of the inchoate lien doctrine and of the incorporation of the doctrine into the federal tax lien provisions, see Kennedy, *The*

simple procedure for filing notice of its lien[38] prior to the date of bankruptcy. Moreover, Congress has not displayed an aversion under the Bankruptcy Act to modifying the government's tax collecting power when necessary to avoid inequitable distribution of the bankrupt's estate. For example, under section 67c (1), the satisfaction of the federal tax lien will, in certain situations, be postponed until the payment of administrative expenses and wage claims.[39] Thus *Kurtz* can to some extent be justified as merely a constructional recognition of the congressional modification of the government's taxing power within the context of bankruptcy.

On the other hand, a contrary result in *Kurtz* may well have disrupted efficient bankruptcy administration. Section 70c was intended to enable the trustee to preserve for unsecured creditors assets encumbered by secret liens. If, however, the trustee is prohibited from avoiding an unfiled and therefore secret tax lien, an element of uncertainty would linger over every bankruptcy administration. In three-quarters of the straight bankruptcy cases there is nothing left for administrative expenses after the satisfaction of the secured creditors and allowance for exemptions.[40] Tax liens are a significant cause of this situation.[41] The primary beneficiaries of the *Kurtz* decision are those creditors whose claims fall within the first two priorities of section 64 (a), including those created by the preservation and administration of the estate.[42] Bankruptcy administration would be facilitated if those who extend credit to the bankrupt estate during administration are accorded the certainty of knowing whether there

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

[38] See note 1 *supra*; Walker, *supra* note 34, at 9.

[39] 66 Stat. 427 (1952), 11 U.S.C. § 107c(1) (1958). Under this provision, federal tax liens on personal property are subordinated to the first two priorities (administrative expenses and wage claims) unless: (1) enforced by sale prior to bankruptcy; (2) the Government takes possession of the property; or (3) the estate of the taxpayer is solvent at the date of bankruptcy.

[40] Countryman, *Bankruptcy Boom*, 77 HARV. L. REV. 1452, 1453 (1964).

[41] MACLACHLAN § 18, at 15.

[42] Section 64a, 52 Stat. 874 (1938), as amended, 11 U.S.C. § 104a (Supp. V, 1964). The first four priorities are: (1) expenses of the administration and preservation of the estate; (2) wage claims; (3) expenses of successful opposition to an arrangement or discharge and of adducing evidence resulting in conviction of a bankruptcy offense; (4) federal, state, and local tax claims. See MACLACHLAN § 151-54. The general unsecured creditors will derive no benefit from the *Kurtz* decision since the government's invalidated lien will remain as a fourth priority claim. Whether the trustee might in certain circumstances be permitted to assert the invalidated lien for the benefit of the estate, and thus affect the claims of other secured creditors, is not clear. See 4 COLLIER ¶ 70.48 n.30.

are sufficient assets to pay their claims.[43] Moreover, effective bankruptcy liquidation is as much a matter of business judgment as of law.[44] If apparently unencumbered assets are actually subject to a secret federal tax lien, unnecessary expenses in planning for the administration of the estate may be incurred. Prime examples would be the uncertainty attenuating decisions such as whether to appoint a receiver or maintain a debtor's business operations.

The *Kurtz* decision is sound not only in the technical reasons by which it justifies the correlation of sections 6323 (a) and 70c, but also in the policy choice which it reflects. Certainly the minimal burden imposed upon the government in its tax-collecting procedure is wholly outweighed by the utility of eliminating a potentially disruptive variable from bankruptcy proceedings.

[43] See 35 IND. L.J. 351, 359-60 (1960).
[44] MACLACHLAN § 76, at 69.