

Bankruptcy - Unrecorded Federal Tax Liens - Rights of a Trustee Under Section 70c of the Bankruptcy Act

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even though the trustee might not invoke 57g. Such an issue was raised in *Katchen* but was not brought to the Supreme Court.

Carl E. Heck, Jr.

BANKRUPTCY — UNRECORDED FEDERAL TAX LIENS — RIGHTS OF
A TRUSTEE UNDER SECTION 70c OF THE BANKRUPTCY ACT

Trustee in bankruptcy sought to invalidate an unrecorded federal tax lien on the property of the bankrupt, alleging that section 70c of the Bankruptcy Act gave him the status of a "judgment creditor," thereby enabling him to prevail over the unrecorded tax lien. The referee invalidated the lien, and his decision was upheld by the district court and court of appeals.¹ The United States Supreme Court affirmed; *held*, a federal tax lien unrecorded at the time of bankruptcy is invalid against the trustee. *United States v. Speers*, 382 U.S. 266 (1965).

Since the trustee in bankruptcy represents general, or unsecured creditors,² his primary objective is to preserve as much of the assets of the bankrupt as possible for distribution to this class. To foster this objective and to protect the bankrupt estate against secret liens the trustee has been vested with title to the bankrupt's property superior to unrecorded liens.³ The first significant legislation gave the trustee the rights of a creditor with a judicial lien on all property of the bankrupt in the custody of the court and with the rights of a "judgment creditor" as to all other property.⁴ Three years later, by amendment of the prede-

296 U.S. 222, 242 (1935). The "res" in *Hillman* was the receivership, but by analogy in a bankruptcy case the "res" would be the bankrupt estate.

1. In the Matter of Kurtz Roofing Co., 335 F.2d 311 (6th Cir. 1964).

2. Bankruptcy Act § 44c, 30 Stat. 544 (1898), as amended, 11 U.S.C. § 110 (1958) [hereinafter cited as Bankruptcy Act]: "The creditors of a bankrupt . . . shall, at the first meeting of creditors . . . appoint a trustee."

Bankruptcy Act § 56(b): "Creditors holding claims which are secured or have priority shall not . . . be entitled to vote at creditors meetings."

See also generally 2 COLLIER, BANKRUPTCY §§ 44.02-44.20 (14th ed. 1940) [hereinafter cited as COLLIER]; 3 COLLIER §§ 56.02-56.11.

3. The first of these statutes, Bankruptcy Act § 70a(5) was sharply limited as to its effectiveness by the case of *York Mfg. Co. v. Cassell*, 201 U.S. 344 (1906), which interpreted the provision to mean that the trustee was vested with superior title only where creditors existed who were similarly protected by state law. In 4 COLLIER § 70.48, at 1401, the author stated: "Since under the laws of many states, unrecorded mortgages, pledges, conditional sales, and the like, as well as many other types of secured transactions dangerous to creditors, are not valid except as to creditors who have levied upon or have fastened a lien on the property in dispute, the *York* case sharply limited the usefulness of the provisions of section 70a(5) . . ."

4. 36 Stat. 838 (1910), now Bankruptcy Act § 70c. The purpose of this

cessor of section 6323 of the Internal Revenue Code,⁵ Congress provided that an unrecorded federal tax lien was invalid against a "judgment creditor."⁶ These statutes stood for almost 40 years, during which the Second Circuit, the only court of appeals to pass squarely upon the question, decided in *United States v. Sands*,⁷ that the trustee was a "judgment creditor" for purposes of avoiding an unrecorded federal tax lien. In 1950 Congress amended section 70c, deleting the phrase "judgment creditor" and providing that the trustee "shall be deemed vested . . . with all the rights, remedies and powers of a creditor . . . holding a lien [by legal or equitable proceedings]" on all property of the bankrupt.⁸

In 1954 the United States Supreme Court held in *United States v. Gilbert Associates, Inc.*,⁹ a case involving a state insolvency proceeding, that an unrecorded federal tax lien prevailed over a municipal tax assessment which had neither been reduced to judgment nor accorded "judgment creditor" status by any statute but had been characterized by a state court in the insolvency proceeding as "in the nature of a judgment."¹⁰ The Court, after stressing the need for uniformity in the application of federal revenue laws, explained that the federal lien should prevail because "Congress used the words 'judgment creditor' in [section 6323] in the usual conventional sense of a

amendment was to give the trustee the power to prevail over *prior unrecorded liens* of which a subsequent creditor of the bankrupt could have no knowledge. S. Rep. No. 691, 61st Cong., 2d Sess. 8 (1910); *Sampsell v. Straub*, 194 F.2d 228, 231 (9th Cir. 1951); *Southern Dairies v. Banks*, 92 F.2d 282, 285 (4th Cir. 1937).

The 1910 amendment provided in part: "Such trustee, 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 legal or equitable 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.)

5. INT. REV. CODE OF 1954, § 6321: "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 . . . belonging to such persons."

Id. § 6322: "The lien imposed by section 6321 shall not be valid as against any . . . judgment creditor until notice thereof has been filed . . ."

6. INT. REV. CODE OF 1939, ch. 2, § 3672, 53 Stat. 449 (1939).

7. 174 F.2d 384, 385 (2d Cir. 1949), rejecting contrary dicta in *In re Taylor-Craft Aviation Corp.*, 168 F.2d 808, 810 (6th Cir. 1948).

8. Act of March 18, 1950, c. 70, 64 Stat. 24, 26. The purpose of the amendment was to erase the distinction, drawn by the old § 70c, between property of the bankrupt coming into the trustee's possession and that which does not. See note 7 *supra*.

9. 345 U.S. 361 (1953).

10. *Id.* at 363.

judgment of a court of record."¹¹ This pronouncement in *Gilbert*, coupled with the deletion of "judgment creditor" from section 70c was enough to convince the courts of appeals that section 6323 did not extend protection to the trustee in bankruptcy.¹²

In the instant case the Court distinguished the out-of-context language from *Gilbert* relied on by the lower courts, principally on the ground that section 70c was not involved or considered in that case.¹³ Then, reviewing the legislative history of section 70c of the Bankruptcy Act and of section 6323 of the Internal Revenue Code, it found a congressional intent to protect the bankrupt estate against unrecorded federal tax liens. It pointed out that Congress, in the 1950 amendment to section 70c, "recognized that the category of those holding judicial liens includes judgment creditors and a judicial lien holder generally has 'greater rights than a judgment creditor.'"¹⁴ Further, the Court noted that the House Report accompanying the legislation made it clear that the revision was intended for the protection of trustees in bankruptcy and, to some extent, to expand their rights.¹⁵ To further buttress its conclusion the Court noted that in enacting section 6323 in 1954, Congress explicitly refused to exclude "artificial" judgment creditors like the trustee in bankruptcy from its protection.¹⁶ Both the Senate and House conferees deemed it "advisable to continue to rely upon judicial interpretation of existing law."¹⁷ The Court concluded that the

11. *Id.* at 364.

12. *Simonson v. Granquist*, 287 F.2d 489 (9th Cir. 1961), *rev'd on other grounds*, 369 U.S. 38 (1962); *In re Fidelity Tube Corp.*, 278 F.2d 776 (3d Cir. 1960), *cert. denied*, 364 U.S. 828 (1960); *Brust v. Starr*, 237 F.2d 135 (2d Cir. 1956). See also *United States v. England*, 226 F.2d 205 (9th Cir. 1955); *In re Taylorcraft Aviation Corp.*, 168 F.2d 808 (6th Cir. 1948). See Note, 39 *NEB. L. REV.* 410 (1960).

13. *United States v. Speers*, 382 U.S. 266, 271 (1965): "In view of the nature of the claim for which superiority was asserted and because its dominant theme was the need for uniformity in construing the meaning of § 3672 [INT. REV. CODE OF 1954, § 6323], *Gilbert* cannot be construed as governing the entirely different situation with respect to the rights conferred by Congress upon a trustee in bankruptcy."

14. *Id.* at 273; 4 *COLLIER* § 70.49, at 1415 n.3.

15. 382 U.S. 266, 271 (1965); U.S. Code Congressional Service 1950, p. 1989.

16. 382 U.S. 266, 273 (1965). The House version of the proposed § 6323 was intended to make it clear that "particular persons shall not be treated as judgment creditors because state or federal law artificially provides or concedes such persons rights or privileges of judgment creditors, or even designates them as such, when they have not actually obtained a judgment in the conventional sense."

17. *Id.* at 274.

existing law referred to was the rule of *United States v. Sands*,¹⁸ since at the time of the proposed 1954 amendment *Gilbert* had not yet been applied by any court to a trustee in bankruptcy.¹⁹

That the Supreme Court in *Speers* was correct in its interpretation of congressional intent now seems certain in view of the 1966 amendment to section 70c of the Bankruptcy Act.²⁰ In an effort to clarify the trustee's powers under the section and erase the doubts which arose after the deletion of the words "judgment creditor" by the 1950 amendment²¹ the new section 70c explicitly provides that as of the date of bankruptcy the trustee shall have "the rights and powers of: (1) a creditor who obtained a judgment against the bankrupt upon the date of bankruptcy . . . (2) a creditor who upon the date of bankruptcy obtained an execution returned unsatisfied against the bankrupt . . . (3) a creditor who upon the date of bankruptcy obtained a lien by legal or equitable proceedings" (Emphasis added.)²² This clear grant of judgment creditor status to the trustee, in the absence of any change in the reference to "judgment creditor" in section 6323 of the Internal Revenue Code, should erase any doubt which may have existed after *Speers*.

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CIVIL LAW PROPERTY — LEVEE SERVITUDE — CIVIL CODE ARTICLE 665

Landowner brought suit to enjoin the levee board, without expropriation procedure, from entering upon or disturbing his property for purposes of repairing and strengthening the levee already situated on the land. Plaintiff contended the property

18. The Court also noted that the *Gilbert* case was not inconsistent with the rule announced in *Sands*. *Id.* at 274.

19. The Court summarily disposed of the government's last argument that §§ 70c and 6323 could not be taken to mean that the trustee should prevail over unrecorded tax liens because such an interpretation would preclude the possibility which appears to be contemplated by § 67(b) of the Bankruptcy Act, that a federal tax lien not perfected until after bankruptcy may nevertheless be "valid against the trustee." The Court said: "The purpose of section 67, sub. b, insofar as tax claims are concerned, is to protect them from section 60, . . . which permits the trustee to avoid transfers made within four months of bankruptcy. . . . It does not nullify or purport to nullify the consequences which flow from the government's failure to file its perfected lien prior to the date when the trustee's rights as a statutory judgment creditor attach." *Id.* at 278.

20. Act of July 5, 1966, 80 Stat. 269, 11 U.S.C. § 501.

21. H.R. Rep. No. 686, 89th Cong., 1st Sess. 9 (1966).

22. Act of July 5, 1966, 80 Stat. 269, 11 U.S.C. § 501.