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Bankruptcy - Priority of Unrecorded Federal Tax Lien - Rights of Trustee in Bankruptcy

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and only in the former case did the court expressly cite section 242 of the *Restatement*.[39]

In the case at bar, the Illinois Supreme Court clearly followed the overwhelming majority of American jurisdictions by relieving the master of liability to a third person injured while a passenger on the master's vehicle at the unauthorized invitation of a servant. However, by adopting the *Restatement* rule and its rationale, the court went one step further by denying recovery on the theory that plaintiff had forfeited her claim against the master by accepting the invitation of the servant. The effect of this decision cannot be underestimated, for clearly it has rendered obsolete in Illinois those key factors previously accepted by our courts in determining the master's liability. No longer will inquiry be made as to whether there is evidence of wilful and wanton misconduct, or whether the accident occurred within the course of employment. The break with the past is clear. It remains now to be seen whether other jurisdictions will follow the example of Illinois and Kansas, the only two jurisdictions which expressly recognize the section as controlling authority.

Robert Williams

[39] In this regard, it will be noted that the Supreme Court of Illinois, in Klatt v. Commonwealth Edison Co., 33 Ill. 2d 481, 211 N.E.2d 720 (1965), cited only Union Gas & Electric Co. v. Crouch, *supra* note 30, Mayhew v. De Coursey, *supra* note 31, and the Reporter's Notes to the *Restatement*.

BANKRUPTCY–PRIORITY OF UNRECORDED FEDERAL TAX LIEN–RIGHTS OF TRUSTEE IN BANKRUPTCY

On June 3, 1960, the District Director of Internal Revenue assessed some $14,000 in withholding taxes and interest against the Kurtz Roofing Company. Kurtz refused to pay upon demand, thereby giving rise to a federal tax lien.[1] On June 20, 1960, Kurtz filed a petition in bankruptcy, but as of this date no notice of the federal tax lien had yet been filed by the government. The trustee in bankruptcy contended that his status was one of a

[1] INT. REV. CODE OF 1954, § 6321 provides: "If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount . . . shall be a lien in favor of the United States upon all property and rights to property, whether real or personal, belonging to such person." INT. REV. CODE OF 1954, § 6322 provides: ". . . the lien imposed by section 6321 shall arise at the time the assessment is made . . ." In addition to property owned at the time of attachment, the lien also attaches to all after-acquired property of the taxpayer while it subsists. Salsbury Motors, Inc. v. United States, 210 F.2d 171 (9th Cir. 1954), *cert. denied*, 347 U.S. 953 (1954). However, the Collector's rights are limited to those of the taxpayer in the property. Shaw v. United States, 331 F.2d 493 (9th Cir. 1964).

"judgment creditor" under the Bankruptcy Act,[2] and as such, would prevail over an unrecorded federal tax lien.[3] The District Court upheld the contention of the trustee and this decision was affirmed by the Sixth Circuit Court of Appeals.[4] Certiorari was granted by the United States Supreme Court, which likewise affirmed. *United States v. Speers*, 86 Sup. Ct. 411 (1965).

Did Congress give the trustee in bankruptcy the rights of a judgment creditor as that term is used in the Internal Revenue Code? This is the critical question presented in the *Speers* case. The Court's resolution of this question in favor of the trustee subordinates the unrecorded federal tax lien to a fourth-ranked unsecured priority claim in bankruptcy[5] and reverses a growing tide of courts of appeal cases giving the government priority irrespective of the lack of recording.[6] Certiorari was granted in the *Speers* case to reconcile the conflict between these decisions and the holding of the Sixth Circuit below.[7] In the ensuing paragraphs an analysis is presented of the reasoning behind the holdings of the courts of appeal[8]

[2] Bankruptcy Act, § 70(c), 66 Stat 430 (1952), 11 U.S.C. § 110(c) (1964), providing in part: "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 the 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."

[3] INT. REV. CODE OF 1954, § 6323 providing in part: "(a) . . . 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 . . ." Aside from the position of one of the protected parties under § 6323, there are generally two other means of defeating the federal tax lien. Prior perfected liens take precedence over the tax lien under the federal rule of first-in-time is first-in-right. United States v. Roessling, 280 F.2d 933 (5th Cir. 1960). Secondly, the property is not that of the taxpayer at all. United States v. Kings County Iron Works, 224 F.2d 232 (2nd Cir. 1955).

[4] United States v. Speers, 335 F.2d 311 (6th Cir. 1964), *cert. granted*, 379 U.S. 958 (1965). The District Court opinion for the Northern District of Ohio is unreported.

[5] Bankruptcy Act § 64(a)(4), 52 Stat. 874 (1952), 11 U.S.C. § 104(a)(4) (1964). Section 64(a) gives priority to certain unsecured claims as follows: "1) administrative expenses, 2) wages, 3) certain creditors' expenses, 4) *taxes owing by the bankrupt to the United States or any State*, 5) other enumerated debts of the bankrupt." (Emphasis added.) Secured creditors (the position sought by the United States in *Speers*) have recourse to their security before any of the Bankruptcy Act priorities come into play. Goggin v. Division of Labor Law Enforcement of California, 336 U.S. 118 (1949).

[6] Brust v. Sturr, 237 F.2d 135 (2d Cir. 1956); *In re* Fidelity Tube Corporation, 278 F.2d 776 (3rd Cir. 1960), *cert. denied sub nom.*, Borough of East Newark v. United States, 364 U.S. 828 (1960); Simonson v. Granquist, 287 F.2d 489 (9th Cir. 1961). See also, United States v. England, 226 F.2d 205 (9th Cir. 1955). Likewise, federal district courts: *In re* Estrada's Market, 222 F. Supp. 253 (D.C.S.D. Cal. 1963); Matter of Green, 124 F. Supp. 481 (D.C.N.D. Ala. 1954).

[7] See *supra* note 4.

[8] Cases cited *supra* note 6.

and their reversal in the instant case. Additionally, the possible impact of the *Speers* holding in the bankruptcy field is explored.

In placing the unrecorded tax lien prior to the trustee's claim, the Second, Third, and Ninth Circuits[9] grounded their decisions principally on one or more of the following three arguments: that the trustee's artificial creditor status arising from the Bankruptcy Act did not entitle him to the notice-filing protection afforded the judgment creditor under the Internal Revenue Code, because the term "judgment creditor" has been construed by the Supreme Court in *United States v. Gilbert Associates*[10] in the conventional sense to mean one holding a judgment rendered in a court of record; secondly, that the language of the 1950 amendment to the Bankruptcy Act[11] is properly interpreted to exclude judgment creditor rights;[12] and thirdly, that Congressional intent to give the United States Government maximum assistance in collecting revenues was embodied in the tax lien laws.[13] Mr. Justice Fortas, speaking on behalf of the Supreme Court in the instant case, considered and then rejected each of these arguments.

The controlling effect of the *Gilbert*[14] case, which was heavily relied upon by all of the opposing courts of appeal, was done away with by a factual distinction. *Gilbert* did not involve bankruptcy or the rights of a trustee in bankruptcy, but rather a state insolvency proceeding. The town of Walpole, New Hampshire, sought priority of its assessed ad valorem

[9] *Ibid.*

[10] 345 U.S. 361 (1953), which interpreted the term "judgment creditor" under INT. REV. CODE OF 1939, § 3672, the predecessor of INT. REV. CODE OF 1954, § 6323. The Supreme Court, in the *Gilbert* case, cited the concurring opinion of Mr. Justice Jackson in United States v. Security Trust and Savings Bank, 340 U.S. 47 (1950) at 51 and 52, wherein Justice Jackson reviews the history of the tax lien statute and indicates that "only a judgment creditor in the conventional sense" is protected. The *Gilbert* decision was relied upon by all of the circuits opposing the position of the instant case. See cases cited *supra* note 6.

[11] The 1950 amendment to the Bankruptcy Act, § 70(c), 64 Stat. 26 (1950), 11 U.S.C. § 110(c) (1964) eliminated any reference to "judgment creditor" status for the trustee and gave him all the "rights, remedies and powers" of a creditor holding a lien acquired "by legal or equitable proceedings" as to all property in which the bankrupt has an interest whether or not the property is in the court's possession. The amended statute, 52 Stat. 881 (1938), provided in pertinent part: "The trustee, as to all property in the possession or under the control of the bankruptcy . . . shall be deemed vested . . . with all the rights, remedies, and powers or a creditor then holding a lien thereon by legal or equitable proceedings . . . and, as to all other property, the trustee shall be deemed vested . . . with all the rights, remedies, and powers of a judgment creditor then holding an execution duly returned unsatisfied. . . ."

[12] *In re* Fidelity Tube Corporation, *supra* note 6 at 781–82.

[13] *Id.* at 778. Maximum assistance, as indicated by the holding of the Third Circuit in the *Fidelity Tube* case, means giving the government secured creditor status in bankruptcy.

[14] See *supra* note 10.

tax lien over the federal government's unrecorded tax lien in the proceeds of the sale of the insolvent's assets in the hands of the state appointed receiver. Under New Hampshire law, the municipal tax assessment is "in the nature of a judgment."[15] The municipality, as a judgment creditor, claimed the protection of notice-filing owed by the federal government to a judgment creditor under the Internal Revenue Code.[16] The Supreme Court rejected the municipality's argument, saying that although the Court could not question New Hampshire's determination of the effect of its municipal tax assessments internally, "the meaning of a federal statute is for this Court to decide."[17] The Court went on to say:

> A cardinal principle of Congress in its tax scheme is uniformity, as far as may be. Therefore, a "judgment creditor" should have the same application in all states. In this instance, we think Congress used the words "judgment creditor" in § 3672 in the usual, conventional sense of a judgment of a court of record, since all states have such courts. We do not think Congress had in mind the action of taxing authorities who may be acting judicially as in New Hampshire and some other states, where the end result is something "in the nature of a judgment," while in other states the taxing authorities act quasijudicially and are considered administrative bodies.[18]

The Supreme Court in the *Speers* case pointed up the fact that the *Gilbert* interpretation of "judgment creditor" under the *Internal Revenue Code of 1939* was made in the light of the dominant need for uniformity in application of the federal tax lien law to varying state-constituted creditors. No such problem exists when we are concerned with the rights of a trustee in bankruptcy, because, by definition, the problem is limited to a construction of purely federal law.[19] Congress may give the trustee any powers it sees fit.

An analysis of Congressional intent in enacting section 70(c) of the Bankruptcy Act and amending it in 1950[20] revealed a desire to implicitly give the trustee in bankruptcy the rights, remedies, and powers of a judgment creditor, such being contrary to the holding of the Third Circuit.[21]

[15] *Id.* at 363.

[16] INT. REV. CODE OF 1939, § 3672 preceding INT. REV. CODE OF 1954, § 6323, the pertinent language of which is set out in *supra* note 3.

[17] United States v. Gilbert Associates, *supra* note 10 at 363.

[18] *Id.* at 364.

[19] United States v. Speers, 86 Sup. Ct. 411, 414 (1965).

[20] Bankruptcy Act, § 70(c), 64 Stat. 26 (1950), 11 U.S.C. § 110(c) (1964). Section 70(c) was reenacted in its present form (with slight additional amendment not affecting the present discussion) at 66 Stat. 430 (1952), 11 U.S.C. § 110(c) (1964) ultimately giving the trustee "all the rights, remedies, and powers" of a creditor holding a lien on the bankrupt's property, a lien acquired "by legal or equitable proceedings." See pertinent statutory language set out in note 2 supra.

[21] See *supra* note 12.

The judicial narrowing of the trustee's rights after the 1950 amendment and prior to the *Spears* case

> seem[s] to be due not so much to positive mistakes in drafting as to an omission to spell out explicitly what might be taken to be fairly implicit in the statute [in regard to the trustee's rights as a judgment creditor], particularly in light of its legislative history.[22]

Speaking generally as to the nature of the Bankruptcy Act, the Supreme Court said that "bankruptcy has the force and effect of the levy of an execution for the benefit of [general] creditors to insure an equitable distribution amongst them of the bankrupt's assets."[23] The enactment of section 47(a)(2) of the Bankruptcy Act,[24] which preceded section 70(c), was nothing more than a specific application of this guiding principle of equitable distribution. The law prior to section 47(a)(2) merely gave the trustee the ownership rights of the bankrupt in the bankrupt's property, subject to all liens, secret or otherwise, of any creditor. By making the owner-trustee a judgment creditor as of the date of bankruptcy under section 47(a)(2), Congress sought to protect the general creditors (whom the trustee represents) from the evils of secret liens that had priority under former law.[25] Enactment of section 70(c) in substantially the same language continued this protection.[26]

The 1950 amendment to section 70(c) deleted any reference to "judgment creditor" rights that the trustee had regarding property not in the court's possession under the 1938 version. The revised statute gives the trustee all the rights, remedies, and powers of a creditor holding a lien by legal or equitable proceedings as to all of the bankrupt's property. As pre-

[22] MacLachlan, *Secured and Prior Claims in Bankruptcy, H.R. 5195 to Amend the Bankruptcy Act, a Comment*, 13 Bus. Law. 128, 134 (1957). Congressional concern over the narrow meaning attached to § 70(c) of the Bankruptcy Act by the courts of appeal brought a number of proposed amendments to reiterate the trustee's judgment creditor rights. One such bill, H.R. 5195, 85th Cong., 1st Sess. (1957), is set out in MacLachlan, *id* at 136, n. 12. See United States v. Speers, 86 Sup. Ct. 411, 416, n. 16 (1965).

[23] Myers v. Matley, 318 U.S. 622, 627 (1943).

[24] Act of June 25, 1910, ch. 412, § 47(a)(2), 36 Stat. 838, 840 § 8 providing in part: ". . . and such trustees, as to all property in the custody or coming into *the custody of the bankruptcy court*, shall be deemed vested with all the *rights, remedies, and powers of a creditor holding a lien by equitable or legal proceedings thereon;* and also, as to all property *not in the custody* of the bankruptcy court, shall be deemed vested with all the *rights, remedies, and powers of a judgment creditor* holding an execution duly returned unsatisfied." (Emphasis added).

[25] 4 Collier, Bankruptcy ¶ 70.47 at 1389, n. 6 (14th ed. 1959). See also, United States v. Eiland, 223 F.2d 118 (4th Cir. 1955) (dictum).

[26] Bankruptcy Act, § 70(c), 52 Stat. 881 (1938), 11 U.S.C. § 110(c) (1964). See *supra* note 22 where-in the statute is set out, and 4 Collier, Bankruptcy ¶ 70.47 at 1392 (14th ed. 1959).

viously mentioned, the Third Circuit deemed the deleted "judgment creditor" language to mean a deletion of such rights.[27] Quite to the contrary, the House report accompanying the proposed amendment indicated an intent "to simplify, and to some extent expand, the general expression of the rights of the trustee in bankruptcy,"[28] and not to cut down his rights. It was felt that since a judgment creditor in some states does not have a lien on the debtor's property, the trustee would not be sufficiently protected with only judgment creditor rights. Thus, he was given the rights of a lien creditor which would include any lesser judgment creditor rights.[29]

Congressional policy to give the federal government maximum assistance in collection of revenues as indicated by the tax lien laws is not without limit. Prior to 1913, the federal tax lien did enjoy unmitigated priority.[30] In 1913 several exceptions to this unmitigated priority were engrafted on the tax lien due to the harsh conditions pointed up by *United States v. Snyder*.[31] This case held that a statutorily created federal tax lien was valid against a bona fide purchaser for value without knowledge or notice of such lien. The 1913 Congressional reaction to this decision gave mortgagees, purchasers and judgment creditors the protection of notice-filing on the part of the government before their claims could be subordinated to the statutory tax lien.[32] Significantly, this protection came three years after the trustee in bankruptcy was given judgment creditor rights.[33] The purpose of giving the trustee such rights was precisely to protect general creditors of the bankrupt from the evils of secret liens,[34] which coincides with the Congressional purpose in giving a judgment creditor protection from the government's own secret tax lien.

In summary, the *Gilbert* case was held to be inapplicable, the 1950 amendment was passed to expand the rights of the trustee to further pro-

[27] *Supra* note 12.

[28] H. R. REP. No. 1293, 81st Cong., 1st Sess. at 7 (1949). See also, Seligson, *Creditor's Rights*, 32 N.Y.U.L. REV. 708, 710 (1957).

[29] Sampsell v. Straub, 194 F.2d 228 (9th Cir. 1952), *cert. denied*, 343 U.S. 927 (1952). See 4 COLLIER, BANKRUPTCY ¶ 70.49 at 1415, n. 3c (14th ed. 1959).

[30] Kennedy, *The Relative Priority of the Federal Government. The Pernicious Career of the Inchoate and General Lien*, 63 YALE L. J. 905 (1954). For a discussion of cases pointing up the need for exception of unlimited federal priority, and notes indicating the history of statutorily engrafted exceptions growing out of these cases, see *id.* at 919–22.

[31] 149 U.S. 210 (1893). See Comment, 36 N.Y.U.L. REV. 1316, 1319–20 (1961).

[32] INT. REV. CODE OF 1913, § 3672, 37 Stat. 1016 (1913). See also, H. R. REP. No. 1018, 62d Cong., 2d Sess. at 2 (1912), accompanying this enactment, in which it is stated that a lien so comprehensive so as to cover all property anywhere imposes an impossible task of ascertaining whether the owner of property is behind in tax payments.

[33] See *supra* note 24.

[34] See *supra* note 25.

tect general creditors, and, in contemplation of the trustee's existing rights as a judgment creditor, the various exceptions to tax lien priority were enacted to give protection from the secret tax lien. The inescapable conclusion follows that the trustee in bankruptcy has the status of a judgment creditor as that term is used in the *Internal Revenue Code*,[35] and so concluded the Supreme Court in *United States v. Speers*.[36] Thus, to maintain secured creditor status the United States will have to file its tax lien before any petition in bankruptcy.

Two potential results seem to flow from the *Speers* decision. Foremost, there is a possibility of an increased number of involuntary bankruptcy petitions at the instance of creditors who may fare better in bankruptcy where the government's unrecorded tax lien is subordinated.[37] Additionally, the government's practice of forebearance in recording tax liens and taking consequent civil action for enforcement[38] may be reversed, which might also tend to increase the number of bankruptcies. Both possibilities are to the detriment of debtors who might otherwise be able, given time, to regain financial stability.

Robert Goldman

[35] INT. REV. CODE OF 1954, § 6323.

[36] 86 Sup. Ct. 411 (1965).

[37] *Id.* at 417.

[38] *Supra* note 21.

BANKRUPTCY–SALE OF MORTGAGED CHATTELS AS WILFUL AND MALICIOUS INJURY TO PROPERTY NOT DISCHARGEABLE IN BANKRUPTCY

On April 7, 1962, defendants executed a chattel mortgage for restaurant equipment, purchased from a dealer, to plaintiff-mortgagee bank, which plaintiff duly recorded. Subsequently, on July 30, 1963, defendants returned some of the mortgaged equipment to the original seller and received a cash refund, without notice to or approval of the chattel mortgage holder. Subsequently, the defendants filed bankruptcy, both individually and with respect to their restaurant partnership, in the United States District Court. Plaintiff first learned of defendant's disposal of the chattels when the receiver in bankruptcy was unable to deliver the chattels to the plaintiff-mortgagee pursuant to a court order. Plaintiff then instituted an action in the Circuit Court of Cook County against defendants for conversion of chattels covered by a chattel mortgage. The trial court rendered judgment for defendants on the grounds that defendant's act of disposing of the chattels did not constitute a conversion within the meaning of the Bankruptcy Act,[1] and that plaintiff's mortgage was not

[1] Bankruptcy Act § 17(a)(2), 30 STAT. 550 (1898), 11 U.S.C. § 35 (1964).