INTERNAL REVENUE CODE SECTION 6323: A TREATMENT OF FIVE SUPERPRIORITIES

I. INTRODUCTION

Liens for unpaid taxes had long been a dark cloud of impending disaster for the unsuspecting third party who provided services to or acquired property from a delinquent taxpayer. The lien arose at assessment and continued until satisfied or discharged. It attached to all property and rights to property of the person liable for the tax.

Individuals and small businesses were the most susceptible victims. They had little knowledge of the scheme of tax collection. Their resources for searching for tax liens were limited, and in the day-to-day realities of the commercial world it was impractical and unreasonable to expect a search of public records for the elusive tax lien. In contrast, the Internal Revenue Service had nearly unlimited resources to search for property with which to satisfy tax deficiencies. The results were often harsh, but legally authorized.

Congressional recognition of the inequities and hardships created by the conflict between the need to generate revenue and the necessity of insuring a degree of certainty in commercial relationships took the form of superpriorities.[1] This action was particularly significant in view of the strong pro-government position taken by the courts in most tax lien cases.

This Comment will examine the first five superpriorities codified in section 6323 of the Internal Revenue Code.[2] The evolution of tax lien law will be discussed, followed by an examination of the statutory material, recent court interpretations, and some legal issues peculiar to Washington State. To illustrate the elements of each superpriority, a schedule[3] dis-

1. Federal Tax Lien Act of 1966, Pub. L. No. 89-719, § 101(a), 80 Stat. 1125 [hereinafter cited as FTLA], *amending* 26 U.S.C. § 6323(c) (1964) (codified at INT. REV. CODE OF 1954, § 6323(b)). *See generally* Plumb, *Federal Liens and Priorities—Agenda for the Next Decade*, 77 YALE L.J. 228 (1967). Before the 1966 legislation, interests now protected by superpriorities were for the most part vulnerable not merely to pre-existing tax liens, but also to those which arose by assessment after the private interest was perfected. In addition, conflicts between state and federal systems gave rise to circular priority situations. *See* Smith v. United States, 113 F. Supp. 702 (D. Hawaii 1953).

2. INT. REV. CODE OF 1954, §§ 6323(b)(1)-(5).

3. *See* Appendix.

secting each superpriority into the interest protected, the nature or form of the interest, the owner of the interest, and the "scienter" requirement is included at the end of this Comment. The elements of each category will be discussed in the text and the peculiarities of each superpriority identified.

II. BACKGROUND

A. *Doctrine of Choateness*

Prior to the enactment of the Federal Tax Lien Act of 1966 (FTLA),[4] the competition between federal tax liens and other lien interests was resolved by the doctrine of *choateness*.[5] In order for a lien interest in property to be choate, it had to be specific and be perfected. The United States Supreme Court measured the choateness of an interest arising prior to the tax lien by applying a three-pronged test requiring that: (1) The identity of the lienor be definite; (2) the property subject to the lien be specifically identified; and, (3) the amount secured by the lien be definite.[6]

The United States Supreme Court has held that whether a lien meets the test of choateness is a federal question,[7] notwithstanding the existence of a state statute defining a lien as specific, perfected and complete. Consequently, while a state's classification of whether a lien is specific and perfected is entitled to weight in federal court, it is subject to reexamination in light of federal decisions.[8]

Congress developed the superpriority concept in order to overcome the choateness doctrine and to settle the issue of the priority of certain interests.[9] By definition, an interest accorded superpriority status takes precedence over a federal tax lien, whether the interest arises before or after the filing of notice of tax lien; it cannot be defeated by a tax lien. It is not dependent

4. Federal Tax Lien Act of 1966, Pub. L. No. 89-719, § 101(a), 80 Stat. 1125, *amending* 26 U.S.C. § 6323 (1964), (codified at INT. REV. CODE OF 1954, § 6323).

5. *See* United States v. City of New Britain, 347 U.S. 81 (1954); Gordon v. Campbell, 329 U.S. 362 (1946).

6. *See* cases cited note 5 *supra*.

7. United States v. Waddill, Holland & Flinn, Inc., 323 U.S. 353 (1945).

8. United States v. Security Trust & Sav. Bank, 340 U.S. 47 (1950). On the other hand, a state court's classification of a lien as *inchoate* is "practically conclusive." *Id.* at 50.

9. H.R. REP. No. 1884, 89th Cong., 2d Sess. (1966), 1966-2 CUM. BULL. 815, 816.

upon a finding of choateness and requires no notice or filing to acquire its superior priority.[10]

B. *Evolution of the Superpriority*

Groundwork for the formulation of specific superpriorities was laid in the Revenue Act of 1928[11] when Congress approved a preferred status for a mortgagee, pledgee or purchaser of a security. The same provision was recodified in the Internal Revenue Code of 1954[12] and restated in the FTLA,[13] appearing in that form in the present Code. The prerequisites to this initial superpriority status were the giving of adequate and full consideration in money or money's worth without actual notice or knowledge of the tax lien by the person acquiring the property.[14] In 1964, Congress added to this first superpriority the purchasers of motor vehicles, again with the same prerequisites.[15]

Despite the formulation and application of the concept of superpriorities, litigation involving competing lien interests continued to crowd court dockets, including the United States Supreme Court.[16] With the passage of the FTLA by Congress, the volume of litigation has declined significantly.[17] The resulting list of superpriorities included eight new categories designed both to reflect current Internal Revenue Service collection and assessment procedures and to recognize the realities of changes in commercial law.[18]

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10. INT. REV. CODE OF 1954, § 6323(b). In contrast, prior to the enactment of the FTLA, if the interest was not specific and perfected there was no priority superior to the tax lien, even though the interest arose prior to the tax lien.

11. Revenue Act of 1928, ch. 852, § 613, 45 Stat. 875 (originally codified at Int. Rev. Code of 1939, ch. 289, § 3672, 53 Stat. 449 (now INT. REV. CODE OF 1954, § 6323(b))).

12. Internal Revenue Code of 1954, ch. 64, § 6323(a), 68A Stat. 779, *as amended*, INT. REV. CODE OF 1954, § 6323(b)(1).

13. FTLA § 101(a), INT. REV. CODE OF 1954, § 6323(b)(1).

14. Revenue Act of 1928, ch. 852, § 613, 45 Stat. 875.

15. Revenue Act of 1964, Pub. L. No. 88-272, §§ 236(c)(1), (d), 78 Stat. 127.

16. Report of Committee on Relative Priority of Government and Private Liens, 3 ABA REAL PROPERTY, PROBATE AND TRUST SECTION 210 (1968).

17. *Id.*

18. An excellent compilation of the history of the legislation was prepared by the Staff of the Ways and Means Committee and is reported in STAFF OF THE COMMITTEE ON WAYS AND MEANS, LEGISLATIVE HISTORY OF H.R. 11256, 89TH CONG., 2D SESS. (Comm. Print 1966).

III. Superpriority—A Dissection

Each superpriority can be dissected into several elements: (1) The interest protected, and its various forms, (2) the owner of the interest, and (3) the requisite scienter.[19] Generally, the interest selected for protection by Congress recognizes a realignment of priorities to give protection to elementary commercial transactions where the owner of the interest cannot reasonably be expected to have knowledge of the tax lien. Of course, knowledge of the tax lien would be expected to defeat the superpriority, but even this condition has exceptions.

A. *The Interests Protected*

1. *Securities*

Under certain conditions a security or a security interest in a security is protected by the Internal Revenue Code even though encumbered with a tax lien.[20]

Security is broadly defined to include capital-garnering mechanisms—regardless of form—as well as negotiable instruments and money.[21] The Internal Revenue Code does not specifically define negotiable instruments and money. However, since the FTLA was intended to recognize the realities of commercial transactions, one would expect the courts to adopt the Uniform Commercial Code definitions.[22]

The priority given to securities is undoubtedly a reflection of the liquidity value and negotiability of these instruments. A security might very well change hands numerous times despite the existence of a tax lien. Because no adequate system has been developed to give effective notice of the existence of the tax lien, the person holding the security may be several transactions removed from the delinquent taxpayer and, as a result, be without an adequate remedy.

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19. *See* Appendix.

20. Int. Rev. Code of 1954, § 6323(b)(1).

21. *Id.* § 6323(h)(4).

22. Wash. Rev. Code § 62A.1-201(24) (1974): "'Money' means a medium of exchange authorized or adopted by a domestic or foreign government as a part of its currency." *Id.* § 62A.3-104(1):

> any writing to be a negotiable instrument within this Article must be signed by the maker or drawer; and contain an unconditional promise or order to pay a sum certain . . . [without any other condition or promise]; and be payable on demand or at a definite time; and be payable to order or to bearer.

Case law has refined the definition of a security by weeding out devices which essentially are not freely negotiable. Various courts have held a security would not include any of the following: a commercial banking account,[23] an insurance policy,[24] a contractor's certified invoice,[25] an assignment of the equity in a note,[26] a dealer's reserve account,[27] or a letter authorizing a bank to pay an attorney out of the proceeds of insurance deposited.[28] On the other hand, a passbook savings account has been held to be a security.[29]

The umbrella of the superpriority which protects securities also includes the *security interest* in a security. The Internal Revenue Code defines a security interest as a commercial relationship involving a contract to secure payment for an obligation or to indemnify against loss or liability.[30] A security interest is recognized if the holder has given a valuable consideration and if the interest has been so far perfected under local law that a subsequent lien arising out of an unsecured obligation cannot defeat it.[31] For example, a loan secured by stock in a corporation would constitute a security interest in a security and meet the requirements of superpriority status if acquired for a valuable consideration. But this is so only if the holder took without notice or knowledge of the tax lien, and was so far perfected under local law that a subsequent lien arising out of an unsecured obligation could not defeat his security interest.

2. *Motor Vehicles*

A purchaser of a motor vehicle takes priority over a prior recorded tax lien if the purchaser did not have actual notice or knowledge of the lien. In addition, the purchaser must take possession of the vehicle and not relinquish it to the seller under any circumstances.[32]

23. United States v. Asher, 54-2 U.S. Tax Cas. ¶ 9454 (S.D. Cal. 1954).

24. United States v. Royce Shoe Co., 137 F. Supp. 786 (D.N.H. 1956).

25. Iron & Glass Dollar Sav. Bank v. Siesal Constr. Co., 52 Am. Fed. Tax R. 1474 (C.P. Allegheny Co., Pa. 1957).

26. Big Farm Tire Corp. v. Boland, 6 Am. Fed. Tax R.2d 5104 (E.D. Va. 1960).

27. Worley v. United States, 340 F.2d 500 (9th Cir. 1965).

28. United States v. First Nat'l Bank, 458 F.2d 560 (6th Cir. 1972).

29. Deak v. The Morris Plan Co., 51 Am. Fed. Tax R. 1396 (S.D. Cal. 1956). The account represented a trust account created by the taxpayer for the benefit of a third party. The account was secured by the passbook and consequently identified as security by the court.

30. INT. REV. CODE OF 1954, § 6323(h)(1).

31. *Id.*

32. *Id.* § 6323(b)(2).

There are no recorded decisions interpreting the applicable statutory definition "a self propelled vehicle which is registered for highway use under the laws of any State or foreign country."[33] The parameters of the definition conceivably extend from a motor bike to a motorized home to the largest diesel truck—as long as there exists a license for use on public highways.

3. Personal Property

The last three statutory superpriorities addressed in this Comment cover the broad category of tangible personal property subject to ownership and not characterized as real estate. There is no significant limitation on the kind of personal property involved. Rather, the special status arises by reason of the transaction. Those transactions protected involve certain retail and casual sale purchases and possessory liens.[34] Protected retail purchases include all forms of tangible personal property.[35] Casual sales—those which might be initiated through a newspaper "want ad" or garage sale—are limited to personal property exempted from levy by the Code,[36] but only if purchased for less than $250 and not the subject of resale.[37] A possessory lien arises in tangible personal property which has been repaired or improved by the person asserting the superpriority status.

The impracticality of pursuing retail and casual sale purchasers was the primary reason for giving superpriority status to these types of transactions. Long ago the Service ascertained that pursuit in these cases was uneconomical, if not impossible, because of the small value of the item, the difficulty in tracing the sales, and the low resale value.[38] Also, Congress indicated in reporting on these transactions that the protection for retail

33. *Id.* § 6323(h)(3).

34. *Id.* § 6323(b)(3).

35. *Id.*

36. *Id.* § 6334(a). Exempt property includes necessary wearing apparel and school books, fuel, provisions and personal effects up to $500, books or tools of a trade or profession up to $250, unemployment benefits, undelivered mail, certain annuity and pension benefits accorded "immunity" under federal law, workmen's compensation, and salary, wages or other income committed by court order to the support of minor children.

37. *Id.* § 6323(b)(4).

38. S. REP. No. 1708, 89th Cong., 2d Sess. (1966), 1966-2 CUM. BULL. 876, 878-79.

and casual sales purchases of personal property was not intended to mandate pursuit of those transactions falling outside the definition.[39] Congress intended that the Service should exercise its discretion in determining which transactions were beyond the statutorily permissible limits and thus subject to the federal tax lien.[40]

The nature of the personal property which gives rise to a possessory lien is not altogether different from the personal property involved in a retail purchase. The key to establishing the superpriority is whether or not the personal property in question is "subject to a lien under local law securing the reasonable price of the repair or improvement of such property . . . ."[41] For example, a possessory lien would arise in the repair of an automobile.[42]

B. *Owner of the Interest*

1. *Purchaser*

The bona fide purchaser was a key concern of the proponents of the Federal Tax Lien Act of 1966.[43] Consequently, four of the 10 superpriorities enumerated in the Code offer protection to the purchaser, including the purchaser of securities, motor vehicles, tangible personal property purchased at retail, and certain personal property purchased at a casual sale.[44]

Prior to the FTLA, the innocent and unsuspecting purchaser had the most to lose. He could purchase property from a delinquent taxpayer whose property was subject to a tax lien, only to find out after his purchase that it could be confiscated by the Service to satisfy the seller's lien. In effect, the purchaser was potentially the financier of his seller's delinquent taxes.

39. *Id.*

40. *Id.* The Committee saw no reason to have potential liability threatening a purchaser, since the Service was not using the authority it had. The Committee did recognize that a series of sales represented a potential for abuse to the detriment of the assessment and collection process; such sales were believed to be used primarily by persons with credit problems, and thus the purpose of such sales was self-evident to the public.

41. INT. REV. CODE OF 1954, § 6323(b)(5).

42. *See* discussion in Section III B 3 *infra*.

43. *See, e.g.*, H.R. REP. No. 1884, 89th Cong., 2d Sess. (1966), 1966-2 CUM. BULL. 815, 817.

44. INT. REV. CODE OF 1954, §§ 6323(b)(1)-(4). *See* Appendix.

The status of a bona fide purchaser is now determined by the value of consideration given to acquire the interest in property.[45] Prior to the FTLA, it was held that, while the consideration given by a purchaser could not be nominal, it could be so small as to have little relation to the value of the property acquired.[46] Congress wanted to avoid this result. Reflecting this congressional concern, the FTLA defined a purchaser as:

> a person who, for adequate and full consideration in money or money's worth, acquires an interest other than a lien or security interest in property which is valid under local law against subsequent purchasers without actual notice.[47]

The scope of the definition was intended to preclude neither a bona fide bargain purchaser,[48] nor a purchaser who has completed performance of his obligation (*e.g.*, completion of installment payments).[49] The statute indicates, however, that the consideration will be measured by its intrinsic value and that the value of the property sold will be measured by its market value.[50]

Litigation before and after the FTLA adds a measure of certainty to the statutory definition of purchaser. The cases interpreting the term follow three theories.

First, purchaser status is generally not recognized where the consideration given does not coincide with the receipt of the property interest. Thus, the courts have concluded that purchaser status is not achieved in the following circumstances: Where an assignment was based on past due consideration;[51] where a security interest is acquired to secure a pre-existing

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45. INT. REV. CODE OF 1954, § 6323(h)(6).

46. Enochs v. Smith, 359 F.2d 924 (5th Cir. 1966).

47. FTLA § 101(a), INT. REV. CODE OF 1954; § 6323(h)(6).

48. *Cf.* United States v. Scovil, 348 U.S. 218, 221 (1955). The Senate Report on the FTLA emphasized that it was not the intention of Congress to preclude the bargain purchaser, but rather to prevent abuse. S. REP. No. 1708, 89th Cong., 2d Sess. (1966), 1966-2 CUM. BULL. 876, 885.

49. S. REP. No. 1708, 89th Cong., 2d Sess. (1966), 1966-2 CUM. BULL. 876, 885. The types of transactions which Congress specifically included as fulfilling the requirement of a bona fide purchaser are: (1) One who has acquired a lease of property; (2) an executory contract to purchase; (3) an option to purchase or lease property or an interest therein; and, (4) an option to renew or extend a lease on property if the interest acquired is not a lien or a security interest. INT. REV. CODE OF 1954, § 6323(h)(6).

50. FTLA § 101(a), INT. REV. CODE OF 1954, § 6323(h)(6).

51. Filipowicz v. Rothensies, 43 F. Supp. 619 (E.D. Pa. 1942).

loan;[52] where a mechanics'[53] or materialmen's[54] lien is foreclosed; or where an assignee has not perfected his interest.[55]

Second, a person may be denied the status of bona fide purchaser because he has failed to give adequate and full consideration. In *Fritz v. United States*[56] a taxpayer agreed to assign to his wife certain monies due from his employer in return for a release from a writ of *ne exeat*. The court held that the assignment did not constitute adequate and full consideration and denied the wife the status of a protected purchaser.[57] In *Coventry Care, Inc. v. United States*,[58] the court concluded that a corporation which gave a 25 percent interest in a business venture in return for an assignment of a promissory note was not a purchaser and was not entitled to superpriority status because the interest given had no value. The court's conclusion was based on the fact that the venture was only anticipatory, was not implemented in a legal form (incorporation or partnership) in writing, and hence was only executory.[59]

Finally, federal courts have also refused to accord a party purchaser status merely because there is a state law defining a party to a particular transaction as a purchaser.[60] The reason for this conclusion is simple enough. If states could determine who was covered under the superpriority statute, the federal government would lose control of the class to be protected and states would ultimately be able to override the intended effect of the federal legislation.

2. *Holder of a Security Interest*

The holder of a security interest gains superpriority status only when the interest is in a security. This is not to say that the only holder of a security interest entitled to preference over

52. Faddis v. Schobert, 45 Am. Fed. Tax R. 1227 (D. Utah 1953).

53. United States v. King County Iron Works, 224 F.2d 232 (2d Cir. 1955).

54. Union Bldg. & Inv. Co. v. Forest Hills Apt., Inc., 30 N.J. Super. 130, 103 A.2d 648 (1954).

55. United States v. Parks Constr. Co., 6 Am. Fed. Tax R.2d 5569 (N.D. Iowa 1960).

56. 328 F. Supp. 1343 (D. Minn. 1971).

57. *Id.* at 1345-46.

58. 366 F. Supp. 497 (W.D. Pa. 1973).

59. *Id.* at 501-02.

60. United States v. Hoper, 242 F.2d 468 (7th Cir. 1957) (beneficiaries receiving proceeds of life insurance defined as purchasers under state law); United States v. Hawkins, 228 F.2d 517, 519 (9th Cir. 1955) (attaching lienor described as purchaser by state law).

a tax lien is the holder of a security interest in a security. The Code also recognizes the security interest which is perfected prior to the tax lien,[61] as did case law under the former doctrine of choateness. However, these other possibilities do not acquire the same absolute right accorded the holder of a security interest in a security.[62]

The terminology "holder of a security interest" replaces the pre-FTLA statutory terms "pledgee" and "mortgagee."[63] It also broadens the scope of application of the concept of a "holder." Pledgees and mortgagees were special classes against which a notice of tax lien had to be filed in order for the lien to be valid. The FTLA extends protection to any holder of a security interest in a security where valuable consideration is given and local law recognizes the priority of the interest over subsequent judgment liens arising out of unsecured obligations.[64]

3. Holder of a Possessory Lien

A special superpriority has been carved out for the holder of a possessory lien.[65] The caveat is that the holder must be in continuous possession of the property from the time the lien arises. In addition, local law must recognize the lien.

The "holder of a possessory lien" must be distinguished from the Code's definition of a mechanics' lienor.[66] The practitioner should be alert to the distinction between section 6323(b)(5), which gives absolute priority to a possessory lien on personal property, and section 6323(a), which applies to a mechanics' lien attaching to real property. The section 6323(b)(5) lien attaches pursuant to repair or improvement of tangible personal property regardless of whether the holder has knowledge of the tax lien. On the other hand, the section 6323(a) lien refers to a mechanics' lien attaching to real property and must

61. INT. REV. CODE OF 1954, § 6323(c).

62. *Compare id.* § 6323(b) (superpriorities) *with id.* § 6323(c) ("limited" superpriorities).

63. *Compare* 26 U.S.C. § 6323(a) (1964), *as amended*, INT. REV. CODE OF 1954, § 6323(a), *with* FTLA § 101(a), INT. REV. CODE OF 1954, § 6323(b)(1)(B). *See also* S. REP. No. 1708, 89th Cong., 2d Sess. (1966), 1966-2 CUM. BULL. 876, 877.

64. FTLA § 101(a), INT. REV. CODE OF 1954, § 6323(h)(1).

65. INT. REV. CODE OF 1954, § 6323(b)(5).

66. *Id.* § 6323(h)(2).

be perfected in accordance with local law prior to the filing of the tax lien[67] in order for the lien to be accorded priority.

Citizen's Co-Op Gin v. United States[68] is the only reported case interpreting the position of a holder of a possessory lien. The taxpayer, a cotton farmer, was given notice that a tax lien was filed. There was no attempt by the Service to levy on the taxpayer's farming operation. The taxpayer continued the operation of the farm, purchasing seed, planting, fertilizing and cultivating the crop. When the crop matured, the taxpayer contracted out the harvest operation, as was the custom. Citizen's Co-Op, the gin, received the cotton in the contractor's name, as was also the custom. After processing, the Co-Op delivered the cotton to a warehouse and received negotiable warehouse receipts in return. The Service levied on the warehouse receipts to satisfy the tax lien. The district court held that the Government's tax lien was subject to the lien of Citizen's Co-Op and its predecessors-in-interest.[69] The Fifth Circuit Court of Appeals affirmed on this point, and with reference to the congressional reports, reasoned that the purpose of the statute was to protect those who add value to the Government tax lien by repairing or improving the encumbered property at their own expense and who could not be expected to search for tax liens at the place of recording.[70] The court found in this case that value had been added and that possession was continuous even though possession was not by one holder.[71] The court reasoned that improvement of the cotton required a chain of improvers and that possession by one was possession by all, so long as those in the chain intended to withhold the property until improvement charges against the property were satisfied. The court concluded that for purposes of construing the statute the warehouse receipts were symbolic of and equivalent to possession. This equitable lien was sufficient to meet the requirements for recognition under local law, thereby giving it priority over the federal tax lien.[72]

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67. *Id.* § 6323(f).

68. 300 F. Supp. 1193 (N.D. Tex. 1969), *remanded on other grounds*, 427 F.2d 692 (5th Cir. 1970).

69. 300 F. Supp. at 1195.

70. 427 F.2d at 695.

71. *Id.* at 696.

72. *Id.*

The Code establishes continuous possession as the key element of the possessory lien superpriority.[73] The holder cannot relinquish control and then reacquire the preferred status.

The issue of possession is particularly relevant to the Washington State practitioner. The Washington statute does not require continuous possession to perfect an interest in property.[74] A client may have a perfected interest and therefore priority according to Washington law, but his lien may fail against a competing federal tax lien because a possessory lien in Washington is perfected by filing a notice of lien with the county auditor,[75] and not by retaining possession as federal law requires. Consequently, if possession is relinquished, the lien holder would lose his superpriority protection.

C. *The Scienter Requirement*

The scienter (or lack thereof) necessary to establish a superpriority varies from the requirement that the interested party have no notice to his having no "actual notice or knowledge." The variations can best be explained by the nature of the transactions and the congressional protection intended.

1. *Actual Notice or Knowledge*

The adoption by Congress of the "actual notice or knowledge" requirement[76] coincides with the standard of the Uniform Commercial Code, adopted by Washington State.[77] The Uniform Commercial Code follows the "white heart theory" or subjective test of actual notice, even though it speaks in terms of "commercial reasonableness," which sounds of the objective or prudent man test.[78] This means that the purchaser is not held liable for what he should have known, but rather for what he in fact did know. In other words, notice must be actual and

73. INT. REV. CODE OF 1954, § 6323(b)(6).

74. WASH. REV. CODE §§ 60.08.010 *et. seq.* (1974). The Washington statute authorizes a lien to any person, firm or corporation that furnishes material in the construction or repair of any chattel at the request of the owner notwithstanding surrender of the chattel after completion of the work. A notice must be filed with the county auditor within 60 days of delivery of the chattel to the owner. The lienor must then foreclose on his lien within 9 months of the filing. The lien is not good against a good faith purchaser for value without actual notice of the lien.

75. *Id.*

76. S. REP. No. 1708, 89th Cong., 2d Sess. (1966), 1966-2 CUM. BULL. 876, 885.

77. WASH. REV. CODE § 62A.1-201(25) (1974).

78. *Id.*

not constructive. Therefore, filing a federal tax lien does not constitute "actual notice" unless the owner of the interest protected is actually aware of the lien. Otherwise, it is constructive notice, even though there was an intent to put the whole world on notice. Consequently, superpriority inures to the benefit of a purchaser despite a federal tax lien being on file, so long as the purchaser does not have actual notice or knowledge of the filing. Congress adopted the more demanding requirement of actual notice so that the Service would carry the burden of proof.[79]

In *United States v. Peoples Bank*[80] the Service claimed it had given notice to a bank teller when an agent called requesting information concerning a delinquent taxpayer's accounts. Even though this conversation prompted an alert bank officer to take action to protect an outstanding loan in anticipation of a tax lien, the court concluded that the telephone notice was not explicit as to the existence of a tax lien and thus did not constitute the requisite notice or knowledge contemplated by the Code.[81]

In contrast, an attorney who received a car from his client as payment of his fee was deemed to have knowledge of the federal tax lien because he was present with his client when a revenue agent explained to the taxpayer that a tax lien would be filed against his property.[82] The court declared that the Code requires only actual notice or knowledge of the existence of the lien, and not the formalities of filing.

The notice or knowledge requirement of the FTLA does not impose a duty to search for tax liens. The statute was "in part an attempt to conform the lien provisions of the internal revenue laws to the concepts developed in [the] Uniform Commercial Code."[83]

The actual notice or knowledge requirement imposes a duty of due diligence when an organization is seeking protection under the superpriority statute. In the language of the Code:

79. S. REP. No. 1708, 89th Cong., 2d Sess. (1966), 1966-2 CUM. BULL. 876, 885.
80. 375 F. Supp. 342 (E.D. Va. 1974).
81. *Id.* at 344.
82. Gallup v. United States, 358 F. Supp. 776 (D. Neb. 1973).
83. S. REP. No. 1708, 89th Cong., 2d Sess. (1966), 1966-2 CUM. BULL. 876.

> [A]n organization shall be deemed for purposes of a particular transaction to have actual notice or knowledge of any fact from the time such fact is brought to the attention of the individual conducting such transaction, and in any event from the time such fact would have been brought to such individual's attention if the organization had exercised due diligence. An organization exercises due diligence if it maintains reasonable routines for communicating significant information to the person conducting the transaction and there is reasonable compliance with the routines. Due diligence does not require an individual acting for the organization to communicate information unless such communication is part of his regular duties or unless he has reason to know of the transaction and that the transaction would be materially affected by the information.[84]

An organization is required by the statute to establish and maintain with reasonable diligence a communication system for the disbursement of information needed for the proper conducting of its business. This prevents the employer and its employees from claiming no knowledge or forgotten knowledge. The duty is the same as that imposed by the Uniform Commercial Code as adopted in Washington.[85]

This principle is illustrated in *United States v. Swan*,[86] a Fifth Circuit case in which a California bank inadvertently accepted for deposit a trust fund warrant drawn on a Texas bank which lacked the endorsement of a co-payee. The deposit was subsequently withdrawn. The missing signature belonged to an attorney for the estate, who had had his name placed on the check by the clerk of the court without court approval, but for the purpose of insuring that the taxes of the estate were paid. The court held that the bank failed to exercise due diligence upon acceptance of the check because it failed to obtain the essential endorsements and therefore failed to derive the benefit of the superpriority conferred by the Internal Revenue Code.

The requirement of having no actual notice or knowledge is a prerequisite in three of the five superpriorities addressed in this Comment, including: (1) The purchaser or holder of a security interest in a security, as well as the security itself; (2) the purchaser of a motor vehicle; and, (3) the purchaser of personal property at casual sale.[87]

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84. INT. REV. CODE OF 1954, § 6323(i)(1).
85. WASH. REV. CODE § 62A.1-201(27) (1974).
86. 441 F.2d 1082 (5th Cir. 1971).
87. INT. REV. CODE OF 1954, §§ 6323(b)(1)-(3). *See* Appendix.

2. Interference with the Collection of the Tax

The standard of scienter imposed upon a retail purchaser of tangible personal property in order to acquire the preferred status is a lesser one than "actual notice or knowledge." The purchaser might have knowledge of the tax lien, but so long as his actions do not hinder, evade or defeat the collection of the tax, his purchase is protected.[88] What constitutes this degree of interference has not been the subject of any litigation. The difference between what is "actual notice or knowledge" and "hinder, evade or defeat" may be a fine line. The lesser standard of scienter seems to require an intent to interfere, with knowledge that the transaction will impede collection.

3. No Scienter Requirement

A possessory lien has an unusual preference in the statutory scheme. Congress recognized that even where a tax lien was filed against a delinquent taxpayer's property, it was to the Government's advantage to allow the property to be kept in good repair.[89] Therefore, even where a repairman knows there is a tax lien against the property he may proceed with his repair and still be reimbursed because he has preserved or improved the property value, which ultimately inures to the benefit of the Government. The sole limitation is that the lienor maintain continuous possession; if this requirement is met, the lienor's perfection is good for the reasonable price of the repair or improvement.[90]

IV. CONCLUSION

The passage of the FTLA culminated years of intensive research and lobbying by interested parties to bring about deserved reforms. It recognized longstanding state statutory privileges of necessity. More importantly, it recognized the inequity of imposing the collection burden on unsuspecting and innocent third parties who deal with delinquent taxpayers.

The five superpriorities considered in this Comment were enacted by Congress because of the impracticability of collection, or because of value added in preserving the Government's

88. INT. REV. CODE OF 1954, § 6323(b)(3).
89. S. REP. No. 1708, 89th Cong., 2d Sess. (1966), 1966-2 CUM. BULL. 876, 879.
90. *Id.*

interest, or to facilitate transfer or negotiability. Therefore, if a superpriority exists, the holder of the interest protected acquires an absolute right to priority over any prior or subsequent federal tax lien.

The priorities established by the FTLA have cost the federal government little in terms of revenue, but the savings to the courts are impressive. The legislation is directly responsible for the precipitous decline in tax litigation since 1967. Tax lien cases in the United States Supreme Court have been almost non-existent, and the burden on the lower courts has been substantially reduced.

Thomas F. Kingen

APPENDIX

SUPERPRIORITIES SCHEME OF INTERNAL REVENUE CODE OF 1954, §§ 6323(b)(1)-(5)

Interest Protected	Form of Nature of Interest Protected	Owner of the Interest	Scienter Requirement
Securities	Security Negotiable Instrument Money	Purchaser	No Actual Notice or Knowledge of Tax Lien
	Security Interest in a Security	Holder of Security Interest	
Motor Vehicle	Motor Vehicle Licensed for Use on Public Roadways	Purchaser	No Actual Notice or Knowledge of Tax Lien
Personal Property	Tangible Personal Property Purchased at Retail	Purchaser	No Intent to Hinder, Evade or Defeat Collection of Tax
Personal Property	Property Subject to Exemption in § 6334 Purchased at Casual Sale	Purchaser	No Actual Notice or Knowledge of Tax Lien
Personal Property	Possessory Lien on Tangible Personal Property	Holder in Continuous Possession	None