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Federal Taxation - Tax Lien - The Role of a State Recording Statute

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jurisdictional basis for granting a divorce to servicemen within the respective forum.⁹⁸ The significance of such statutes is unclear, especially since two states have enacted both the serviceman divorce statute and the Uniform Divorce Recognition Act.

The New York decision in *Rosenstiel* and, more significantly, in the *Wood* case,⁹⁹ has in effect done away with the discrepancy between recognition of sister-state and foreign divorce decrees. New York refrained from applying its own domicile rules to the foreign judgment because jurisdiction was established under the foreign rules, both parties appearing in the litigation. This approach may or may not be the most salutary and realistic one to take today. But while divorce laws in the several states remain so widely divergent and while states like New York retain archaic standards for divorce, the bulk of problems arising from the migratory divorce are not solved. Indeed, this leads to the further, more obvious consideration that those who can afford the luxury of a "quickie" sister-state divorce or (in New York) a foreign divorce, realize greater legal benefits than those who are less affluent. Legislative action, rather than judicial leniency, is therefore necessary to remedy these problems, which can ultimately be traced to the stringent divorce laws such as those now operative in New York.¹⁰⁰

Pauline R. Karlsberg

Federal Taxation — Tax Lien — The Role of a State Recording Statute

I. THE FEDERAL TAX LIEN

Section 6321 of the Internal Revenue Code of 1954 provides for the imposition of a tax lien on the property and rights to property, both real and personal, which belong to a taxpayer who neglects or refuses to pay his taxes after demand has been made upon him.¹

⁹⁸ See note 45 *supra*.

⁹⁹ *Rosenstiel v. Rosenstiel*; *Wood v. Wood*, 16 N.Y.2d 717, 262 N.Y.S.2d 86 (1965).

¹⁰⁰ As this issue went to press, New York passed a new divorce law. See N.Y. Times, April 28, 1966, p. 36, col. 3-7. Not only did New York broaden its grounds for divorce, but it also set out statutory presumptions of New York citizenship when a party obtains a divorce out of state. The statute, however, fails to declare that a divorce obtained out of state by a New York domiciliary will not have effect in New York. In view of the judicial background in New York of recognition of such divorces, the courts may yet determine that domicile has not been made a jurisdictional requisite for recognition of divorces obtained out of New York.

¹ The statute rests upon the congressional power to levy and collect taxes, U.S. CONST. art. I, § 8, and was held to be constitutional in *Michigan v. United States*, 317 U.S. 338 (1943).

The lien arises when a jeopardy assessment is made by the district director of Internal Revenue and, by operation of law, automatically attaches to all the property of the delinquent taxpayer. No court proceeding is necessary. Section 6323(a) requires that the government file notice of the lien before it is valid against mortgagees, pledgees, purchasers, and judgment creditors. If these protected classes acquire their interests in the taxpayer's property before the notice is filed, the lien is invalid against them.² Section 6323(a) was enacted because of a number of instances in which property purchased from a delinquent taxpayer by a bona fide purchaser had been seized and sold by the federal government under what is now section 6321.³ The lien had arisen before they had acquired their interests, but since the government did not have to file notice, they had no knowledge of the lien.

II. APPLICATION OF THE LIEN

Two basic issues arise in contests between the United States and purchasers of property from a delinquent taxpayer. First, does the delinquent taxpayer have an interest in the property in question? Second, is the purchaser protected by section 6323(a)?

Under section 6321, the lien attaches to all property and rights to property belonging to the delinquent taxpayer. State law determines the interest of the parties in the property while federal law controls whether or not the lien attaches to the state-defined interests.⁴ This treatment is said to strike a proper balance between the legitimate and traditional interests which the state has in creating and defining the property interests of its citizens, and the necessity for a uniform administration of the federal revenue statutes.⁵

² INT. REV. CODE of 1954, § 6323(a). The notice must be filed at the office designated by the state where the property is located, or, if the state has not designated an office, in the office of the clerk of the federal district court for the judicial district in which the property is located.

³ In *United States v. Curry*, 201 Fed. 371 (D. Md. 1912), the court said that the government's lien was unaffected by the fact that a subsequent purchaser became such without knowledge that the federal government had any claim upon the property. In *United States v. Snyder*, 149 U.S. 210 (1893), property subject to a federal tax lien was conveyed to a purchaser without knowledge of the lien. The purchaser maintained that, since the lien was not recorded in compliance with Louisiana law, it was void as against a bona fide purchaser. The Court held that because of the variations existing in state laws, to subject federal tax law to the recording laws of the states would be a violation of the constitutional direction to assess and enforce taxes with uniformity. As originally written, the federal tax lien statute contained no exceptions or limitations. REV. STAT. § 3186 (1875). Subsequent purchasers were not protected from the imposition of a tax lien on property in which they had acquired an interest. Nor was the federal government required to observe the local procedure for the filing of liens against property.

⁴ *United States v. Aquilino*, 363 U.S. 509 (1960); *United States v. Bess*, 357 U.S. 51 (1958); *United States v. Dallas National Bank*, 152 F.2d 582 (5th Cir. 1945).

⁵ *United States v. Bess*, note 4 *supra*.

In *Aquilino v. United States*,⁶ the delinquent taxpayer was a general contractor whose payments from a job were subject to a statutory trust for the benefit of the unpaid sub-contractors. The Court remanded the case to the state court⁷ for a determination of whether the sub-contractors had an ordinary lien or whether they had beneficial title to the funds, reasoning that if they had equitable title, the lien could not attach. The New York court of appeals held that the sub-contractors had equitable title, and that the general contractor had no interest to which the lien could attach.⁸ Thus, an important factor in deciding whether a lien will attach to property is whether the taxpayer holds *equitable* title. The Fourth and Ninth Circuits have also considered this factor essential in deciding whether the taxpayer has any property to which a tax lien will attach.⁹

A purchaser within the protection of section 6323 (a) is one who acquires title to property for a valuable consideration in the manner of vendor and vendee.¹⁰ The Treasury regulations use essentially the same definition, but add in explanation that the determination of whether a person is a purchaser shall be made by reference to the facts and realities in a given situation rather than to the technical form or terminology used. A person may be entitled to protection as a purchaser under section 6323 (a) even though he is otherwise designated under state law.¹¹

III. UNITED STATES V. CREAMER INDUSTRIES, INC.¹²

On January 21, 1959, Creamer Industries, Inc., and Maxwell Steel Company entered into an agreement whereby *all* of Maxwell's assets were to be conveyed to Creamer. The contract and the deeds of conveyance inadvertently omitted the description of six lots of land. On

⁶ *United States v. Aquilino*, 363 U.S. 509, 514 (1960).

⁷ The taxpayer had impleaded the United States and the unpaid subcontractors as rival claimants to the funds in the New York state courts.

⁸ *Aquilino v. United States*, 10 N.Y.2d 271, 176 N.E.2d 826 (1961).

⁹ In *Swartz v. United States*, 191 F.2d 618 (4th Cir. 1951), the taxpayer married a woman while he had a wife living. He fraudulently led the woman to believe that he was her husband, and she conveyed property purchased with her own money to taxpayer and herself as tenants by the entireties. Tax liens were filed against the land for taxpayer's deficiency in income taxes. The court held that since the woman had equitable title based on a theory of resulting or constructive trust, the land was not subject to sale under execution of an income tax deficiency judgment. In *United States v. Winnett*, 165 F.2d 149 (9th Cir. 1947), the maker of a promissory note under California law had an equitable right of set off which was prior in time to the government's lien against the property of the payee of the note. The government was not allowed to assert its lien until the equitable right was satisfied. The rights of the Internal Revenue collector seeking to establish a lien for taxes on a taxpayer's right to property do not extend beyond those of the taxpayer.

¹⁰ *United States v. Scovil*, 348 U.S. 218 (1955).

¹¹ Treas. Reg. § 301.6323-1a.(2) (ii) (1955).

¹² 349 F.2d 625 (5th Cir.), *cert. denied*, 382 U.S. 957 (1965).

March 24, 1959, the United States made a jeopardy assessment against Maxwell for delinquent federal income and excise taxes, and filed notice thereof two days later. Subsequently, Maxwell executed and delivered to Creamer a correcting deed which was recorded on April 28, 1959. The United States claimed that its tax lien attached on the date of filing to the lots omitted from the original contract and deeds. Creamer brought suit to enjoin the sale of the property. The district court ruled that Creamer was a purchaser within the meaning of section 6323 (a) and, therefore, that the government's lien on the lots was invalid.¹³ The Fifth Circuit Court of Appeals reversed and held that the lien had attached to the property in question and that Creamer was not a protected purchaser within the meaning of section 6323 (a). The court implied that section 6323 (a) was applicable only to the situation in which a purchaser acquires his interest in the property subsequent to assessment and prior to notice.¹⁴ The court found that since there was no occurrence which changed Creamer's rights between assessment and the filing of notice, Creamer could not be a purchaser within the protection of section 6323 (a).¹⁵ This reasoning is correct since if the purchase took place before assessment, there would be no interest of the taxpayer to which the lien could attach. Also, the purchaser is protected by his prior interest. If the purchase took place after the filing of notice, the purchaser has constructive notice of the lien and purchases at his peril.

The Texas Recording Statute requires that a transfer of real property be recorded before it is valid against bona fide purchasers and creditors.¹⁶ The court in the instant case held that the United States was a "creditor" within the meaning of the statute,¹⁷ using *Henderson v. Odessa Building & Finance Co.*¹⁸ to reach its decision. In *Henderson*, a judgment creditor asserted its lien against a lot which the debtor had intended to convey to a purchaser in a deed given prior to levy, but in which the lot had been incorrectly described. It was held:

The failure to convey the lot levied upon by [the creditor] . . . through mutual mistake of the parties gave [the purchaser] . . . an equitable right to have the deed reformed by correction deed or a decree in equity, but, as [the creditor] . . . had no knowledge of such equity at

¹³ 63-2 U.S. Tax. Cas. ¶ 9699 (N.D. Tex. 1963).

¹⁴ 349 F.2d at 628.

¹⁵ *Ibid.*

¹⁶ TEX. REV. CIV. STAT. ANN. art. 6627 (1840). This statute provides that all sales of realty are void as to all creditors and subsequent purchasers for valuable consideration without notice unless such deeds are recorded. However, as between the parties, and to purchasers and creditors with notice, the sale is valid and binding.

¹⁷ 349 F.2d at 628.

¹⁸ 24 S.W.2d 393 (Tex. Comm. App. 1930).

the time the levy was made, the lien thereby affixed was superior to [the purchaser's] . . . right to such reformation.¹⁹

The Fifth Circuit, in *Creamer*, ruled that the *Henderson* decision was almost "on all fours" with the present case, and rendered judgment for the United States.

This case illustrates a recurring problem in tax lien litigation — whether or not a purchaser of property from a delinquent taxpayer must record his interest to protect it from later attachment and sale by the United States to satisfy delinquent taxes of the prior owner. The Internal Revenue Code does not require by its terms such a recording and the Supreme Court has not ruled on this point.²⁰ In the absence of such a ruling, the lower courts have followed state law.²¹ The result is that failure to record the transfer has been held to be immaterial when recording is not required by state law,²² but only a recorded interest is protected where recording is necessary in order to render the interest valid as against third persons acting in good faith.²³ This distinction is questionable in light of the fact that the government does not rely on record title in assessing deficiencies and filing notice thereof. The Eighth Circuit, in *Gauvey v. United States*,²⁴ so reasoned in holding that federal tax liens are not affected by state recording statutes. In *Creamer*, the court allowed the government to cut off the equity of the purchaser even though Maxwell, the taxpayer, had only bare legal title to the property in question. The government was thus permitted to take a greater interest in the property than was held by the taxpayer. Since the government does not rely on record title, it should get only what the taxpayer *actually* has, and not what a judgment creditor or mortgagee who does rely on record title might receive. Under the *Henderson* decision, Maxwell held only record legal title while *Creamer* held the equitable right of reformation or equitable title. *Creamer* thus allows the government lien to attach to any interest a state bona fide purchaser or creditor might reach. This ignores the distinction, as pointed out by Judge Brown in his dissent, between the approaches of the Texas Recording Act and the federal tax lien statute. The Texas Recording statute speaks in terms of the persons against whom the conveyance

¹⁹ *Id.* at 394.

²⁰ *But see* the separate opinion of Justice Whitaker, joined by Justices Douglas, Burton, and Harlan, dissenting, in *United States v. R.F. Ball Constr. Co.*, 355 U.S. 587 (1958), in which the view was expressed that a mortgage was superior to a federal tax lien although it was not recorded under the state's fraudulent conveyance statute.

²¹ *But see* *Gauvey v. United States*, 291 F.2d 42 (8th Cir. 1961), where the court held that the state recording statute could not affect a federal tax lien.

²² *United States v. Anders Contracting Co.*, 111 F. Supp. 700 (D.S.C. 1953).

²³ *Underwood v. United States*, 118 F.2d 760 (5th Cir. 1941).

²⁴ 291 F.2d 42 (8th Cir. 1961).

is not good, such as bona fide purchasers and judgment creditors. On the other hand, Judge Brown stated, the federal tax lien statute speaks in terms of the origin of the lien:

The tax lien arises, the tax lien comes into being, only as to property or rights to property belonging to the taxpayer. [Maxwell] had no right to such property. And yet it is this—ownership by the taxpayer—which gives rise to the lien for the National Government. Congress has not said that this Nation has a tax lien against any and all property once owned by a delinquent taxpayer *to the same extent as some innocent purchaser . . . might have under local recordation statutes.*²⁵

Judge Brown's position is supported by the Ninth Circuit in *United States v. Winnett*,²⁶ which held that the rights of the internal revenue collector seeking to establish a lien for taxes on a taxpayer's right to property do not extend beyond those of the taxpayer. This seems to be the more just and equitable rule.

Finally, the Fifth Circuit in *Creamer*, while freely quoting the *Aquilino* decision, ignored the beneficial interest rule of *Aquilino*. Maxwell held only bare legal title to the property in question as did the contractor in *Aquilino*, while *Creamer* held all the beneficial interest as did the sub-contractors in *Aquilino*.²⁷ Thus, the Fifth Circuit's decision in *Creamer* seems to conflict with the rule laid down by the *Aquilino* decision.²⁸ To be consistent with *Aquilino*, it would have been better for the court to raise a constructive trust as did the district court in *Swartz v. United States*.²⁹

IV. CONCLUSION

The court's decision in *Creamer* appears to be incorrect. It seemingly ignored the beneficial interest rule. Further, there is a conflict among the circuits as to the effect of a state recording statute. Since the government does not rely on recording statutes, it should not be able to cut off the equity of a purchaser who did not record his interest and should be limited when enforcing a tax lien only to those rights that the delinquent taxpayer had. Because of this conflict among the Fifth, Eighth and Ninth Circuits, the Supreme Court should resolve the question of whether the government can cut off the equity of an unrecorded purchase at its earliest opportunity, or as Judge Brown suggests in his dissent, Congress should step into the

²⁵ 349 F.2d at 629 (Brown, J., dissenting). (Emphasis added.)

²⁶ 165 F.2d 149 (9th Cir. 1947).

²⁷ In fact since the date of the original contract of sale between *Creamer* and Maxwell, *Creamer* had been receiving all rents and benefits from the lessees of the property in question.

²⁸ See notes 4 and 8 *supra* and accompanying text.

²⁹ 191 F.2d 618 (4th Cir. 1951).