



6-1-1952

Liens -- Priority of Federal Tax Claims Over Inchoate Liens -- Difference in Equity Receivership and Bankruptcy

Dickson McLean Jr.

Follow this and additional works at: <http://scholarship.law.unc.edu/nclr>



Part of the [Law Commons](#)

Recommended Citation

Dickson McLean Jr., *Liens -- Priority of Federal Tax Claims Over Inchoate Liens -- Difference in Equity Receivership and Bankruptcy*, 30 N.C. L. REV. 442 (1952).

Available at: <http://scholarship.law.unc.edu/nclr/vol30/iss4/17>

This Note is brought to you for free and open access by Carolina Law Scholarship Repository. It has been accepted for inclusion in North Carolina Law Review by an authorized editor of Carolina Law Scholarship Repository. For more information, please contact law_repository@unc.edu.

fully protects the insurer since it fails to allow recovery if the terminated breach in any way affects the loss, and it recognizes the right of the insurer to declare a forfeiture at the time of the breach if he so desires.²³ A just and equitable rule may be entirely abrogated by unsympathetic or strict application, and the instant case seems to represent a rather strict application.

WALKER Y. WORTH, JR.

Liens—Priority of Federal Tax Claims Over Inchoate Liens— Difference in Equity Receivership and Bankruptcy

A corporation was adjudged insolvent and a receiver appointed to liquidate the assets. On the question of priority of payment between federal tax claims under Section 3466 of the United States Revised Statutes¹ and the employees' liens for wages under G. S. 55-136,² the North Carolina Supreme Court held the federal claim was to be given priority.³

Section 3466 of the United States Revised Statutes, providing for priority of payment of debts due the United States, applies when the insolvent has been divested of ownership of his property.⁴ The divest-

²³ *Globe & Rutgers' Fire Ins. Co. v. Pruitt*, 188 Ark. 92, 64 S. W. 2d 91 (1933); *Aetna Ins. Co. v. Robinson*, 213 Ind. 44, 10 N. E. 2d 601 (1937).

¹ 31 U. S. C. §191 (1946): "Whenever any person indebted to the United States is insolvent or whenever the estate of any deceased debtor, in the hands of the executors or administrators, is insufficient to pay all the debts due from the deceased, the debts due to the United States shall be first satisfied; and the priority established shall extend as well to cases in which a debtor not having sufficient property to pay all his debts, makes a voluntary assignment thereof, or in which the estate and effects of an absconding, concealed, or absent debtor, are attached by process of law, as to cases in which an act of bankruptcy is committed."

² N. C. GEN. STAT. §55-136 (1943): "In case of the insolvency of a corporation, partnership, or individual, all persons doing labor or service of whatever character in its regular employment have a lien upon the assets thereof for the amount of wages due to them for all labor, work, and services rendered within two months next preceding the date when proceedings in insolvency were actually instituted and begun, . . . which lien is prior to all other liens that can be acquired against such assets."

³ *Leggett v. Southeastern People's College, Inc.*, 234 N. C. 595, 68 S. E. 2d 263 (1951).

⁴ Before the priority under Section 3466 attaches, the insolvency must be manifested in one of the modes specified under the section. In addition, "Under this act these rules have been clearly established: First, no lien is created; second, the priority established can never attach while the debtor continues the owner and in possession of the property, though he may be unable to pay all his debts; third, no evidence can be received of the insolvency of the debtor until he has been divested of his property in one of the modes stated; and fourth, whenever the debtor is thus divested of his property, the person who thus becomes invested with the title is thereby made a trustee for the United States. . . ." *Beaston v. Farmers' Bank*, 12 Pet. 102, 133 (U. S. 1838); *Bramwell v. U. S. Fidelity & Guaranty Co.*, 269 U. S. 483 (1926); *United States v. Oklahoma*, 261 U. S. 253 (1923); *Bishop v. Black*, 233 N. C. 333, 64 S. E. 2d 167 (1951). The priority attaches at the date of the appointment of a receiver. *Bramwell v. U. S. Fidelity & Guaranty Co.*, *supra*.

ing of the property of the insolvent such as will call into play the priority of the United States under Section 3466 is commonly obtained in an equity receivership, since distribution of the estate in bankruptcy is controlled by the provisions of the Bankruptcy Act.⁵

The North Carolina decision is in accord with the interpretation of this section by the federal courts, which gives debts due the United States superiority over all liens which are not specific and perfected regardless of the time when such liens arise.⁶ The federal courts have been reluctant to qualify liens competing with federal claims as specific and perfected⁷ and will do so only where the lien is definite in respect to the identity of the lienor,⁸ the amount of the lien,⁹ and the property to which the lien attaches,¹⁰ and where all the steps necessary to complete the lien have been taken.¹¹ In the instant case, the court found that the lien of the employees for wages under G. S. 55-136 did not attach to specific property and in effect created only a priority of payment which must be subordinated to the federal priority granted by section 3466.¹²

⁵ A consent receivership amounts to a voluntary assignment which calls section 3466 into play. *United States v. Butterworth-Judson Corp.*, 269 U. S. 504 (1926); *Price v. United States*, 269 U. S. 492 (1926). Section 3466 is not applicable to give the government priority in bankruptcy. *Guaranty Title & Trust Co. v. Title Guaranty Co.*, 224 U. S. 152 (1912).

⁶ *United States v. Security Trust and Savings Bank*, 340 U. S. 47 (1950); *Illinois v. Campbell*, 329 U. S. 362 (1946); *United States v. Waddill*, 323 U. S. 352 (1945); *United States v. Texas*, 314 U. S. 480 (1941); *United States v. Knott*, 298 U. S. 544 (1936); *New York v. Maclay*, 288 U. S. 290 (1933); *Spokane County v. United States*, 279 U. S. 80 (1921); *Thelluson v. Smith*, 2 Wheat. 396 (U. S. 1817). See *Bishop v. Black*, 233 N. C. 333, 64 S. E. 2d 167 (1951). Federal priority under section 3466 does not override a prior mortgage, *United States v. Hooe*, 3 Cranch 73 (U. S. 1805); nor a prior judgment plus execution and levy, *Conard v. Atlantic Insurance Co.*, 1 Pet. 386, 442-44 (U. S. 1828); *Thelluson v. Smith*, 2 Wheat. 396, 496 (U. S. 1817).

⁷ See Rogge, *The Differences in the Priority of the United States in Bankruptcy and in Equity Receiverships*, 43 HARV. L. REV. 251 (1929); Note, 29 N. C. L. REV. 293 (1951); Note, 56 YALE L. J. 1258 (1947).

⁸ *United States v. Knott*, 298 U. S. 544, 550 (1936) (creditors to benefit from deposit of securities with state official not ascertained).

⁹ *United States v. Waddill*, 323 U. S. 353 (1945) (amount of landlord's lien for future rent uncertain); *United States v. Texas*, 314 U. S. 480, 485-86 (1941) (amount of state gasoline taxes unsettled).

¹⁰ *Illinois v. Campbell*, 329 U. S. 362 (1946); *United States v. Waddill*, 323 U. S. 352 (1945); *Thelluson v. Smith*, 2 Wheat. 396 (U. S. 1817) (general judgment on land). Section 3466 priority is superior to the lien of a docketed judgment unless levy of execution on the judgment has proceeded far enough to take specific land or other property out of the possession of the debtor. *Conard v. Atlantic Insurance Co.*, 1 Pet. 386, 442-444 (U. S. 1828); *Thelluson v. Smith*, 2 Wheat. 396 (U. S. 1817); *United States v. Sullivan*, 19 F. Supp. 695 (W. D. N. Y. 1937). See *In re Gruner*, 295 N. Y. 510, 68 N. E. 2d 514 (1946); *Spokane Merchant's Assn. v. State*, 15 Wash. 2d 186, 130 P. 2d 373 (1942); cf. *In re Meyer's Estate*, 159 Pa. Super. 296, 48 A. 2d 210 (1946).

¹¹ *United States v. Security Trust and Savings Bank*, 340 U. S. 47 (1950); *United States v. Waddill*, 323 U. S. 352 (1945); *County of Spokane v. United States*, 279 U. S. 80 (1929); *Conard v. Atlantic Insurance Co.*, 1 Pet. 386 (U. S. 1828). See *Bishop v. Black*, 233 N. C. 333, 64 S. E. 2d 167 (1951).

¹² *Accord*: *United States v. Emory*, 314 U. S. 423 (1941); *Lerman v. Lincoln Novelty Co.*, 130 N. J. Eq. 144, 21 A. 2d 827 (1941).

In contrast to the subordination of the lien for wages in receivership, where the debtor is carried into bankruptcy, claims for wages earned within three months of the proceedings prevail over tax claims of the federal government by express provision of the Bankruptcy Act.¹³ This variance between the rights of the wage-earner in receivership and bankruptcy is illustrative of the general standing of claims in the two proceedings. Where there are competing non-lien federal claims,¹⁴ it is as a rule beneficial to creditors to have property of an insolvent debtor distributed in bankruptcy rather than in equity receivership.¹⁵

Except as expressly stated in the Bankruptcy Act, bankruptcy proceedings do not discharge liens upon the property of the debtor. The trustee takes control of the property of the debtor, but, by virtue of section 67 of the Act, the property remains subject to liens existing at the time of the petition.¹⁶ The priority granted to federal tax claims by section 64 of the Act is limited to the property remaining for distribution among general creditors after payment of all valid liens.¹⁷

¹³ Section 64(b) of the Bankruptcy Act places wages up to \$600 due employees which were earned within three months of bankruptcy in clause (2) in the order of priority, whereas taxes are placed in clause (4). 11 U. S. C. §104(a) (1946).

¹⁴ Section 3466 does not create a lien for the government. See note 4 *supra*.

¹⁵ See Sarnar, *Correlation of Priority and Lien Rights in the Collection of Federal Taxes*, 95 UNIV. PA. L. REV. 739 (1947); Rogge, *The Differences in the Priority of the United States in Bankruptcy and in Equity Receiverships*, 43 HARV. L. REV. 251 (1929); Note, 56 YALE L. J. 1258 (1947). The acts which call section 3466 into play will often justify an involuntary petition in bankruptcy. The applicable act of bankruptcy consists in having made a general assignment for the benefit of creditors, or, while insolvent, having suffered appointment of a receiver or trustee put in charge of the debtor's property. 11 U. S. C. §21(a) (4, 5) (1946). See 11 U. S. C. §95 (1946) for the provisions as to which creditors may file petition for bankruptcy. In North Carolina, the power of a court of equity to appoint a receiver is inherent and not limited by the specific statutory provisions. Receivership is used most commonly (1) to preserve specific property which is the subject of litigation; (2) to tide a person over a temporary period of financial embarrassment; and (3) to prevent preferences and to assure the equitable distribution of the assets of an insolvent. *Sinclair v. Moore Central R.R.*, 228 N. C. 389, 49 S. E. 2d 555 (1947). See also: *Kelly v. McLamb*, 182 N. C. 158, 108 S. E. 435 (1921); N. C. GEN. STAT. §§1-502, 55-147 (1943).

¹⁶ 11 U. S. C. §107 and §110 (1946). *City of Richmond v. Bird*, 249 U. S. 174 (1919); *Guaranty Title & Trust Co. v. Title Guaranty Co.*, 224 U. S. 152 (1912); *Thompson v. Fairbanks*, 196 U. S. 516 (1905); *United States v. Sampsell*, 153 F. 2d 731 (9th Cir. 1946); *In re Dunavant*, 96 Fed. 542 (W. D. N. C. 1899); *Sample v. Jackson*, 225 N. C. 380, 35 S. E. 2d 236 (1945); 4 COLLIER, BANKRUPTCY §67.02 (14th ed. 1942). The trustee in bankruptcy is vested with all the rights of a creditor holding a lien by legal or equitable proceedings. 11 U. S. C. §110(c) (1946). The competing lien must meet the requirements of the state law such as will give it priority over the lien of the trustee. For example, and unrecorded mortgage will not prevail against the lien of the trustee. *M. & J. Finance Co. v. Hodges*, 230 N. C. 580, 55 S. E. 2d 201 (1949).

¹⁷ *City of Richmond v. Bird*, 249 U. S. 174, 177 (1919); *Lott v. Salsbury*, 237 Fed. 191 (4th Cir. 1916); *In re Tresslar*, 20 F. 2d 663 (M. D. Ala 1927); *In re Rowe & Bros.*, 18 F. 2d 658 (W. D. Pa. 1927); *In re Caswell Construction Co.*, 13 F. 2d 667 (N. D. N. Y. 1926); *In re Hosmer*, 233 Fed. 318 (S. D. Iowa 1916).

Furthermore, in contrast to the requirement of a specific and perfected lien for priority against federal claims in receivership, inchoate general liens are specifically protected and validated in bankruptcy. Section 67(b) of the Bankruptcy Act allows a statutory lien to prevail against the trustee in bankruptcy, even though it is not perfected at the time of the filing of the petition, so long as it is perfected within the period permitted by applicable lien law.¹⁸ Such a lien would as a result also be satisfied before the priority of distribution set up for federal taxes by section 64. Thus, liens inchoate at the time of the filing of the petition but subsequently perfected have been allowed payment before the order of distribution set up by section 64 in the cases of a mechanic's or materialman's lien,¹⁹ subcontractor's lien,²⁰ and a lien for state taxes.²¹ Liens for a liability still contingent²² or for an amount still unascertained at the time of the filing of the petition²³ have been allowed validity against the trustee in bankruptcy. In addition, liens obtained by judicial proceedings, such as garnishment, attachment, and judgment liens, are allowed unless invalidated by section 67(a) for being obtained within four months of the petition while the debtor is insolvent.²⁴

Where the federal claim for taxes has been perfected into a lien, the situation once again changes. After the proper steps to create a federal tax lien have been taken, the tax lien itself prevails against the trustee in bankruptcy and against unsecured creditors.²⁵ Where another

¹⁸ 11 U. S. C. §107(b) (1946): "Statutory liens in favor of employees, contractors, mechanics, landlords, or other classes of persons, and statutory liens for taxes and debts owing to the United States or any State, may be valid against the trustee, even though arising or perfected while the debtor is insolvent and within four months prior to the filing of the petition in bankruptcy . . . [or if the liens] arise but are not perfected before bankruptcy, they may nevertheless be valid, if perfected within the time permitted by and in accordance with the requirements of the laws creating them." This section has no application to non-statutory liens. It furnishes no authority for perfection of contractual liens after bankruptcy proceedings, which is governed by 11 U. S. C. §96 (1950) concerning preferences. A transfer made for a present consideration within four months of bankruptcy is not deemed a preference where perfecting (if required) follows within 21 days or a lesser statutory period (if any).

¹⁹ *In re Taylorcraft Aircraft Corp.*, 168 F. 2d 808 (6th Cir. 1948); *American Coal Burner Corp. v. Merritt*, 129 F. 2d 314 (6th Cir. 1942); *New York-Brooklyn Fuel Corp. v. Fuller*, 11 F. 2d 802 (2d Cir. 1926); *In re Grisslar*, 136 Fed. 754 (2d Cir. 1905); *In re Etherton*, 88 F. Supp. 874 (S. D. Cal. 1950); *In re Caswell Construction Co.*, 13 F. 2d 667 (N. D. N. Y. 1926); *In re McAllister-Newgard Co.*, 193 Fed. 265 (D. Minn. 1912); *In re Lillington Lumber Co.*, 132 Fed. 886 (E. D. N. C. 1904).

²⁰ *Pittsburgh Plate Glass Co. v. Kinney*, 291 Ill. 84, 125 N. E. 730 (1919).

²¹ *Delaney v. City and County of Denver*, 185 F. 2d 246 (10th Cir. 1950).

²² *Security Mortgage Co. v. Powers*, 278 U. S. 149 (1928).

²³ *In re Knox-Powell-Stockton Co.*, 100 F. 2d 979 (9th Cir. 1939).

²⁴ Section 67(a), Bankruptcy Act, 11 U. S. C. §107(a) 1946); 4 COLLIER, BANKRUPTCY §67.07-67.12 (14th ed. 1942).

²⁵ 11 U. S. C. §107(b) (1946). *Goggin v. Division of Labor Law Enforcement of California*, 336 U. S. 118 (1948) (tax lien superior to wage claim); *In re Taylorcraft Aviation Corp.*, 168 F. 2d 808 (6th Cir. 1948); *United States v. Sampsell*, 153 F. 2d 731 (9th Cir. 1946); *Dial v. Chatman*, 70 F. 2d 21 (4th Cir.

competing lien is in the picture, the question of priority between the liens becomes an ordinary contest under applicable lien law independent of the provisions of the Bankruptcy Act, since both liens are superior to the right of the trustee.²⁶ In respect to the four classes protected against the federal tax lien by recordation—purchasers, judgment creditors, mortgagees, and pledgees—the federal lien ranks in accordance with the general rule, “first in time, first in right,” on the basis of recordation.²⁷ But in respect to all other liens, recent cases indicate that the tax lien will be given priority over inchoate liens which have not become specific and perfected, by analogy to the requirement under section 3466 in receivership proceedings.²⁸

If the analogy of liens under section 3466 in receiverships is to be carried over in its full vigor to a contest of competing liens outside receivership, a creditor will gain little from having the debtor carried into bankruptcy where the federal tax claim has been perfected into a lien. Where there is no tax lien in the picture, however, substantial advantage may result for holders of inchoate liens by going into the bankruptcy court. Creditors faced with a competing federal tax claim might well investigate the benefits to be gained from having the estate of an insolvent debtor liquidated in bankruptcy rather than receivership proceedings. The instant case appears to have been a situation in point.

DICKSON McLEAN, JR.

1934). Section 3670 of the Internal Revenue Code, 26 U. S. C. §3670 (1946), provides for a lien for federal taxes (other than estate and gift taxes) upon all property of the taxpayer after demand has been made. The liens become effective as against subsequent purchasers, judgment creditors, mortgagees, and pledgees from the date of recordation of the lien by virtue of Section 3672. As against all other parties the federal tax lien is effective from the time the assessment list is received by the collector. *United States v. Sampsell*, 153 F. 2d 731 (9th Cir. 1946); *In re MacKinnon Mfg. Co.*, 24 F. 2d 156 (7th Cir. 1928); *United States v. Record Publishing Co.*, 60 F. Supp. 194 (N. D. Cal. 1945). The lien for estate and gift taxes becomes effective against all parties from the date of the receipt of the assessment list. 26 U. S. C. §§827(a), 1009 (1946); *Detroit Bank v. United States*, 317 U. S. 329 (1943).

²⁶ *In re Taylorcraft Aviation Corp.*, 168 F. 2d 808 (6th Cir. 1948); *United States v. Sampsell*, 153 F. 2d 731 (9th Cir. 1946); *Seymour v. Wildgen*, 137 F. 2d 160 (10th Cir. 1943); *Dial v. Chatman*, 70 F. 2d 21 (4th Cir. 1934); *Lerner Stores Corp. v. Electric Maid Bake Shops*, 24 F. 2d 780 (5th Cir. 1928).

²⁷ *United States v. Sampsell*, 153 F. 2d 731 (9th Cir. 1946); *Dial v. Chatman*, 70 F. 2d 21 (4th Cir. 1934); *Ormsbee v. United States*, 23 F. 2d 926 (S. D. Fla. 1926).

²⁸ *United States v. Security Trust & Savings Bank*, 340 U. S. 47 (1950); *United States v. Reese*, 131 F. 2d 466 (7th Cir. 1942); *In re Capital Foundry Corp.*, 64 F. Supp. 885 (E. D. N. Y. 1946); Note, 29 N. C. L. Rev. 293 (1951). *But cf.* *United States v. Alabama*, 313 U. S. 274 (1941).