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Notes

When First in Time is Not First in Right: The Supreme Court Frustrates Judgment Creditors in *United States v. McDermott*

[The Nation should] have a tax system which looks like someone designed it on purpose.¹

I. INTRODUCTION

As the level of consumer debt continues to rise in the United States,² many creditors find debt collection increasingly difficult.³ Consequently, creditors may seek to obtain judgments through the legal system in order to assist in collecting debts. Creditors, however, should be wary of *United States v. McDermott*,⁴ a recent Supreme Court decision that diminishes the effectiveness of obtaining judgments from debtors who are subject to federal tax liens.

In cases in which a debtor remains solvent but defaults on debt repayments, a creditor may protect its position by securing a garnishment against the debtor or by attaching the debtor's assets.⁵ Yet even

1. William E. Simon, *quoted in* U.S. DEPARTMENT OF THE TREASURY, BLUEPRINTS FOR BASIC TAX REFORM 1 (1977), *reprinted in* FRED R. SHAPIRO, THE OXFORD DICTIONARY OF AMERICAN LEGAL QUOTATIONS 401 (1993) (alteration in original).

2. In October 1993, the consumer installment debt increased by \$8.1 billion over the previous three months, bringing the adjusted total to \$776.71 billion. Robert D. Hershey, Jr., *Consumer Installment Debt Jumps*, N.Y. TIMES, Dec. 8, 1993, Late Edition, at D1. This figure represents roughly \$3,000 of debt for every man, woman, and child in this country. The increase also represents the largest monthly increase since January 1988, with the exception of a 1989 increase caused by a technical change in the compilation method. *Id.* Moreover, these figures do not include automobile leases or home equity loans. *Id.*

3. The number of bankruptcies filed in the United States is but one way of illustrating the problems experienced by creditors. According to the American Bankruptcy Institute, 1992 saw a record number of 971,517 bankruptcies filed in U.S. courts, 92% of which were personal bankruptcies. *Bankruptcy Filings Rise*, MIAMI HERALD, Mar. 18, 1993, at C3.

4. 113 S. Ct. 1526 (1993). In *McDermott*, the Court weighed the competing claims of a federal tax lien and a state judgment lien on a debtor's after-acquired property. The Court granted priority to the federal tax lien even though the judgment lien was created before notice of the tax lien was filed. *Id.* at 1530-31.

5. Generally, a creditor may only seize property pursuant to a lien—a property interest created to secure a debt. Steve H. Nickles, Lecture, *The Brendan Brown Lecture*:

when a debtor is solvent, attachment or garnishment affords a creditor only a relatively low level of security.⁶ Consequently, a creditor may choose to bolster its position by returning to the courts for a judgment against the defaulting debtor. Generally, the docketing of a judgment creates a lien that attaches to the debtor's real property and sometimes to the debtor's personal property.⁷ In addition, state judgment lien statutes commonly provide that the lien attaches to property the debtor does not yet own but will later acquire—so-called “after-acquired property.”⁸

Still, a judgment lien does not guarantee that the creditor will be paid, since there may also be other secured creditors. This risk arises from the common law rule of lien priority, set forth in the adage “first in time is first in right.”⁹ In other words, to insure collection, a judg-

Radical Reductionism in Debtor-Creditor Law, 39 CATH. U. L. REV. 765, 765 (1990). A creditor holding a lien is a secured creditor with a legal right to possess collateral that may be forcibly applied to satisfy the secured debt. *Id.* If there is not enough property to satisfy all lienholders, unsecured creditors (those creditors without liens or with liens unsupported by value) will likely remain unpaid. *See id.* at 766. Accordingly, creditors generally seek liens as early as possible. *Id.* For further discussion of these points, see generally *id.* at 765-69.

6. Unlike a judgment lien, the attachment or garnishment lien is considered “inchoate,” meaning that it is open to contingencies that stand in the way of execution. *See United States v. Security Trust & Sav. Bank*, 340 U.S. 47, 50 (1950). Accordingly, securing an attachment or garnishment lien is often an intermediate step taken prior to obtaining a judgment. *See infra* part II.B for further discussion of the inchoate lien.

7. *See generally* 49 C.J.S. *Judgments* §§ 454-58, 471-73, 477 (1947); 46 Am. Jur. 2d *Judgments* § 257 (1969). The modern judgment lien developed from the Statute of Westminster II, which was enacted in the year 1285. 49 C.J.S. *Judgments* § 454 (1947). It often exists today as a creature of statute. *Id.* Utah has a typical judgment lien statute, which provides in relevant part:

From the time the judgment of the district court or circuit court is docketed and filed in the office of the clerk of the district court of the county it becomes a lien upon all the real property of the judgment debtor, not exempt from execution, in the county in which judgment is entered, owned by him at the time or by him thereafter acquired during the existence of said lien. . . . The lien shall continue for eight years unless the judgment is previously satisfied . . . in which case the lien of the judgment ceases.

UTAH CODE ANN. § 78-22-1 (1992). As with the Utah lien, it is usually essential that there be a final judgment for a specific sum that is capable of collection by execution upon the debtor's property. 49 C.J.S. *Judgments* § 458 (1947). Unlike other liens, however, a judgment lien is normally a general lien upon all real property held by the debtor, rather than upon specific property. 49 C.J.S. *Judgments* § 455 (1947). For further discussion of the judgment lien, see *infra* part IV.A.

8. 46 AM. JUR. 2D *Judgments* § 257 (1969); 49 C.J.S. *Judgments* § 477 (1947). *See supra* note 7 (setting forth the text of UTAH CODE ANN. § 78-22-1 (1992), which states that the judgment lien is a lien on property “owned or acquired during the existence of the judgment, located in the county in which the judgment is entered” (emphasis added)).

9. *See Rankin & Schatzell v. Scott*, 25 U.S. (12 Wheat.) 177, 179 (1827) (“The principle is believed to be universal, that a prior lien gives a prior claim, which is entitled to

ment creditor generally must win the race to be the first to docket its lien and thereby gain priority over other creditors.¹⁰

Yet even then, federal tax law may frustrate a judgment lien creditor who stands "first in time." Under the Internal Revenue Code, persons who refuse to pay federal taxes after demand will have a lien placed upon all of their real and personal property.¹¹ This lien arises on the date that the tax is *originally assessed* against the taxpayer.¹² Consequently, a creditor who finds a solvent debtor in default, garnishes the debtor's wages, prevails in a litigation battle, obtains a judgment, and, finally, wins the race to docket its judgment still cannot rest easy, since the United States government may also be a creditor.

prior satisfaction . . .").

10. In the case of secured transactions covered by the Uniform Commercial Code ("U.C.C."), the general rule is that lien priority follows the order in which liens are perfected. U.C.C. § 9-312(5)(a), 3A U.L.A. 350 (1992). For example, when the collateral securing a lien is one or more accounts receivable, chattel paper, or inventory, a financing statement must be filed with the appropriate state authority. U.C.C. § 9-302(1), 3A U.L.A. 50. A financing statement is valid under the U.C.C. if it is signed by the debtor, provides the names and addresses of the debtor and secured party, and gives a description of the collateral. U.C.C. § 9-402(1), 3A U.L.A. 546. In any event, merely attaching a creditor's security interest to specific collateral is not enough to perfect a lien. U.C.C. § 9-303(1), 3A U.L.A. 117. The security interest is only perfected when both the security interest attaches and the financing statement is filed. *Id.*

According to one commentator, "[p]erfection' refers to the steps necessary to make a lien or other interest in property enforceable, as far as is legally possible, against third parties' claims." Steve H. Nickles, *Setting Farmers Free: Righting the Unintended Anomaly of UCC Section 9-312(2)*, 71 MINN. L. REV. 1135, 1147 (1987). Perfection usually requires some form of "notorious conduct," such as a public filing, which provides notice of the interest to the public. *Id.* According to Nickles, "[a]n effect of a perfection requirement, if not also a purpose, is to establish a clear, certain, and uniform signal as to when a lien or other interest has been created for purposes of applying the first-in-time rule. The efficiency of the rule is thereby enhanced." *Id.* at 1149. "In most cases the secured party may obtain perfection either by filing . . . or by taking possession of the collateral." BLACK'S LAW DICTIONARY 1137 (6th ed. 1990) (defining the perfection of a security interest).

11. 26 U.S.C. § 6321 (1988). Section 6321 provides:

If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount (including any interest, additional amount, addition to tax, or assessable penalty, together with any costs that may accrue in addition thereto) 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.

Id.

12. 26 U.S.C. § 6322 (1988). Section 6322 states:

Unless another date is specifically fixed by law, the lien imposed by section 6321 shall arise at the time the assessment is made and shall continue until the liability for the amount so assessed (or a judgment against the taxpayer arising out of such liability) is satisfied or becomes unenforceable by reason of lapse of time.

Id.

On March 24, 1993, the Supreme Court decided *United States v. McDermott*,¹³ in which it held that a judgment creditor's lien on after-acquired property did not have the "choateness" necessary to enjoy priority over a later-filed federal tax lien.¹⁴ According to the Court, a judgment lien on after-acquired property cannot be choate because the property subject to the lien cannot be established until the debtor acquires it.¹⁵ Therefore, the private judgment lien cannot take priority over a federal tax lien unless the debtor acquires the property before the notice of the federal tax lien is filed.¹⁶ This decision effectively subordinates all private judgment liens on after-acquired property to federal tax liens, except in those cases where the IRS fails to file notice before the debtor acquires the property.

This Note analyzes the *McDermott* decision and the effect it will have on judgment creditors. The Note begins by examining the federal tax lien from an historical perspective, reviewing its creation, evolution, and the protection that Congress has afforded private creditors from federal tax liens.¹⁷ It then examines the "choateness" doctrine and the key decisions applying the doctrine in weighing private creditors' claims.¹⁸ Finally, this Note discusses *United States v. McDermott*, concluding that it overlooks the nature of the judgment lien, undercuts more than eighty years of law protecting judgment creditors, and ignores significant implications regarding debtor-creditor relations.¹⁹

II. BACKGROUND

In *McDermott*, the Supreme Court based its analysis on past legislation that gave judgment lienholders priority in certain circumstances and on judicial decisions outlining and interpreting the requirement that private liens be "choate" to receive priority.²⁰ Accordingly, this Part first provides an historical perspective on the creation and evolution of

13. 113 S. Ct. 1526 (1993).

14. *Id.* at 1530. In *United States v. Pioneer Am. Ins. Co.*, 374 U.S. 84 (1963), the Supreme Court required that judgment creditors' liens be "choate" in order to have priority over a later federal tax lien. *Id.* at 89. According to the Court, to be "choate," the lienor's identity, the property subject to the lien, and the amount of the lien must be established. *Id.* For further discussion of the doctrine of choateness, see *infra* part II.B.

15. *McDermott*, 113 S. Ct. at 1529-30.

16. *Id.*

17. See *infra* part II.A.

18. See *infra* part II.B.

19. See *infra* parts III-V.

20. See *McDermott*, 113 S. Ct. at 1528-30. For a definition of "choate" in the context of lien priority, see *infra* notes 46-58 and accompanying text.

the federal tax lien, examining the protection from federal tax liens that private creditors have received. It then reviews the decisions establishing the “choateness” doctrine, which is used to evaluate the merits of private lienholder priority claims. Finally, this Part reviews the most recent legislation governing the federal tax lien, the Federal Tax Lien Act of 1966²¹ (“FTLA”).

A. *The History of the Federal Tax Lien and Creditor Protection*

Soon after its formation, Congress addressed the priority of all types of federal claims.²² In 1789, Congress enacted what has come to be known as the “Insolvency Statute,”²³ which gave the federal government priority over all claims in certain cases of insolvency.²⁴ Yet as the Civil War led to an expansion of the government’s revenue requirements, tax collection was frustrated at times by a loophole in the Insolvency Statute that allowed debtors to defeat federal priority by transferring their assets to a third party before the government could enforce its liens.²⁵ The government thus had a need for a lien that would secure its tax claims in cases where the Insolvency Statute did not apply: where the delinquent taxpayer was solvent.²⁶ Congress reacted by authorizing a federal tax lien on solvent debtors that attached to all of the debtor’s property immediately upon the debtor’s failure to pay federal taxes when due.²⁷ Under the Insolvency Statute, taxpayers had been able to refuse to pay federal taxes and then transfer their assets before the government began enforcement proceedings, thus

21. Pub. L. No. 89-719, 80 Stat. 1125 (1966) (codified as amended in scattered sections of 26 U.S.C.). This Note will focus upon those portions of the FTLA that are codified at 26 U.S.C. §§ 6321, 6322, and 6323(a) (1988).

22. WILLIAM T. PLUMB, JR., *FEDERAL TAX LIENS* 191 (3d ed. 1972).

23. Act of July 31, 1789, ch. 5, § 21, 1 Stat. 42. The Act of July 31, 1789 was the fifth statute enacted by the First Congress. William T. Plumb, Jr., *Federal Liens and Priorities—Agenda for the Next Decade*, 77 *YALE L.J.* 228, 234 n.45 (1967). The Insolvency Statute is codified in its current form at 31 U.S.C. § 3713(a)(1) (1988). The law has retained substantially the same form since the Act of March 3, 1797, ch. 20, § 5, 1 Stat. 515. Plumb, *supra*, at 234 n.45.

24. The current version of the Insolvency Statute reads in part: “A claim of the United States Government shall be paid first when (A) a person indebted to the Government is insolvent” 31 U.S.C. § 3713(a)(1) (1988). The Insolvency Statute was deemed constitutional in 1805. *United States v. Fisher*, 6 U.S. (2 Cranch) 358, 396-97 (1805).

25. Christopher L. Hencke, Note, *Nesbitt v. United States: Denying an Implied Tax Lien Exception to the Federal Priority in Insolvency*, 33 *CATH. U. L. REV.* 741, 749-50 (1984).

26. See Frank R. Kennedy, *The Relative Priority of the Federal Government: The Pernicious Career of the Inchoate and General Lien*, 63 *YALE L.J.* 905, 919-20 (1954).

27. Act of July 13, 1866, ch. 184, § 9, 14 Stat. 107. The current version of this early legislation is found at 26 U.S.C. § 6321 (1988). See *supra* note 11 for the text of § 6321.

leaving the federal government with priority over nothing.²⁸ In contrast, the new statute allowed the taxpayer's assets to be encumbered with a lien as soon as the taxpayer refused to pay; the lien would stay attached to the assets even if transferred to another party.²⁹

The early federal tax lien proved burdensome to private creditors of tax debtors. The federal tax lien did not have to be filed or recorded to be valid³⁰ and, consequently, could operate unknown to the public as a "secret lien."³¹ Despite the seeming inequity of this, the Supreme Court ruled in *United States v. Snyder*³² that an unfiled federal tax lien took priority over a claim held by a good faith purchaser of real property who bought without notice of the lien.³³ After *Snyder*, buyers could find their new property burdened with liens that they had no means of discovering, and the federal government could execute such liens through a forced sale of the property.³⁴ As one commentator stated, "*Snyder* imposed individual hardships and impaired alienation

28. See Kennedy, *supra* note 26, at 919-20.

29. See *id.*

30. See PLUMB, *supra* note 22, at 53.

31. See Plumb, *supra* note 23, at 229. The government has an interest in withholding notice of its liens: Public notice of liens against a taxpayer will substantially curtail the taxpayer's ability to obtain credit, which in turn reduces the chances that the taxpayer will regain sufficient financial stability to satisfy the tax debt. PLUMB, *supra* note 22, at 131. As a result, the government has made a practice of withholding public notice whenever it believes that there is a reasonable chance that a delinquent taxpayer will regain financial stability. *Id.* (citing *United States v. Speers*, 382 U.S. 266, 276 n.21 (1965); S. REP. NO. 277, 89th Cong., 1st Sess. 18 (1965) (stating the Treasury Department's position)).

32. 149 U.S. 210 (1893).

33. *Snyder*, 149 U.S. at 213-14. In *Snyder*, a federal lien for unpaid tobacco taxes attached to realty held by Snyder, a tax debtor. *Id.* at 211. Two years later, Snyder sold the property to the International Cotton Press Company ("International"), which bought without knowledge of the unfiled tax lien. *Id.* Even though International was an innocent purchaser, the Court held that the land transferred to International remained subject to the lien and reasoned that if federal taxes "can be thwarted by . . . a state statute [requiring the federal government to file notice of its lien] . . . it would follow that the potential existence of the government of the United States is at the mercy of state legislation." *Id.* at 214.

34. See Hencke, *supra* note 25, at 751-52. The federal tax lien statute effectively required prospective buyers to "[ascertain] from all the collectors in the United States whether or not the vendor was delinquent in the payment of taxes." H.R. REP. NO. 1018, 62d Cong., 2d Sess. 1 (1912) (emphasis added).

Following the *Snyder* decision, a district court allowed such a forced sale. *United States v. Curry*, 201 F. 371 (D. Md. 1912). Still, the *Curry* court recommended that the tax lien statute be amended to remedy the inequity of this type of sale. *Id.* at 374. Congress subsequently enacted legislation that called for the government to file notice to make its liens valid against mortgagees, purchasers, and judgment creditors. See *infra* notes 36-37 and accompanying text.

of property.”³⁵

Since the *Snyder* decision, Congress has amended the law governing federal tax liens to soften their impact on various parties and to provide protection to certain private creditors. In 1913, Congress provided protection to purchasers, mortgagees, and judgment creditors³⁶ by imposing upon the federal government a “notice-filing provision,” which requires the government to file notice in a designated office in order to achieve priority.³⁷

35. Kennedy, *supra* note 26, at 920-21.

36. The phrase “judgment creditor” is not defined in federal tax lien statutes. *Don King Prods., Inc. v. Thomas*, 945 F.2d 529, 533 (2d Cir. 1991). Current Treasury Department regulations specify that to achieve judgment creditor status, a creditor must “[obtain] a valid judgment, in a court of record and of competent jurisdiction, for the recovery of specifically designated property or for a certain sum of money.” Treas. Reg. § 301.6323(h)-1(g) (1993). The Supreme Court has stated that “Congress used the words ‘judgment creditor’ in § 3672 [the predecessor of 26 U.S.C. § 6323(a)] in the usual, conventional sense of a judgment of a court of record” *United States v. Gilbert Assocs., Inc.*, 345 U.S. 361, 364 (1953).

Nevertheless, obtaining a judgment alone may not guarantee judgment creditor status for purposes of priority over other liens. For example, in *Fore v. United States*, 339 F.2d 70, 71 (5th Cir. 1964), *cert. denied*, 381 U.S. 912 (1965), a creditor who had obtained a judgment claimed to have priority over a federal tax lien even though he had not fixed a lien to the debtor’s personalty before the federal government filed its tax lien. The Fifth Circuit rejected this view, ruling that to achieve priority, the creditor would have to become a judgment lien creditor. *Id.* at 72. Indeed, today the tax code specifically refers to “judgment lien creditor[s].” See William F. Young, Jr., *Priority of the Federal Tax Lien*, 34 U. CHI. L. REV. 723, 728 (1967).

37. Act of Mar. 4, 1913, ch. 166, 37 Stat. 1016 (“[A federal tax] lien shall not be valid as against any mortgagee, purchaser, or judgment creditor until notice of such lien shall be filed by the collector”) (current version codified at 26 U.S.C. § 6323(a) (1988 & Supp. IV 1992)).

To illustrate the effect of the notice-filing provision, suppose a tax assessment of \$50,000 is made on January 1 against a taxpayer who fails to pay upon demand. The taxpayer owns a home worth \$75,000, and on January 15, one of the taxpayer’s private creditors files a judgment against him in the county of his residence, creating a judgment lien against the home. Finally, suppose the IRS files proper notice of the federal tax lien on January 20.

Without the benefit of the notice-filing provision, the private creditor’s judgment lien would be subordinated to the IRS lien since, according to § 6322 (set forth *supra* note 12), the federal lien arose upon the January 1 assessment, two weeks before the private creditor’s judgment lien arose. Pursuant to the notice-filing provision, however, the private creditor’s judgment lien would have priority as to the taxpayer’s residence. Even though the IRS lien arose on January 1, the notice-filing provision provides that it did not become valid against the private creditor’s judgment lien until notice of it was filed on January 20. Since validity of a lien is not retroactive, the private creditor’s filing on January 15 entitles it to priority. See Fed. Tax. Coordinator 2d (Res. Inst. Am.) ¶ V-6302 pp. 54,411-12 (1992).

Congress added pledgees as a class protected by the notice filing provision in 1939. Revenue Act of 1939, ch. 247, § 401, 53 Stat. 882. Congress replaced pledgees and mortgagees with mechanic’s lienors and “holder[s] of a security interest” as protected parties in 1966. Federal Tax Lien Act of 1966, Pub. L. No. 89-719, 80 Stat. 1125

Congress also recognized that searches for federal tax liens are sometimes impractical.³⁸ Consequently, it granted "superpriority"—priority over already existing and filed federal tax liens—to both lenders secured by securities and purchasers of securities.³⁹ In 1964, Congress extended superpriority status to purchasers of motor vehicles.⁴⁰ With the passage of the FTLA in 1966, Congress further expanded superpriority status by adding additional classes.⁴¹ Still, the protection from federal tax lien priority remained restricted to those creditors expressly protected by statute; for all others, federal tax liens assumed priority upon tax assessment, regardless of the date the government filed notice.⁴²

B. *The Choateness Doctrine: Limits on Creditor Protection*

Even as Congress was extending protection from federal liens to private creditors in the early part of this century, the Treasury was turning with greater frequency to the tax lien as a method of collecting its debts.⁴³ Mindful of the federal government's interest in collecting the debts owed to it,⁴⁴ courts experienced increasing litigation related

(1966) (codified at 26 U.S.C. § 6323(a) (1988 & Supp. IV 1992)).

38. Plumb, *supra* note 23, at 229; PLUMB, *supra* note 22, at 54 ("Congress was aware that the burden of this search [for prior notices of tax liens] would seriously hamper the transferability of certain properties and would result in injustice to purchasers who could not be expected to (or could not possibly) make a search for federal tax liens.").

39. Revenue Act of 1939, ch. 247, § 401, 53 Stat. 882, 883 (currently codified at 26 U.S.C. § 6323(b)(1) (1988)); see PLUMB, *supra* note 22, at 54. The purpose of this superpriority protection was disclosed in the committee report accompanying the bill. *United States v. Security Trust & Sav. Bank*, 340 U.S. 47, 53 (1950) (Jackson, J., concurring). The report states:

While it is true that the filing of the notice of the tax lien may constitute notice in the case of real property, it is inequitable for the statute to provide that it constitutes notice as regards securities. . . . An attempt to enforce such liens on recorded notice would in many cases impair the negotiability of securities and seriously interfere with business transactions.

H.R. REP. NO. 855, 76th Cong., 1st Sess. 26 (1939).

40. Revenue Act of 1964, Pub. L. No. 88-272, § 236, 78 Stat. 127 (currently codified at 26 U.S.C. § 6323(b)(2) (1988)).

41. See *infra* part II.C for further discussion of the FTLA.

42. Plumb, *supra* note 23, at 229.

43. Peter F. Coogan, *The Effect of the Federal Tax Lien Act of 1966 Upon Security Interests Created Under the Uniform Commercial Code*, 81 HARV. L. REV. 1369, 1376 (1968).

44. See, e.g., *United States v. Kimbell Foods*, 440 U.S. 715, 734 (1979) ("The importance of securing adequate revenues to discharge national obligations justifies the extraordinary priority accorded federal tax liens through the choateness and first-in-time doctrines."); *Bull v. United States*, 295 U.S. 247, 259 (1935) ("[T]axes are the lifeblood of government, and their prompt and certain availability an imperious need . . ."); *Security Trust*, 340 U.S. at 51 ("[T]he purpose of the federal tax lien statute [is]

to the concessions Congress had provided to private creditors.⁴⁵ In an effort to assign priority to various creditors, the Supreme Court began to use the choateness doctrine to evaluate claims of private creditors.⁴⁶ The effect of this doctrine is that in spite of its purported deference to the “first in time” policy,⁴⁷ the Court has given the federal government absolute priority over all private liens that are not choate.⁴⁸ The Court

to insure prompt and certain collection of taxes.”); Frank R. Kennedy, *From Spokane County to Vermont: The Campaign of the Federal Government Against the Inchoate Lien*, 50 IOWA L. REV. 724, 750 (1965) (“The premise has been that the paramount need is the collection of federal claims . . .”).

45. *E.g.*, United States v. Vermont, 377 U.S. 351 (1964); United States v. Pioneer Am. Ins. Co., 374 U.S. 84 (1963); United States v. City of New Britain, 347 U.S. 81 (1954); United States v. Security Trust & Sav. Bank, 340 U.S. 47 (1950). For a discussion of these cases, see *infra* notes 52-68 and accompanying text.

46. The choateness doctrine sprang from the decision in *Spokane County v. United States*, 279 U.S. 80 (1929). In *Spokane County*, the Supreme Court of Washington had ruled that two counties’ property taxes created a binding lien only on the specific property against which the taxes were assessed. *Id.* at 94. The Court, relying on this ruling and assuming that none of the property held by the receiver was assessed for taxes until after the federal priority had attached, ruled that the county’s nonspecific liens were subordinate to the existing federal priority under the Insolvency Statute. *Id.* at 94-95. In other words, the United States Supreme Court created a standard that private liens must be choate at the time federal taxes are assessed in order for the private liens to achieve priority.

In practice, it became nearly impossible for private lienholders to meet this standard and receive priority under the Insolvency Statute. *See, e.g.*, *Gilbert Associates*, 345 U.S. at 361 (holding that private creditors could only have choate interests if they had possession or title to the property prior to the debtor’s insolvency); *United States v. Texas*, 314 U.S. 480 (1941) (deeming a state tax lien to be inchoate since the property subject to the lien was not specific, the amount of the claim secured by the lien was uncertain, and judicial procedure was needed to enforce the lien); *New York v. Maclay*, 288 U.S. 290 (1933) (denying priority in insolvency to a New York franchise tax lien where the state tax had not been assessed until after the appointment of receivers, which signaled the insolvency of the state tax debtor); *cf. Vermont*, 377 U.S. at 357-58 (describing the absolute priority given to the United States Government under the Insolvency Statute and ultimately holding that the standard of choateness applied to solvent debtors was less demanding than that applied to debtors under the Insolvency Statute).

In the 1940’s, the government first began to argue that the choateness rationale should also be followed in cases not governed by the Insolvency Statute, *i.e.*, cases involving solvent debtors. Kennedy, *supra* note 26, at 922-25. While the argument did not initially succeed, the government finally prevailed with this reasoning in *Security Trust*, which extended the choateness doctrine to the law governing federal tax liens for the first time. *Id.* at 923-24; *Security Trust*, 340 U.S. at 51. *See infra* notes 52-54 and accompanying text for further discussion of *Security Trust*.

47. *See, e.g.*, *United States v. City of New Britain*, 347 U.S. 81, 87-88 (1954).

48. *See Kennedy, supra* note 26, at 911-13. *See text accompanying infra* notes 55-58 for a current and more complete description of choateness. Unless a private creditor enjoys “superpriority” status, discussed *supra* note 39 and accompanying text, its lien must be choate either (a) before the IRS files notice of its lien (for creditors protected by the notice filing provision); or (b) before the federal tax lien arises (for creditors not

has also ruled that while a state's law defines the property subject to its liens,⁴⁹ federal law determines whether a state-created lien is choate.⁵⁰

The Supreme Court has repeatedly used the choateness doctrine to frustrate state-created liens. In the period of 1950 to 1964, the Court decided most of the seminal lien priority cases and granted priority to very few state-created liens.⁵¹ In the first of these cases, *United States v. Security Trust & Savings Bank*,⁵² the Court extended the choateness doctrine beyond Insolvency Statute applications for the first time.⁵³ Although under prior law a private creditor would have

protected by the notice filing provision) to achieve priority. See *infra* text accompanying note 62.

49. The Court stated:

[B]oth federal and state courts must look to state law, for it has long been the rule that "in the application of a federal revenue act, state law controls in determining the nature of the legal interest which the taxpayer had in the property . . . sought to be reached by the statute."

Aquilino v. United States, 363 U.S. 509, 512-13 (1960) (quoting *Morgan v. Commissioner*, 309 U.S. 78, 82 (1940)).

50. In *United States v. Waddill, Holland, & Flinn, Inc.*, 323 U.S. 353, 356 (1945), landlords of an insolvent tax debtor held a Virginia-created lien that Virginia's Supreme Court of Appeals deemed as "fixed and specific, and not one which is merely inchoate." While the United States Supreme Court could not deny that this was a valid pronouncement of Virginia law, and despite having pronounced in *Spokane County* that specificity "is really a state question," 279 U.S. at 94, the Court nevertheless restated the role of state law in determining priority as follows:

[I]t is a matter of federal law as to whether a lien created by state statute is sufficiently specific and perfected to raise questions as to the applicability of the priority given the claims of the United States by an act of Congress. . . . A state court's characterization of a lien as specific and perfected, however conclusive as a matter of state law, cannot operate by itself to impair or supersede a long-standing Congressional declaration of priority.

Waddill, Holland, & Flinn, 323 U.S. at 356-57. Although the Supreme Court was reluctant to accept the state court's characterization of a lien as choate in *Waddill, Holland, & Flinn*, it readily accepted the opposite characterization of another lien less than two years later: "[I]f the state court itself characterizes the lien as inchoate, this characterization is practically conclusive." *Illinois ex rel. Gordon v. Campbell*, 329 U.S. 362, 371 (1946).

51. *E.g.*, *United States v. Pioneer Am. Ins. Co.*, 374 U.S. 84 (1963); *United States v. R. F. Ball Constr. Co.*, 355 U.S. 587 (1958); *United States v. White Bear Brewing Co.*, 350 U.S. 1010 (1956); *United States v. Acri*, 348 U.S. 211 (1955); *United States v. Security Trust & Sav. Bank*, 340 U.S. 47 (1950). For discussion of these cases, see *infra* notes 52-62 and accompanying text. One commentator stated that the choateness doctrine has made the Insolvency Statute "an instrument of oppression." Young, *supra* note 36, at 725.

52. 340 U.S. 47 (1950).

53. *Id.* at 51. In *Security Trust*, a private creditor held attachment liens on four parcels of real estate that belonged to a tax debtor. *Id.* at 48. Before the creditor obtained a judgment on the debt, the United States filed notice of a federal tax lien. *Id.* Because California law provided that a subsequent judgment lien merged with an attachment lien and related back to the time of attachment, the California Court of Appeals

generally enjoyed priority over a federal tax lien if its lien arose before the federal tax was assessed, the *Security Trust* Court added the additional requirement that the private creditor's lien be choate.⁵⁴

A turn favorable to creditors came in the unanimous *United States v. City of New Britain* decision.⁵⁵ For the first time, the Court deemed a state-created lien choate and, therefore, worthy of priority over subsequent federal tax liens on the basis of the "first in time" principle.⁵⁶

ruled that the private creditor's lien enjoyed priority over the federal tax lien. *Id.* at 49. On review, the United States Supreme Court held that the attachment lien was inchoate, stating: "Numerous contingencies might arise that would prevent the attachment lien from ever becoming perfected by a judgment awarded and recorded. Thus the attachment lien is contingent or inchoate . . ." *Security Trust*, 340 U.S. at 50; *see also* *United States v. Acri*, 348 U.S. 211 (1955) (deeming an attachment lien inchoate because it was contingent upon the outcome of the underlying suit).

After deeming the attachment lien inchoate, the Court extended the choateness doctrine to federal tax lien law, reasoning that since inchoate liens lacked priority under the Insolvency Statute, inchoate liens should also be denied priority over federal tax liens. *Security Trust*, 340 U.S. at 51. The Court added: "If the purpose of the federal tax lien statute to insure prompt and certain collection of taxes due the United States from tax delinquents is to be fulfilled, a similar rule must prevail here." *Id.*

54. Kennedy, *supra* note 44, at 728. Kennedy also observed that *Security Trust* overruled thirty cases in the lower courts that had denied the priority of the federal tax lien over prior liens on the basis of the "first in time" principle, which did not take choateness into account. Kennedy, *supra* note 26, at 924-25 & n.115.

Security Trust led to a series of decisions defeating garnishment, landlords', attachment, sureties', and mechanics' liens that the Court considered inchoate. *See generally* Kennedy, *supra* note 44, at 729-30 & nn.24-26; Patricia Nassif Fetzer, *The Purchase Money Security Interest and the Federal Tax Lien: A Proposal For Legislative Change*, 36 HASTINGS L.J. 873, 888 & n.77 (1985). *United States v. White Bear Brewing Co.*, 350 U.S. 1010 (1956), is a rather severe example of these decisions. In *White Bear*, the Court reversed a Seventh Circuit decision and found a mechanic's lien inchoate, even though the lien was "specific, prior in time, perfected in the sense that everything possible under state law had been done to make it choate, and was being enforced before the federal tax lien arose." *Id.* at 1010 (Douglas, J., dissenting).

55. 347 U.S. 81 (1954), *vacating* *Brown v. General Laundry Serv.*, 94 A.2d 10 (Conn. 1952).

56. *New Britain*, 347 U.S. at 84-85. In *New Britain*, the Court was confronted with a common problem: the federal tax lien statute stated that federal liens were inferior to prior mortgages and judgment liens but superior to New Britain's liens, while Connecticut law provided that the city's liens were superior to the mortgages and judgment liens. *Id.* at 83-85; *see also* *Brown*, 94 A.2d at 12-13. The Connecticut Supreme Court of Errors determined that Congress not only intended to subordinate federal liens to prior mortgages and judgment liens, but also to liens superior to these as well. *Id.* at 15. Consequently, it gave priority to the city's liens first, followed by the mortgages and judgment liens, and then the federal liens. *Id.*

The Court began its analysis by determining that the city's liens were choate and as binding as the federal liens. *New Britain*, 347 U.S. at 84. Departing from other cases giving federal liens nearly absolute priority under the Insolvency Statute, the Court observed that the law governing liens against solvent debtors did not provide "paramount authority" to federal liens. *Id.* Instead, the Court relied on the Connecticut Supreme Court's determination regarding the specificity of the city liens, ruling that the

New Britain announced the seminal test for determining priority of state-created liens: A state-created lien takes priority over a later federal tax lien when “there is nothing more to be done to have a choate lien—when the identity of the lienor, the property subject to the lien, and the amount of the lien are established.”⁵⁷ Lienholders were comforted by the *New Britain* decision, realizing that if choate, their liens would enjoy priority over later federal liens.⁵⁸

In *United States v. Pioneer American Insurance Co.*,⁵⁹ the Court delivered a setback to private lienholders by extending the choateness doctrine to those liens ostensibly protected from unfiled federal liens by the notice-filing provision.⁶⁰ The *Pioneer* Court deemed a

“first in time” principle applied. *Id.* at 85-86. Although the Court ruled that under the law controlling liens against solvent debtors a prior choate state lien will have priority over a later federal lien, it nevertheless vacated the judgment of the Connecticut Supreme Court and remanded the case for determination of the priority of two competing private liens. *Id.* at 88.

57. *New Britain*, 347 U.S. at 84. *New Britain* provided justification for applying the choateness doctrine to protect federal liens. The Court hypothesized that “[o]therwise, a State could affect the standing of federal liens, contrary to the established doctrine, simply by causing an inchoate lien to attach at some arbitrary time even before the amount of the tax, assessment, etc., is determined.” *Id.* at 86.

The requirement of choateness should not be confused with the concept of perfection. While perfection usually requires that a private creditor’s lien be filed with an appropriate state authority in order for it to have priority over another private creditor’s lien, *see supra* note 10, choateness generally requires something more—it requires that there be no contingencies standing in the way of execution of the lien. *See, e.g., Security Trust*, 340 U.S. at 50. In *Security Trust*, an attachment lien, even though filed, was contingent upon the outcome of an underlying suit. *Id.*

58. This comfort proved short-lived. Four years later, in *United States v. R.F. Ball Constr. Co.*, 355 U.S. 587 (1958), the Court first considered a priority claim pitting a consensual lien against a federal tax lien. In a baffling per curiam opinion, the Court reversed a Fifth Circuit ruling, finding an assignment of receivables from a subcontractor to a surety to be: (1) a mortgage within the meaning of the tax lien statute; and (2) inchoate and unperfected. *Id.* at 587. For a later interpretation of *Ball*, *see Pioneer*, 374 U.S. at 89-91.

Although the Court did not explain why the assignment was inchoate, one commentator suggests four potential reasons for the ruling: (1) the surety did not perfect the security interest by filing notice; (2) the surety’s lien was not one explicitly protected by the federal tax lien statute; (3) the assignment covered after-acquired property, and the sums to be due under the subcontract were uncertain; and (4) the obligation secured by the surety’s lien was contingent and the ultimate amount uncertain (since it depended upon whether the subcontractor defaulted under its subcontract and the amount needed to cure a default). Kennedy, *supra* note 44, at 734-35.

In *Pioneer*, the Court clarified and relied upon the *Ball* holding (that the assignment was an inchoate mortgage). *See Pioneer*, 374 U.S. at 89-91.

59. 374 U.S. 84 (1963).

60. In response, one commentator noted: “It is nevertheless fanciful to attribute to Congress an intent to adopt a doctrine which had not yet made its first appearance at the time of the enactment of the original notice-filing provision and which was first applied to the federal tax lien nearly forty years later.” Kennedy, *supra* note 44, at 731

mortgagee's prior lien for attorney's fees inchoate, since the ultimate amount of the attorney's fees was not ascertainable when notice of the federal lien was filed.⁶¹ In other words, *Pioneer* stands for the proposition that the sole significance of the notice-filing provision is that it requires that private liens held by creditors protected under the notice-filing provision be choate on the date notice of the tax lien is filed, rather than on the date the taxes are assessed.⁶²

After *Pioneer*, one key question remained unanswered: Whether private creditors seeking priority over federal tax liens needed to meet the same choateness standard that they had to meet under the Insolvency Statute. In *United States v. Vermont*,⁶³ the Court took the position that the standard of choateness used under the Insolvency Statute is more strict than the standard used under federal tax lien law.⁶⁴ Thus, while a federal lien is given nearly absolute priority in

(emphasis added). Kennedy added: "[A]ny suggestion that Congress intended to qualify the protection afforded mortgagees, pledgees, and judgment creditors by enacting the doctrine of the inchoate and general lien . . . rests on sheer fiction." *Id.* at 731 n.32. He further maintained:

A persuasive reason for not applying the doctrine . . . is that the doctrine . . . would withdraw protection from most of the persons on the congressionally prescribed list of beneficiaries of notice-filing. *Protection of the judgment creditor would be particularly difficult to reconcile with the doctrine . . .* Even where a judgment lien is recognized, the lien typically is a general one, attaching to whatever realty the debtor may then or thereafter own within the bailiwick of the court rendering the judgment.

Id. at 731-32 (emphasis added).

61. 374 U.S. at 90-91. The government nevertheless admitted that its liens were subordinate to the mortgage principal and interest, since the mortgage agreement was reached prior to when notice of the tax liens was filed. *Id.* at 86.

The Court agreed with the government and held that mortgagees were subject to the choateness doctrine, stating it "has never held that mortgagees face a less demanding test of [choateness] . . . than other interests when competing with the federal lien." *Pioneer*, 374 U.S. at 89-90. The Court then concluded that the claim for attorney's fees was inchoate at the time the tax liens were filed and, therefore, was subordinate to the federal liens. *Id.* at 90-92.

62. Plumb, *supra* note 23, at 231 n.26.

63. 377 U.S. 351 (1964).

64. *Id.* at 358. Compare *United States v. Gilbert Associates*, 345 U.S. 361 (1953) (ruling that under the Insolvency Statute a private lien is inchoate until the creditor takes possession of or title to the subject property) with *New Britain*, 347 U.S. at 84 (ruling that a state lien against a solvent debtor was choate because "the identity of the lienor, the property subject to the lien, and the amount of the lien [were] established"). See *supra* note 46 for a discussion of the strict standard of choateness used in cases decided under the Insolvency Statute. See *supra* notes 55-58 and accompanying text for further discussion of *New Britain*, the first case decided under the existing tax lien statute to find a competing private lien choate. Because of the different standards applied to solvent and insolvent debtors, a private lien that is competing with a federal tax lien may be judged under a more stringent choateness standard if the debtor becomes insolvent.

cases under the Insolvency Statute, such priority is not automatic under federal tax lien law.⁶⁵

The *Vermont* Court upheld the priority of a Vermont tax lien over a later federal lien, even though both liens attached to all the debtor's property.⁶⁶ The Court rejected an argument that would later play a key role in *McDermott*: that a prior state lien must attach "to specifically identified portions of [the taxpayer's] . . . property" in order to be choate.⁶⁷ The *Vermont* Court concluded that a lien attaching "to all the taxpayer's property" was choate.⁶⁸

Overall, the choateness doctrine severely diminished the creditor protection rooted in the "first in time" principle. Until the ascent of the choateness doctrine beginning in 1950, the power of the federal tax lien as a weapon for tax enforcement had been balanced by measures

65. The *Vermont* Court also resolved another issue: whether a state-created lien, worded almost identically to a federal tax lien, can be inchoate. The Court reviewed its decision in *New Britain*, in which it upheld state-created liens on the basis that they were just as valid as the federal tax lien. *Vermont*, 377 U.S. at 355 (citing *New Britain*, 347 U.S. at 84). On this basis, the *Vermont* Court concluded, such a state-created lien would have to be choate. *Id.* at 358.

66. *Vermont*, 377 U.S. at 352-59. The State of Vermont had enacted a tax lien statute virtually identical to the existing federal statute. *Id.* at 352. On October 21, 1958, the state assessed a debtor for withheld state income taxes, which, according to the Vermont statute, placed a lien on all the debtor's assets lasting until the liability was satisfied. *Id.* More than three months after the state assessment, the IRS assessed the debtor for unpaid unemployment taxes. *Id.* at 353. Shortly thereafter, the state sued and won a judgment against the debtor, joining as a defendant a bank in which the debtor had deposited funds. *Id.* The federal government later brought an action, which was the subject of *Vermont*, to foreclose its lien against the debtor's bank accounts and establish priority over the state lien. *Vermont*, 377 U.S. at 353-54.

The Supreme Court considered the Vermont liens choate on the basis that there was "nothing more to be done to have a choate lien . . . the identity of the lienor, the property subject to the lien, and the amount of the lien [were] established." *Id.* at 355 (quoting *New Britain*, 347 U.S. at 84).

Writing for the Court, Justice Stewart provided further insight:

[U]nlike those cases in which the *Security Trust* rationale was applied to subordinate liens on the ground that judgment had not been obtained prior to the time the federal lien arose, it is as true of Vermont's lien here as it was true of the federal lien in *New Britain* that "[t]he assessment is given the force of a judgment, and if the amount assessed is not paid when due, administrative officials may seize the debtor's property to satisfy the debt."

Vermont, 377 U.S. at 358-59 (quoting *Bull v. United States*, 295 U.S. 247, 260 (1935)) (footnotes omitted).

67. *Vermont*, 377 U.S. at 355. See *infra* notes 127, 156 and accompanying text for discussion of treatments of this argument by the *McDermott* majority and dissent.

68. *Vermont*, 377 U.S. at 355. See also *Wisconsin v. Bar Coat Blacktop, Inc.*, 640 F. Supp. 407, 414 (W.D. Wis. 1986) (reasoning that *Vermont* stands for the proposition that a state lien directed to all of a taxpayer's property, rather than to specific portions of property, is not necessarily inchoate).

providing equity and relief to certain nonfederal creditors.⁶⁹ While the pre-1950 view had been that to gain priority a private lien need only be "first in time," the Court's new doctrine added the hurdle that the lien need also be choate.⁷⁰

C. The Federal Tax Lien Act of 1966

As the choateness doctrine was applied to federal tax liens on solvent debtors during the 1950s, the practices of commercial finance were changing as well. During this period, it became common to secure financing agreements with forms of after-acquired property such as future accounts receivable, inventory, and rights under long-term contracts.⁷¹ At the same time, states throughout the country adopted the Uniform Commercial Code ("U.C.C."), and with this statutory boost, "floating lien"⁷² financing became increasingly widespread.⁷³ The commercial community was soon troubled, however, when these methods of financing began to fall victim to the choateness doctrine,⁷⁴ since creditors competed for after-acquired property with federal tax liens.⁷⁵

Recognizing that the confusing new judicial concept of choateness was undermining the financing methods fostered by the U.C.C., Congress enacted the Federal Tax Lien Act of 1966 ("FTLA"),⁷⁶ which was incorporated into the Internal Revenue Code as sections 6321 through 6323 and has since remained largely unchanged.⁷⁷

69. See *supra* part II.A.

70. See text accompanying *supra* notes 51-62.

71. For discussion of the changes in financing, see generally Coogan, *supra* note 43, at 1376-77; Fetzer, *supra* note 54, at 874-86; Robert Peace, *Choateness and Lien Priority: Private Lien Creditors vs. the IRS*, 106 BANKING L.J. 157, 158 (1989); Olivia F. Gallo, Comment, *Conflict Between the Uniform Commercial Code and the Federal Tax Lien Act*, 7 WHITTIER L. REV. 1009, 1009-26 (1985).

72. A debtor's providing a security interest in its after-acquired property means that the creditor's interest attaches immediately whenever the debtor acquires new property; in a sense, the security interest "floats" over the debtor's estate. See Nickles, *supra* note 10, at 1140-41. Thus, an interest in after-acquired property is often termed a "floating lien." *Id.*

73. Fetzer, *supra* note 54, at 877, 888; Peace, *supra* note 71, at 158.

74. Michael St. James, *Federal Tax Liens—Making Bankruptcy Attractive to Creditors*, 46 BUS. LAW. 157, 159 (1990). Since floating lien financing was based upon an amorphous, constantly changing collateral and often secured a fluctuating debt, it soon became common for these liens to be subordinated to federal tax liens. Coogan, *supra* note 43, at 1377.

75. See, e.g., *Glass City Bank v. United States*, 326 U.S. 265 (1945) (holding that the federal tax lien burdened a tax debtor's after-acquired property).

76. Pub. L. No. 89-719, 80 Stat. 1125 (1966).

77. 26 U.S.C. §§ 6321, 6322, 6323 (1988 & Supp. IV 1992).

While Congress did not adopt the full extent of private creditor protection recommended by the American Bar Association,⁷⁸ it nevertheless enacted the FTLA based on considerations of equity⁷⁹ and designed it to conform tax lien law to U.C.C. concepts.⁸⁰

The FTLA both modified the federal tax lien's position vis-a-vis state liens with respect to the choateness doctrine and the "first in time" principle and recognized the priority of many state liens over federal liens.⁸¹ Still, in many respects, the FTLA merely constituted a repackaging and restatement of existing law. For instance, sections 6321 and 6322 of the federal tax code, which had previously established the federal lien and specified its duration, remained largely unchanged.⁸²

A major goal behind the FTLA was to conform federal law to the commercial transactions governed by the U.C.C. The FTLA attempted to accomplish this in at least two ways. First, it expanded the superpriority provisions now codified in section 6323(b).⁸³ Second, it provided specific protection for certain "commercial transactions financing agreements," including agreements creating security interests in after-acquired property.⁸⁴

78. See Fetzer, *supra* note 54, at 874; Peace, *supra* note 71, at 157.

79. Hencke, *supra* note 25, at 753.

80. H.R. REP. NO. 1884, 89th Cong., 2d Sess. 1-2 (1966). This House Report, which accompanied the bill that became the FTLA, stated:

Since the adoption of the Federal income tax in 1913, the nature of commercial financial transactions has changed appreciably. Business practices have been substantially revised and, as a result, many new types of secured transactions have been developed. . . . [In addition,] [u]nder the [Uniform] Commercial Code, priority now is afforded new types of commercial secured creditors not previously protected.

This bill is in part an attempt to conform the lien provisions of the internal revenue laws to the concepts developed in this Uniform Commercial Code.

Id.

81. *United States v. Kimbell Foods*, 440 U.S. 715, 738 (1979).

82. Young, *supra* note 36, at 724; Fed. Tax Coordinator, *supra* note 37, at 55,108. See *supra* notes 11-12 for the text of these sections.

83. Peace, *supra* note 71, at 162-63. See *supra* notes 38-41 and accompanying text for discussion of the previous superpriority provisions. Superpriority—the priority granted to state interests over all federal liens—was extended under the FTLA to eight new areas of interests: (1) personal property purchased at retail; (2) personal property purchased in casual sale; (3) personal property subject to possessory lien; (4) real property tax and special assessment liens; (5) residential property subject to a mechanic's lien for certain repairs and improvements; (6) attorney's liens; (7) certain insurance contracts; and (8) passbook loans. Peace, *supra* note 71, at 162-63; Fed. Tax Coordinator, *supra* note 37, at 55,108-09.

84. Peace, *supra* note 71, at 163. According to Peace:

In general, this provision states that a filed federal tax lien is inferior to a security interest that comes into existence *after* the tax lien filing if the subsequent security interest is in qualified property and the interest is created with a

For traditional judgment lien creditors, however, the FTLA amendments did not alter the status quo established by the "first in time" principle and the notice-filing provision.⁸⁵ Still, the FTLA reinforced protections already enjoyed by judgment creditors, and with the

commercial transactions financing agreement. . . .

. . . The term "qualified property" includes only commercial financing security acquired by the taxpayer within forty-five days after the date of a tax lien filing.

Id. (emphasis added). A "commercial transactions financing agreement" is defined in § 6323(c)(2)(A) as an agreement (i) to make loans to the taxpayer to be secured by "commercial financing security" (either commercial paper, receivables, mortgages, or inventory) acquired by the taxpayer or (ii) to purchase commercial financing security (other than inventory). 26 U.S.C. § 6323(c)(2) (1988). This provision was the principal measure adopted under the FTLA to conform with the U.C.C. For further discussion of the effects of this provision, see generally Fetzer, *supra* note 54; PLUMB, *supra* note 22 (highlighting the casual sale superpriority provision); Coogan, *supra* note 43; Nickles, *supra* note 10; Gallo, *supra* note 71.

Furthermore, while purchasers and judgment creditors remained protected under the notice-filing provision of section 6323(a), pledgees and mortgagees were replaced by mechanic's lienors and "holder[s] of a security interest" as protected parties. 26 U.S.C. § 6323(a) (1988 & Supp. IV 1992). A "security interest" is defined as follows:

The term "security interest" means any interest in property acquired by contract for the purpose of securing payment or performance of an obligation or indemnifying against loss or liability. A security interest exists at any time (A) if, at such time, the property is in existence and the interest has become protected under local law against a subsequent judgment lien arising out of an unsecured obligation, and (B) to the extent that, at such time, the holder has parted with money or money's worth.

26 U.S.C. § 6323(h)(1) (1988). Under this definition, notice-filing protection would exist for a typical home mortgage, auto loan, or other lending arrangement secured by property in the possession of the debtor.

85. The FTLA's addition of security interest holders as a protected class and protection of "commercial transaction financing agreements" provided priority to the after-acquired property interests mainly held by commercial, consensual lienors, rather than the traditional judgment creditor involved in *McDermott*.

Most FTLA-prompted litigation has involved attempts to classify consensual security arrangements as falling within the protection of the FTLA—litigation that is not relevant to the focus of this Note. *See, e.g.,* Southern Rock, Inc. v. B & B Auto Supply, 711 F.2d 683 (5th Cir. 1983) (rejecting an attempt to classify an assignment of receivables within § 6323(c)(1)); Rice Investment Company v. United States, 625 F.2d 565 (5th Cir. 1980) (rejecting an attempt to classify a security interest in after-acquired inventory within § 6323(c) on the basis that the inventory was not "qualified property"); Sgro v. United States, 609 F.2d 1259 (7th Cir. 1979) (rejecting an attempt to classify a security arrangement under § 6323(c) where the agreement was not one to make loans and where it was entered in the course of trade or business).

Still, the FTLA has generated an issue with some relevance to this Note, that being the issue of when a security interest in after-acquired property has been acquired and attached. *See* Peace, *supra* note 71, at 163-72 for further discussion of this area. Most decisions on this issue, however, deal with consensual security agreements based on commercial lending arrangements. Those decisions are thus not directly related to *McDermott*, which dealt instead with after-acquired property subject to a nonconsensual judgment lien.

FTLA, Congress, for the first time, provided specific protection to creditors having a security interest in after-acquired property. The FTLA also codified the "first in time" principle and reaffirmed both the notice-filing provision and the choateness doctrine as it applied to judgment creditors.⁸⁶

III. DISCUSSION

When the Supreme Court granted certiorari⁸⁷ in *United States v. McDermott*, it undertook to rule on the priority of a federal tax lien against a nonconsensual, state-created lien for the first time since the enactment of the FTLA. The *McDermott* Court addressed questions raised by competing claims of a federal tax lien and a private creditor's judgment lien on a debtor's after-acquired property.⁸⁸

A. *McDermott: The Facts and Lower Court Opinions*

In 1981, Bruce and Betty McDermott contracted to sell real estate (the "South Street property" or "the property") located in Salt Lake City, Utah.⁸⁹ Under the terms of the contract, the buyers gave the McDermotts \$191,000 in cash and \$146,000 in a note to be paid in monthly installments.⁹⁰ To secure the note, the buyers also issued a Trust Deed on the South Street property, conveying their interest to a trustee.⁹¹ Under the terms of the sale, the McDermotts were to retain legal title to the South Street property until the buyers made their final payment.⁹²

86. The House report accompanying the bill that became the FTLA acknowledged the choateness doctrine in the following passage:

Under decisions of the Supreme Court a mortgagee, pledgee, or judgment creditor is protected at the time notice of the tax lien is filed if the identity of the lienor, the property subject to the lien, and the amount of the lien are all established at such time. . . . [S]ubsection (a) of new section 6323 retains this basic rule of Federal law.

H.R. REP. NO. 1884, 89th Cong., 2d Sess. 35 (1966). Furthermore, in *Kimbell Foods*, the Court reasserted that the choateness doctrine must still be applied to state-created liens. 440 U.S. at 720-21.

87. 112 S. Ct. 2272 (1992).

88. *United States v. McDermott*, 113 S. Ct. 1526, 1530-31 (1993).

89. Brief for Petitioner at 2, *United States v. McDermott*, 113 S. Ct. 1526 (1993) (No. 91-1229).

90. *McDermott v. Zions First Nat'l Bank, N.A.*, 945 F.2d 1475, 1477 (10th Cir. 1991) [hereinafter *Zions*].

91. *Id.*

92. *Id.* at 1477-78 & n.4. In an installment land sale contract, the vendors (here the McDermotts) retain legal title to the property as security for the purchase price. *Butler v. Wilkinson*, 740 P.2d 1244, 1254 (Utah 1987). The title serves as the basis for forfeiting the buyer's interest and retaking possession of the property in the case of

On December 9, 1986, the Internal Revenue Service ("IRS") assessed the McDermotts for unpaid federal taxes due from the years 1977 through 1981.⁹³ This assessment created a lien in favor of the United States on all the McDermotts' property,⁹⁴ including after-acquired property.⁹⁵ The IRS, however, did not file notice of the tax lien in Salt Lake County until September 9, 1987.⁹⁶ In the meantime, on June 22, 1987, Zions First National Bank (the "Bank") obtained a \$67,977.67 state court judgment against the McDermotts, which it docketed with the Salt Lake County Clerk on July 6, 1987.⁹⁷ Under Utah law, this created a judgment lien on all the McDermotts' real property in Salt Lake County, including after-acquired property.⁹⁸

When the buyers defaulted on their note, the McDermotts began foreclosure proceedings on the South Street property and eventually repurchased the property at a trustee's sale on September 23, 1987,⁹⁹ two weeks after the IRS filed notice of its lien and two months after the Bank docketed its judgment.¹⁰⁰ There is no evidence that either the IRS or the Bank had attempted to execute its lien prior to this time.¹⁰¹

To facilitate the sale of the South Street property to a third party, the McDermotts, the IRS, and the Bank entered into an escrow agreement

default. *Cannefax v. Clement*, 818 P.2d 546, 549 (Utah 1991). Additionally, the interest may be sold or mortgaged based upon the amount the buyer owes under the contract. *Butler*, 740 P.2d at 1255.

This interest of the vendor has been called "bare" or "naked" legal title. *Cannefax*, 818 P.2d at 549. Under the doctrine of equitable conversion, the buyer obtains an equitable interest in the land even though he does not yet have legal title. *Butler*, 740 P.2d at 1255 n.5. Furthermore, the buyer is treated as the owner of the land and "may mortgage his or her equity in the land, assign it to a third party as security for a loan, or sell the interest by way of an assignment." *Id.* at 1254 (citations omitted); *see also* *Lach v. Deseret Bank*, 746 P.2d 802, 805 (Utah Ct. App. 1987) (stating that the buyer is "thereafter treated as the owner of the land").

93. *McDermott*, 113 S. Ct. at 1527.

94. 26 U.S.C. §§ 6321, 6322 (1988). *See supra* note 11 for the text of § 6321, and *supra* note 12 for the text of § 6322.

95. *Glass City Bank v. United States*, 326 U.S. 265, 267 (1945); *Wisconsin v. Bar Coat Blacktop*, 640 F. Supp. 407, 412 (W.D. Wis. 1986).

96. *McDermott*, 113 S. Ct. at 1527.

97. Brief for Respondent at 3, *United States v. McDermott*, 113 S. Ct. 1526 (1993) (No. 91-1229). The Bank's judgment arose out of litigation regarding a defaulted promissory note the McDermotts issued to the Bank guaranteeing repayment of a loan independent of, and irrelevant to, the South Street property. *Zions First Nat'l Bank, N.A. v. McDermott*, No. C86-09140 (3d Jud. Dist. Ct. Salt Lake County June 22, 1987).

98. UTAH CODE ANN. § 78-22-1 (1992). *See supra* note 7 for the text of this statute.

99. Brief for Respondent, *supra* note 97, at 3.

100. *See supra* text accompanying notes 96-97.

101. *Zions*, 945 F.2d at 1477.

(the "Agreement").¹⁰² The Agreement provided that the IRS and the Bank released their claims on the South Street property, but reserved their rights to the cash proceeds of the sale of the property based upon the priorities of their liens at the time the McDermotts reacquired the property.¹⁰³ Pursuant to the Agreement, the McDermotts initiated an interpleader action in state court and deposited \$135,575.50, the net proceeds of the sale of the South Street property.¹⁰⁴

The IRS removed the case to the United States District Court for the District of Utah.¹⁰⁵ Ruling on cross-motions for summary judgment, the district court concluded that both liens simultaneously attached to the South Street property at the time the McDermotts reacquired it.¹⁰⁶ The court also determined that under the Agreement, the IRS waived all claims it may have had on any "personalty" interest retained by the McDermotts under the real estate contract conveying the South Street property to the buyers.¹⁰⁷ Applying the common law rule of "first in time, first in right,"¹⁰⁸ the district court held that the Bank's judgment lien had priority over the IRS lien because it was docketed before the IRS filed its notice.¹⁰⁹

The Tenth Circuit unanimously affirmed the district court's decision, although it did so on different grounds.¹¹⁰ It agreed with the district court's conclusion that the Bank and the IRS had intended, by

102. *McDermott*, 113 S. Ct. at 1527-28.

103. *Id.* The March 4, 1988 Agreement contained the following pertinent language:

It is understood that the releases delivered herewith by the IRS and Zions are unconditional. The monies placed in escrow shall be in lieu of all legal or equitable rights of the IRS and Zions to the real property released by them as part of this agreement. Neither party hereto waives any rights, defenses, and claims that they may have had or any of them may have had in any interest in and to the real property, such rights being reserved and shall apply to the cash proceeds being held in escrow in substitution of the subject real property. The respective priorities of the parties to the cash proceeds shall be identical to the priorities of the respective liens of the parties as they existed against the real property as of September 23, 1987, after Bruce J. McDermott successfully bid and purchased the property at the Trustee's Sale, notwithstanding the change in form of collateral.

Brief for Respondent, *supra* note 97, at 4.

104. Brief for Petitioner, *supra* note 89, at 3.

105. *McDermott*, 113 S. Ct. at 1528.

106. *Zions*, 945 F.2d at 1478.

107. *Id.* See *supra* note 103 for the Agreement provisions examined by the district court.

108. See *supra* note 9, citing *Rankin & Schatzell*, 25 U.S. (12 Wheat.) at 179 ("The principle is believed to be universal, that a prior lien gives a prior claim, which is entitled to prior satisfaction . . .").

109. *Zions*, 945 F.2d at 1478.

110. *Id.* at 1475.

the Agreement, that their liens would attach to the South Street property.¹¹¹ While the issue of whether the McDermotts had rights in the South Street property to which the federal lien could attach would normally be resolved under Utah law,¹¹² the Tenth Circuit declared that the IRS and the Bank had made state law inapplicable by implicitly recognizing in the Agreement that their liens would attach to the McDermotts' real property interest in the South Street property.¹¹³ The court then reiterated that federal law governs priority among federal tax liens and state-created liens.¹¹⁴

Citing the choateness test from *New Britain*,¹¹⁵ the Tenth Circuit reasoned that under *Vermont*, if a creditor perfects a lien on all of a debtor's real property before the federal government provides notice of

111. *Id.* at 1478-79. The Tenth Circuit also noted that at the time of the district court decision, "it was not clear in Utah whether or not a judgment lien could attach to a vendor's interest in a real estate contract." *Id.* at 1479 n.5. The court further noted that in 1990, a Utah Court of Appeals decision held that a vendor had no such property rights to which a lien could attach. *Id.* (citing *Cannefax*, 786 P.2d 1377). Other states take the contrary view. *E.g.* *Mooring v. Brown*, 763 F.2d 386 (10th Cir. 1985) (applying Colorado law); *First Sec. Bank v. Rogers*, 429 P.2d 386 (Idaho 1967); *May v. Emerson*, 96 P. 454 (Or. 1908); *Heath v. Dodson*, 110 P.2d 845 (Wash. 1941).

The *Cannefax* decision was later affirmed by the Supreme Court of Utah. *Cannefax*, 818 P.2d 546 (Utah 1991), *aff'g* 786 P.2d 1377 (Utah Ct. App. 1990). In doing so, the Utah Supreme Court stated that "the mere retention of title of land subject to a land sale contract does not amount to ownership of real property for purposes of [UTAH CODE ANN.] § 78-22-1 [1953]." 818 P.2d at 550.

This distinction is critical. If the McDermotts had an interest before the foreclosure to which the Bank's judgment lien could attach, then arguably the Bank's lien had attached to the McDermotts interest when it was created on July 6—two months prior to the IRS's Notice of Tax Lien. Since "[t]he lien imposed by section 6321 [establishing federal tax liens] shall not be valid as against any . . . judgment lien creditor *until notice thereof . . . has been filed*," 26 U.S.C. § 6323(a) (1988 & Supp. IV 1992) (emphasis added), this would have given priority to the Bank's lien.

The Tenth Circuit also noted that the federal tax lien may have attached to the McDermotts' beneficial interest, but that the IRS had not argued this point. *Zions*, 945 F.2d at 1479 n.5. In this respect, it is important to note that while a Utah judgment lien can only attach to the real property interests of a debtor, UTAH CODE ANN. § 78-22-1, a federal tax lien can attach to either the real or personal interests of the debtor. 26 U.S.C. § 6321. Implicit in the district court and Tenth Circuit's decisions is the conclusion that the Agreement waived the IRS's interest in the personalty aspect of the contract that conveyed the South Street property to the original purchasers. *See supra* notes 103, 107, *infra* note 113 and accompanying text. The IRS disputed this conclusion in the Supreme Court. *See Brief for Petitioner, supra* note 89, at 4 n.2. However, the Court did not address the issue.

112. *Zions*, 945 F.2d at 1479 (citing *Aquilino*, 363 U.S. at 512-13).

113. *Id.*; *see also supra* notes 103, 108.

114. *Zions*, 945 F.2d at 1479 (citing *United States v. Equitable Life Assurance Soc'y*, 384 U.S. 323, 328 (1966)).

115. The lien must be "perfected in the sense that there is nothing more to be done to have a choate lien . . ." *New Britain*, 347 U.S. at 84.

its tax lien, the creditor's lien takes priority, even with respect to property acquired after both liens arose.¹¹⁶ The court then concluded that since the Bank's lien, like the lien in *Vermont*, was noncontingent, specific in amount, and fully enforceable once docketed, it was entitled to priority over the later-filed IRS lien.¹¹⁷

B. *The Opinion of the Supreme Court*

In a six-to-three decision, the Supreme Court reversed the Tenth Circuit.¹¹⁸ Although the majority and dissent agreed that the guidance provided by the relevant statutes and precedents was unclear,¹¹⁹ they did not agree on whether the Bank's lien was choate at the time the IRS filed notice. The majority observed that although the IRS's lien attached when the McDermotts reacquired the South Street property, the lien became valid against the Bank's lien on the date the IRS filed notice.¹²⁰ The majority then concluded that the Bank's lien did not become choate until it attached to the South Street property when the McDermotts reacquired it, and since that occurred after the IRS filed notice, the IRS had priority.¹²¹ In contrast, the dissent concluded that the Bank's lien became choate when the Bank docketed and filed its judgment against the McDermotts with the clerk of the state court.¹²²

Writing for the majority, Justice Scalia reaffirmed the propositions that federal tax liens do not enjoy automatic priority, and that unless otherwise provided by statute, the common law rule of "first in time is first in right" applies.¹²³ He then opined that according to the current notice-filing provision, the IRS's lien could not have gained priority over the Bank's lien under any circumstances until the IRS filed notice.¹²⁴ Accordingly, Justice Scalia examined whether, under the dictates of *New Britain*, the Bank's lien was choate before the IRS

116. *Zions*, 945 F.2d at 1480.

117. *Id.* at 1481. For a discussion of the Tenth Circuit ruling, see James Serven, *Taxation*, 69 DENV. U. L. REV. 1037, 1076-80 (1992).

118. *McDermott*, 113 S. Ct. at 1526. Justice Scalia delivered the opinion of the Court, in which Chief Justice Rehnquist and Justices White, Blackmun, Kennedy, and Souter joined. *Id.* Justice Thomas wrote a dissenting opinion, in which Justices Stevens and O'Connor joined. *Id.*

119. *See McDermott*, 113 S. Ct. at 1531 ("[W]e would hardly proclaim the statutory meaning we have discerned in this opinion to be 'clear.'"); *id.* at 1534 (Thomas, J., dissenting) ("[O]ur precedents do not provide the clearest answer to the question.")

120. *McDermott*, 113 S. Ct. at 1530.

121. *Id.* at 1529-30.

122. *Id.* at 1532.

123. *Id.* at 1528 (citing *New Britain*, 347 U.S. at 85; *Rankin & Schatzell*, 25 U.S. (12 Wheat.) at 179).

124. *McDermott*, 113 S. Ct. at 1528.

filed notice.¹²⁵

The *New Britain* criterion most at issue in *McDermott* was whether the property subject to the Bank's lien was sufficiently established for the lien to be considered choate. In this regard, Justice Scalia first criticized the Tenth Circuit's conclusion that *Vermont* established that a noncontingent, state-created lien on all of a debtor's real property will take priority over a federal lien regardless of whether the state-created lien covers after-acquired property.¹²⁶ According to Justice Scalia, the *Vermont* Court merely concluded that a state-created lien on all of a debtor's property need not *attach* to specifically identified portions of the debtor's property to be choate.¹²⁷ He stressed that *Vermont* left open the precise question presented in *McDermott*: whether a lien on after-acquired property can ever be choate under the *New Britain* criteria.¹²⁸

In the pivotal point of the *McDermott* decision, Justice Scalia announced that the Bank's lien did not become choate until it attached to the South Street property at the time the McDermotts reacquired it.¹²⁹ Accordingly, he rejected the argument that because the Bank, after docketing its judgment, did not need to do anything further to make its lien enforceable against the after-acquired property, the Bank's lien became choate at the point of docketing.¹³⁰ Justice Scalia analogized that under the U.C.C., a security interest in after-acquired property is not perfected when a creditor files a financing statement¹³¹

125. Justice Scalia quoted the *New Britain* Court's statement that for a lien to be perfected, "the identity of the lienor, the property subject to the lien, and the amount of the lien [must be] established." *Id.* (quoting *New Britain*, 347 U.S. at 84) (emphasis omitted).

126. *McDermott*, 113 S. Ct. at 1528. See *supra* text accompanying note 116 for discussion of the Tenth Circuit's reading of *Vermont*.

127. Justice Scalia stated that the critical argument rejected in *Vermont* was not that: [T]he State's claim could not be superior unless [the property claimed by the State and federal government] had been "specifically identified" as property subject to the State's lien, but rather that the State's claim could not be superior unless it had "*attach[ed]*" to specifically identified portions of that property."

McDermott, 113 S. Ct. at 1528-29 n.2 (citation omitted) (alteration in original).

128. *Id.* at 1529 ("We did not consider, and the facts as recited did not implicate, the quite different argument made by the United States in the present case: that a lien in after-acquired property is not 'perfected' as to property yet to be acquired").

129. *Id.* at 1529-30.

130. *Id.* at 1529. According to the majority, this argument misconstrued the *New Britain* requirement that for perfection, "nothing more [had] to be done to have a choate lien," *New Britain*, 347 U.S. at 84, adding that the argument "would simply have us substitute the concept of 'best efforts' for the concept of perfection." *McDermott*, 113 S. Ct. at 1529 n.4.

131. A financing statement is a document that is signed by the debtor and names the

but rather when the interest attaches to a specific piece of property upon acquisition.¹³² Accordingly, Justice Scalia concluded, the Bank's lien did not become choate until the McDermotts reacquired the South Street property, because only then could "the property subject to the lien" be established within the *New Britain* criteria.¹³³ Noting that the Bank conceded that its lien did not attach to the South Street property until the McDermotts reacquired it,¹³⁴ Justice Scalia concluded that the Bank's state-created lien was not "first in time" because at the time of reacquisition, the IRS had already filed notice of its lien.¹³⁵

Justice Scalia then focused on the priority enjoyed by federal tax liens. Although he acknowledged that both the Bank's lien and the IRS's lien relied on after-acquired property provisions to attach simultaneously to the South Street property,¹³⁶ Justice Scalia determined that under section 6323(a) of the federal tax code, the IRS's filing of notice rendered its lien valid for "first in time" purposes.¹³⁷ Unlike the Bank's judgment lien, Justice Scalia maintained, a filed tax lien is valid regardless of whether it has attached to a specific piece of property.¹³⁸

debtor and secured party, provides their addresses, and gives a description of the collateral. U.C.C. § 9-402(1), 3A U.L.A. 546 (1992); see *supra* note 10 for further discussion of financing statements.

132. *McDermott*, 113 S. Ct. at 1529 (citing U.C.C. § 9-203, 3 U.L.A. 363 (1992); U.C.C. § 9-303(1), 3A U.L.A. 117 (1992)).

133. *McDermott*, 113 S. Ct. at 1529-30 n.5. Justice Scalia emphasized the "unavoidable realities that the property subject to a lien is not 'established' until one knows what specific property that is, and that a lien cannot be anything other than 'inchoate' with respect to property that is not yet subject to the lien." *Id.* He further urged:

[H]ow could [the judgment lien] have been at th[e] time [it was created] "definite" as to this property, when the identity of this property . . . was yet unknown? Or "noncontingent" as to this property, when the property would have remained entirely free of the judgment lien had the McDermotts not later decided to buy it? Or "summarily enforceable" against this property when the McDermotts did not own, and had never owned, it? . . . [O]f course it was *not* "immediately enforceable" . . . against property that the McDermotts had not yet acquired.

Id.

134. *Id.* at 1529-30 (citing Brief for Respondent, *supra* note 97, at 16, 21). It should be noted that the Bank's brief did not merely state that "its lien did not actually attach to the property at issue here until the McDermotts acquired rights in that property" as quoted by the Court, *McDermott*, 113 S. Ct. at 1530, but stated that at that time, both liens "simultaneously attached *specifically* to the Property." Brief for Respondent, *supra* note 97, at 16 (emphasis added).

135. *McDermott*, 113 S. Ct. at 1530.

136. *Id.*

137. *Id.*

138. *Id.* ("We think . . . that under the language of § 6323(a) . . . the filing of notice

Justice Scalia concluded by addressing the fairness of the Court's ruling. Responding to the argument that the common law rule of "first in time" should apply unless a lien-creating statute clearly manifests a contrary intent,¹³⁹ he conceded that such a rule might be appropriate where simultaneously perfected liens arise out of voluntary transactions—but not in the situation posed by *McDermott*.¹⁴⁰ To illustrate, he drew a scenario in which two succeeding private lenders with notice rely on after-acquired property as security.¹⁴¹ In such circumstances, Justice Scalia reasoned, the second lender, knowing of the first lender's prior claim, can make an informed choice of whether or not to extend credit.¹⁴² In contrast, Justice Scalia maintained, the IRS does not have a similar choice; it must assess and collect taxes from all taxpayers, regardless of any previously filed security agreements that encumber the taxpayers.¹⁴³ He also urged that the "first to file" presumption the Bank advocated is inapposite under the tax statutes, which generally give the IRS priority even if it never files notice.¹⁴⁴

C. The Dissenting Opinion

Writing for the dissent, Justice Thomas agreed that under the notice-filing provision, the date the IRS files notice determines a federal tax lien's priority.¹⁴⁵ He argued, however, that the key criterion under *New Britain* is whether the private lien was perfected on the filing date, in the sense that there was nothing more to be done for it to become choate.¹⁴⁶ In Justice Thomas's opinion, the Bank's lien would have achieved choateness under this criterion if the property subject to the lien were sufficiently established at the time the IRS filed

renders the federal tax lien extant for 'first in time' priority purposes regardless of whether it has yet attached to identifiable property.").

139. *McDermott*, 113 S. Ct. at 1530 (citing Brief for Respondent, *supra* note 97, at 11).

140. *McDermott*, 113 S. Ct. at 1530-31.

141. *Id.* at 1531.

142. *Id.* Justice Scalia reasoned:

When two private lenders both exact from the same debtor security agreements with after-acquired-property clauses, the second lender knows, by reason of the earlier recording, that that category of property will be subject to another claim, and if the remaining security is inadequate he may avoid the difficulty by declining to extend credit.

Id.

143. *McDermott*, 113 S. Ct. at 1531.

144. *Id.*

145. *Id.* at 1531 (Thomas, J., dissenting).

146. *Id.* (Thomas, J., dissenting) (citing *New Britain*, 347 U.S. at 84).

its notice.¹⁴⁷ He concluded that precedent established that a lien on after-acquired property may be choate before the debtor acquires rights in the property.¹⁴⁸

According to Justice Thomas, the proper focus for determining whether property is sufficiently established is “whether the lien is free from ‘contingencies’ that stand in the way of its execution.”¹⁴⁹ For example, notwithstanding the fact that the state-created lien in *Vermont* did not attach to a specific piece of property, Justice Thomas urged, the Court granted it priority since it was “‘summarily enforceable’ upon assessment and demand.”¹⁵⁰ Justice Thomas further recognized that although priority under the notice-filing provision is a federal question, state law must be consulted to resolve the question.¹⁵¹ He emphasized that under Utah law, the Bank’s lien was noncontingent, definite to the type of property, and immediately enforceable upon the debtor’s acquisition of the property.¹⁵² Justice Thomas maintained that because the Bank’s lien had reached this stage of certainty, nothing else needed to be done for the lien to become choate, and the Bank was thus entitled to priority over the later-filed federal tax lien.¹⁵³

147. *McDermott*, 113 S. Ct. at 1531 (Thomas, J., dissenting) (citing *New Britain*, 374 U.S. at 84).

148. *Id.* at 1531 (Thomas, J., dissenting). Justice Thomas argued that the Bank’s lien was “definite as to the property in question, noncontingent, and summarily enforceable,” *id.* at 1532, and, therefore, had “‘acquired sufficient substance and ha[d] become so perfected,’ with respect to the McDermotts’ after-acquired real property, ‘as to defeat [the] later-filed federal tax lien.’” *Id.* at 1531 (Thomas, J., dissenting) (quoting *Pioneer*, 374 U.S. at 88) (alteration in original).

149. *McDermott*, 113 S. Ct. at 1531-32 (Thomas, J., dissenting) (citing *Security Trust*, 340 U.S. at 50).

150. *Id.* at 1532 (Thomas, J., dissenting) (citing *Vermont*, 377 U.S. at 359 & n.12). In contrast, Justice Thomas reasoned, the lien at issue in *Security Trust* was not given priority since it required that steps be taken to make it enforceable. *Id.* at 1532 (Thomas, J., dissenting).

151. *Id.* (Thomas, J., dissenting) (“Although the choateness of a state-law lien under § 6323(a) is a federal question, that question is answered in part by reference to state law, and we therefore give due weight to the State’s ‘classification of [its] lien as specific and perfected.’”) (citing *Pioneer*, 374 U.S. at 88 n.7; *Security Trust*, 340 U.S. at 49) (alteration in original).

152. *McDermott*, 113 S. Ct. at 1532 (Thomas, J., dissenting) (citing *Belnap v. Blain*, 575 P.2d 696, 700 (Utah 1978); *UTAH R. CIV. P.* 69). Justice Thomas also observed that “[n]othing in the law . . . suggests that the possibility . . . that the McDermotts would *not* acquire the [South Street property] was a ‘contingency’ that rendered the Bank’s otherwise perfected general judgment lien subordinate to intervening liens.” *Id.* at 1533 (Thomas, J., dissenting). He further noted that the Bank’s lien was “‘not subject to alteration by a court on equitable grounds.’” *Id.* at 1532 (Thomas, J., dissenting) (quoting *Taylor Nat’l, Inc. v. Jensen Bros. Constr. Co.*, 641 P.2d 150, 155 (Utah 1982)).

153. *McDermott*, 113 S. Ct. at 1534 (Thomas, J., dissenting).

Justice Thomas took issue with the Court's attempt to distinguish *Vermont*, stating that the argument of the government rejected in *Vermont* was "analytically indistinguishable" from the argument the Court accepted in *McDermott*.¹⁵⁴ He reasoned that in *Vermont*, the state lien applied to all property rights, whenever acquired.¹⁵⁵ Furthermore, according to Justice Thomas, the *Vermont* Court rejected the argument that the state lien could not have priority unless it "specifically identified" the bank account in question as subject to the lien.¹⁵⁶ Therefore, Justice Thomas argued, the acquisition of a specific piece of property should not be a requirement for a lien to be choate.¹⁵⁷ Although at the time the IRS filed its notice it may have been uncertain

154. *Id.* at 1532-33 (Thomas, J., dissenting). Furthermore, Justice Thomas noted:

The Department of Treasury regulations defining "judgment lien creditor" for purposes of § 6323(a) set forth only three specific requirements for a choate lien (corresponding to the three "establish[ment]" criteria of *New Britain*). The judgment creditor must "obtai[n] a valid judgment" (thus establishing the lienor) for the recovery of "specifically designated property or for a certain sum of money" (thus establishing the amount of the lien), and if recording or docketing is "necessary under local law" for the lien to be effective against third parties, the judgment lien "is not perfected with respect to real property until the time of such recordation or docketing." The last requirement—recording or docketing—is the only specific requirement recognized in the regulations for establishing the real property subject to the judgment lien. The regulations in no way suggest that § 6323(a) imposes any "attachment" condition for after-acquired property. Such a condition would be, in effect, an additional recordation requirement that is not otherwise imposed by local law.

Id. at 1532 n.1 (Thomas, J., dissenting) (citing 26 C.F.R. § 301.6323(h)-1(g) (1992)). Justice Scalia responded that the regulation also says that to have priority, a judgment lien must be choate, which does not occur "until the identity of the lienor, *the property subject to the lien*, and the amount of the lien are established." *Id.* at 1530 n.6 (quoting 26 C.F.R. § 301.6323(h)-1(g)) (emphasis added).

155. *McDermott*, 113 S. Ct. at 1533 (Thomas, J., dissenting).

156. *Id.* at 1533 n.2 (Thomas, J., dissenting). In contrast, Justice Scalia opined that the failed argument was not that the property be identified as subject to the state lien, but that the lien must attach to specifically identified portions of the property. *See supra* notes 126-28 and accompanying text (further discussing Justice Scalia's position).

Justice Thomas argued that the majority's reasoning, like the Government's failed argument in *Vermont*, partly relied on dicta in *New Britain* that "'attachment to specific property [is] a condition for choateness of a State-created lien.'" *McDermott*, 113 S. Ct. at 1533 (Thomas, J., dissenting) (quoting Brief for United States at 19, *United States v. Vermont*, 375 U.S. 940 (1963) (No. 509)) (alteration in original). He explained the failure of both arguments by pointing out that *New Britain, Security Trust*, and "all of our cases before *Vermont*" involved two liens that had attached to the same property and "provided no occasion to consider the necessity of attachment to property that was not specifically identified at the time the state lien arose." *Id.* at 1533 (Thomas, J., dissenting).

157. *McDermott*, 113 S. Ct. at 1533 (Thomas, J., dissenting) ("If specific attachment is not required for the state lien to be 'sufficiently choate' . . . then neither is specific acquisition.").

whether the McDermotts would specifically reacquire the South Street property, Justice Thomas observed, the property was known to be subject to the lien because the Bank's lien applied to all after-acquired property without limitation.¹⁵⁸

Justice Thomas further observed that state law would provide the Bank at least some level of satisfaction.¹⁵⁹ Under typical state law, he noted, "the Bank's interest in after-acquired real property generally could not be defeated by an intervening statutory lien."¹⁶⁰ Although in some states the order of docketing determines the priority of judgment liens,¹⁶¹ Justice Thomas observed, in other states liens that attach simultaneously are regarded as being in parity and are satisfied on a pro rata basis.¹⁶² Justice Thomas also charged that the majority's analogy to the U.C.C. was misguided, and that the rules governing security interests in personal property have no application to judgment liens on real property and should not be relied upon in determining choateness.¹⁶³

158. *Id.* at 1533 n.2 (Thomas, J., dissenting). Justice Thomas argued that in *Vermont*, the Court rejected the argument that the property must be "specifically identified" as subject to the state lien. *Id.* He further maintained:

At the time of the federal filing [in *Vermont*], the debtor's interest in the bank account, like the McDermotts' interest in the property at issue here, could have been uncertain or indefinite from the creditors' perspective. Nevertheless, in both cases, the particular property was "known to be subject to the [state] lien," simply because that lien, by its terms, applied without limitation to all property acquired at any time by the debtor.

Id. (Thomas, J., dissenting) (citation omitted).

Justice Scalia disputed this interpretation and maintained that the debtor in *Vermont* could not have acquired its interest in the bank account prior to the filing of the federal tax lien and have that interest be uncertain. *Id.* at 1528 n.2. Justice Scalia then noted that the argument the Court rejected in *Vermont* was not that the state lien must specifically identify the property subject to its lien, but that the state lien must attach to specifically identified portions of the property. *Id.*; see also *supra* notes 126-28 and accompanying text (further discussing Justice Scalia's position).

159. *McDermott*, 113 S. Ct. at 1534 (Thomas, J., dissenting) ("[U]nder state common law, the Bank would either retain its full priority in the property by virtue of its earlier filing or, at a minimum, share an equal interest with the competing lienor."). Justice Thomas also maintained that even if Justice Scalia was correct in concluding that attachment is required for choateness, the federal lien did not attach until the Bank's lien did—when the McDermotts reacquired the South Street property. *Id.* at 1534 n.4 (Thomas, J., dissenting). In that event, Justice Thomas urged, the Bank's lien should be in accordance with the common law rule of parity. *Id.* (Thomas, J., dissenting).

160. *Id.* at 1533 (Thomas, J., dissenting).

161. *Id.* (Thomas, J., dissenting) (citing *Lowe v. Reiersen*, 276 N.W. 224, 227 (Minn. 1937)).

162. *McDermott*, 113 S. Ct. at 1533 (Thomas, J., dissenting) (citing *Bank of Boston v. Hafler*, 482 N.E.2d 542, 547 (Mass. App. Ct. 1985); *McAllen State Bank v. Saenz*, 561 F. Supp. 636, 639 (S.D. Tex. 1982)).

163. *Id.* at 1534 n.3 (Thomas, J., dissenting).

Finally, Justice Thomas concluded that the majority's narrow reading of *Vermont* ignored the purpose of the amendments that Congress made to the tax lien statutes throughout the 20th century.¹⁶⁴ He stressed that Congress amended the statutes in order to protect private parties against harsh applications of federal tax lien priority.¹⁶⁵ According to Justice Thomas, the Court's ruling renders creditors with security interests in after-acquired property once again subject to secret tax liens.¹⁶⁶

IV. ANALYSIS

As Justice Scalia stated in *McDermott*, it is difficult to discern the meaning of the law governing federal tax lien priority.¹⁶⁷ To further complicate matters, as Justice Thomas observed, precedents do not provide a clear answer to the question of priority of liens secured by after-acquired property.¹⁶⁸ Nevertheless, a sound analytical course can be traced through the confusion. The *McDermott* Court failed to recognize and follow this course. In so doing, the Court neglected to honor the stature it had previously ascribed to final judgments, disregarded the long-standing judicial recognition that judgment liens may be enforced against after-acquired property, and misread its own precedents on the choateness doctrine. The Court also reversed an eighty-year trend of protecting judgment creditors from harsh applications of the federal tax lien. Finally, *McDermott* renders the notice-filing provision ineffective with regard to liens on after-acquired property and fosters a return to the days when the IRS's "secret lien" won priority over the diligent judgment creditor. These aspects of *McDermott* are examined below.

A. *The Historical Stature of Judgment Liens*

It is undisputed that the Bank had received a final, binding judgment in its litigation with the McDermotts, as opposed to only a pre-judg-

164. *Id.* at 1534 (Thomas, J., dissenting).

165. *Id.* (Thomas, J., dissenting) ("[T]he Court's parsimonious reading of *Vermont* undercuts the congressional purpose—expressed through repeated amendments to the tax lien provisions in the century since *United States v. Snyder* . . . of 'protect[ing] third persons against harsh application of the federal tax lien.'") (quoting Kennedy, *supra* note 26, at 922).

166. *Id.* at 1534 (Thomas, J., dissenting) ("The attachment requirement erodes the 'preferred status' granted to judgment creditors by § 6323(a), and renders a choate judgment lien in after-acquired property subordinate to a 'secret lien for assessed taxes.'") (citing *Pioneer*, 374 U.S. at 89).

167. *McDermott*, 113 S. Ct. at 1531.

168. *Id.* at 1534 (Thomas, J., dissenting).

ment attachment or garnishment.¹⁶⁹ Historically, judgment liens like the Bank's "ha[ve] always been regarded as the *highest* form of security to a creditor."¹⁷⁰ Courts have traditionally viewed the judgment lien as a final resolution of a credit dispute—the principal and conclusive avenue of enforcing a claim against a debtor.¹⁷¹

The Supreme Court itself has suggested that the holder of a final, binding judgment has reached the highest level of protection.¹⁷² Furthermore, the Court underscored the high regard it has had for judgment creditors such as the Bank when it struck down the *Security Trust* and *Pioneer* liens on the very basis that they had not ripened to final judgments when federal notice was filed.¹⁷³ This illustrates the essence of a judgment: It provides a final, binding determination that may later be used to seize property and which thereby renders prior attachments or garnishments choate. In this sense, a lien arising from a final judgment, docketed so as to be enforceable over other parties' interests,¹⁷⁴ is choate per se.

The *McDermott* Court also misunderstood the protection Congress has given the judgment lien. In reaching its decision, it appears that the Court assumed that the judicial system and Congress have not affirmatively recognized that judgment liens may be enforced against after-acquired property.¹⁷⁵ Yet cases recognizing after-acquired

169. *Zions*, 945 F.2d at 1477; *McDermott*, 113 S. Ct. at 1527; see *supra* note 97 and accompanying text.

170. 49 C.J.S. *Judgments* § 455 (1947) (emphasis added) (citing *Corporation of America v. Marks*, 73 P.2d 1215, 1217-18 (Cal. 1937); *Morton v. Adams*, 56 P. 1038, 1039 (Cal. 1899)).

171. Under English and American common law, "the principal avenue for a creditor to enforce a claim for the payment of money . . . was to reduce his claim to a judgment . . . and thereupon to resort to the appropriate remedies for its enforcement." STEFAN A. RIESENFELD, *CREDITORS' REMEDIES AND DEBTORS' PROTECTION* 2-3 (3d ed. 1979).

172. In his dissent in *United States v. White Bear Brewing Co.*, 350 U.S. 1010 (1956), Justice Douglas acknowledged: "The Court apparently holds that under [the federal tax lien statute] a lien that is specific and choate under state law, no matter how diligently enforced, can never prevail against a subsequent federal tax lien, *short of reducing the lien to final judgment.*" *Id.* at 1011 (Douglas, J., dissenting) (emphasis added).

173. *Security Trust*, 340 U.S. at 50; *Pioneer*, 374 U.S. at 90-91; see *supra* notes 53, 61 and accompanying text. In *Vermont*, the Court also emphasized that the choateness doctrine had been used as a basis of subordinating liens that were *not supported by a final judgment* at the time a federal lien was filed. See *supra* note 66. For further discussion of the inherent choateness of the judgment lien, see *infra* part IV.B.

174. As in many other states, under Utah law, the judgment becomes a lien on the debtor's property at the time it is docketed; hence it is docketing that creates the lien, making it enforceable over other parties interests. See *Orton v. Adams*, 444 P.2d 62, 63 (Utah 1968).

175. Justice Scalia manifested this view in sections scattered throughout his opinion. For example, he stated: "We did not consider [in *Vermont*] . . . that a lien in

property provisions in judgment liens date back to at least 1842.¹⁷⁶ In 1909 the Supreme Court itself recognized that an Arizona statute allowed judgment liens to extend to a debtor's after-acquired property.¹⁷⁷ Hence, by the time Congress extended protection to judgment creditors in 1913 with the notice-filing provision,¹⁷⁸ it must have known that judgment liens commonly created valid interests in after-acquired property.

The Court also concluded that because the FTLA only addressed after-acquired property in the context of U.C.C.-type security interests,¹⁷⁹ Congress chose not to grant priority to judgment liens on after-acquired property.¹⁸⁰ Yet prior to enacting the FTLA, Congress had already provided protection to judgment creditors with after-acquired property interests through the notice-filing provision.¹⁸¹ With the FTLA, Congress was merely responding to pressure to modernize

after-acquired property is not 'perfected' as to property yet to be acquired." *McDermott*, 113 S. Ct. at 1529.

Regarding the FTLA, Justice Scalia wrote: "According *special* priority to certain state security interests [within the commercial financing provision—§ 6323(c)] . . . obviously presumes that otherwise the federal tax lien would prevail . . . regardless of when it attaches to the subject property." *Id.* at 1530. He also stated: "[T]he persuasive reason [for not giving the Bank an equal interest] is the existence of § 6323(c), which displays the assumption that all unperfected security interests are defeated by the federal tax lien. There is no reason why this assumption should not extend to judgment liens as well." *Id.* at 1530 n.7.

176. See, e.g., *Greenway & Marshall v. Cannon*, 22 Tenn. (3 Hum.) 177, 179 (1842) (holding that a statutory lien extends to after-acquired property as well as property owned at the time of judgment). Tennessee was not alone in linking the judgment lien to after-acquired property. Prior to 1913, at least ten other states recognized interests in after-acquired property created by judgment liens. *Trustees of R.E. Bank v. Watson & Hubbard*, 13 Ark. 74, 82-85 (1852); *Hibernia Sav. & Loan Soc'y v. London & Lancashire Fire Ins. Co.*, 71 P. 334, 335 (Cal. 1903); *Harrison v. Roberts*, 6 Fla. 711, 712-14 (1856); *Wales v. Bogue*, 31 Ill. 464, 467 (1863); *Colt v. DuBois*, 7 Neb. 391, 396 (1878); *Smith v. Hogg*, 40 N.E. 406, 408 (Ohio 1895); *Appeal of Bucknor*, 4 A. 738, 739 (Pa. 1886); *Thulemeyer v. Jones*, 37 Tex. 560, 571 (1872); *Coad v. Cowhick*, 63 P. 584, 586 (Wyo. 1901); cf. *Wronkow v. Oakley*, 31 N.E. 521, 524 (N.Y. 1892) (considering an order to suspend a judgment creditor's existing rights to after-acquired property).

177. In *Bradford v. Morrison*, 212 U.S. 389 (1909), the Court quoted Act No. 50 of the Session Laws of 1891 of the territory of Arizona, page 50, § 4: "Every judgment when so docketed shall, for a period of five years . . . be a lien on the real property in the county where the same is docketed . . . [including] which [property] he may have at any time thereafter within said period of five years." 212 U.S. at 393-94 (emphasis added).

178. See *supra* notes 36-37 and accompanying text for discussion of the 1913 notice-filing provision.

179. See *supra* note 84 and accompanying text for discussion of the after-acquired property interests recognized in the FTLA.

180. See *McDermott*, 113 S. Ct. at 1530 & n.7.

181. See *supra* notes 36-37 and accompanying text.

federal tax lien law by recognizing U.C.C.-type transactions involving after-acquired property interests.¹⁸² As for judgment liens, the FTLA only reorganized existing law that had already recognized after-acquired property interests.¹⁸³

In sum, an historical perspective shows that the *McDermott* Court should have granted priority to the Bank's judgment lien without hesitation. The lien was choate per se, in view of the time-honored treatment of the judgment lien as the final, definite, and ultimate form of creditor protection.¹⁸⁴ The after-acquired property feature of the lien should not have altered this conclusion—that feature was nothing more than a commonly used mechanism for securing judgment liens. The *McDermott* decision should have been a straightforward application of the notice-filing provision affording the Bank priority over the IRS.

B. Judgment Liens on After-Acquired Property are Choate

Assuming for the sake of argument that judgment liens on after-acquired property are not choate per se, they nevertheless satisfy the *New Britain* choateness test—which the *McDermott* Court misapplied in concluding that the Bank's lien was inchoate when the IRS filed its notice because the specific property subject to the Bank's lien was not established. The crux of the Court's opinion was that the Bank's lien could be choate only after it had attached to the South Street property.¹⁸⁵ This striking proposition will force creditors to act to attach each specific piece of property that their debtors acquire, which will ultimately render the judgment lien "largely useless" as a means of debt collection.¹⁸⁶ Additionally, the Court overlooked its earlier ruling in *Vermont*, which gave priority to a state-created lien that also did not attach to a particular property until after a federal lien had been filed.¹⁸⁷

182. See *supra* notes 76-80 and accompanying text.

183. See *supra* notes 82, 85-86 and accompanying text.

184. See *supra* notes 170-173 and accompanying text (discussing this aspect of the judgment lien). See also *supra* note 60 (quoting Kennedy, who stated that it would be "particularly difficult" to reconcile a judicially created concept of choateness with the protection Congress has afforded the judgment creditor).

185. See *supra* notes 129-135 and accompanying text; *McDermott*, 113 S. Ct. at 1529-30.

186. Nickles, *supra* note 10, at 1141 n.10.

187. *Vermont*, 377 U.S. at 358-59 (rejecting the government's contention that the Vermont liens "did not meet the standards of 'specificity' until Vermont attached the funds held by the [debtor's bank], at which time the federal tax lien had already come into existence") (emphasis added). *Id.* at 356-57. In contrast, the *McDermott* Court concluded that while a state lien does not need to attach to specific portions of property, it must still attach to a piece of property, whatever it may be, in order to be choate. *McDermott*, 113 S. Ct. at 1528-30 & nn.2-3.

In addition to ignoring precedent, the Court's attachment argument also rests upon a flawed analogy and faulty logic. In justifying its attachment requirement, the Court analogized the choateness of the judgment lien to a U.C.C. requirement.¹⁸⁸ Yet, as Justice Thomas pointed out, the U.C.C. is not relevant because it applies to personal property.¹⁸⁹ Even more importantly, the U.C.C. deals with security interests created under contract,¹⁹⁰ rather than with nonconsensual, statutory interests such as judgment liens.¹⁹¹

The Court also concluded that the Bank's lien was inchoate because it was open to the contingency that the McDermotts might not reacquire the South Street property.¹⁹² This is a stretch of reasoning that defies the practical realities of how and why liens are used. To the extent that the ultimate success of any lien is contingent upon a creditor taking physical possession of the secured property, the Court's logic would render all liens inchoate until executed—at which point the lien has served its full purpose.

The Court also rejected the contention that the Bank's own "best efforts" toward pursuing its lien could ensure choateness.¹⁹³ This rejection falsely assumes that executing a lien raises an after-acquired property provision to the level of choateness. Courts have long recognized that execution does not raise a lien to a higher status, but instead merely constitutes the procedural means of satisfying the lien.¹⁹⁴ In addition to disregarding this basic attribute of the judgment lien, the Court also failed to give appropriate weight to the fact that the Bank made every possible effort to collect the amount due on the loan—the Bank's judgment, once docketed, afforded the most

188. *McDermott*, 113 S. Ct. at 1529; see *supra* notes 131-32 and accompanying text.

189. *McDermott*, 113 S. Ct. at 1534 n.3 (Thomas, J., dissenting).

190. U.C.C. § 9-102(2), 3 U.L.A. 73 (1992).

191. *Id.* The Court, to justify its rule, emphasized that judgment creditors, unlike the government, are voluntary creditors. *McDermott*, 113 S. Ct. at 1531; see *supra* notes 139-143 and accompanying text. Nonetheless, while it may be true that the Bank was initially a voluntary creditor, not all judgment creditors are voluntary. Victims of accidents caused by drunk drivers, for example, do not choose to become judgment creditors. For further discussion of this distinction, see *infra* text accompanying note 207-08.

192. *McDermott*, 113 S. Ct. at 1529 n.5. *But see* 49 C.J.S. *Judgments* § 457 (1947) ("A judgment lien is for a definite amount, and is not dependent on any contingency, or affected by changes in the value of the property to which it attaches.") (citing *Kelly v. Minor*, 252 F. 115, 116 (4th Cir. 1918)).

193. *McDermott*, 113 S. Ct. at 1529 & n.4. See *supra* note 130 and accompanying text.

194. See, e.g., *In re Fornabai*, 227 F. Supp. 928, 931 (D.N.J. 1964); *Giordano v. Wolcott*, 134 A.2d 593, 595 (N.J. Super. Ct. App. Div. 1957), *cert. denied*, 143 A.2d 9 (N.J. 1958) ("An execution does not [raise a lien] to a higher status than its underlying judgment and has no independent obligating vitality.").

complete protection a private creditor can acquire short of actual possession.

The Court's ruling is also off the mark in view of other precedent. Unlike the lien defeated in *Security Trust*, the first decision to apply the choateness doctrine,¹⁹⁵ the Bank's lien was not subject to numerous contingencies that might have prevented it from becoming choate through a judgment.¹⁹⁶ The Bank's lien arose from a final judgment in a specific dollar amount, in contrast with the liens the Court subordinated as inchoate in *Acri*,¹⁹⁷ *White Bear Brewing Co.*,¹⁹⁸ and *Pioneer*,¹⁹⁹ each of which bore contingencies that could only be eliminated with a final judgment.

Furthermore, the property subject to the Bank lien was established, and after-acquired property was a class of property subject to the lien.²⁰⁰ As specifically stated in *Vermont*, the same standard of choateness applies to both state-created and federal liens that cover all of a debtor's property.²⁰¹ Since it is not necessary to seize specific property to have a perfected judgment lien,²⁰² in *McDermott* the Bank's lien was choate when the Bank docketed its judgment.

C. Policy Considerations Weigh Against the Court's Decision

The *McDermott* decision not only misinterprets existing law, it also reverses an eighty-year trend of creditor protection and signals a return to the era of the *Snyder* "secret lien." By effectively deeming after-acquired property provisions of judgment liens perpetually inchoate, *McDermott* guarantees that federal tax liens will have priority over judgment liens on after-acquired property, regardless of when the government files notice of its lien. This nullifies the protection Congress specifically provided for judgment creditors with the notice-filing provision²⁰³ and gives the IRS further incentive to delay filing

195. See *supra* notes 52-54 and accompanying text; *United States v. Security Trust & Sav. Bank*, 340 U.S. 47 (1950).

196. See *Security Trust*, 340 U.S. at 50.

197. For discussion of *Acri*, see *supra* note 53.

198. For discussion of *White Bear Brewing Co.*, see *supra* notes 54 and 172.

199. For discussion of *Pioneer*, see *supra* notes 59-62 and accompanying text.

200. See *supra* note 158 and accompanying text; *McDermott*, 113 S. Ct. at 1533 & n.2 (Thomas, J., dissenting).

201. See *supra* notes 64-68 and accompanying text; *Vermont*, 377 U.S. at 358-59.

202. *United States v. State*, 87 S.E.2d 577, 581 (S.C. 1955). Cf. *Bank of California, Nat'l Ass'n v. United States*, 520 F.2d 302, 304-05 (9th Cir. 1975) (holding a seizure pursuant to a judgment without a court decree choate for priority purposes).

203. See *supra* notes 36-37 and accompanying text (discussing the notice-filing provision and its application to judgment creditors).

notice of its liens in order to facilitate tax collection.²⁰⁴

In addressing the fairness of the Court's decision, Justice Scalia maintained that the "first in time" presumption is inapposite in tax law, which follows a "general rule" of assigning creditor priority to the IRS.²⁰⁵ Certainly, the priority usually afforded the IRS is largely justified by the fundamental need for effective tax collection.²⁰⁶ Still, this broad favoritism toward the government highlights those instances in which Congress has chosen to afford protection to the private creditor. Despite the force of policy arguments promoting the general rule, the Court still cannot ignore those measures, such as the notice-filing provision, that establish explicit exceptions.

The Court also attempted to justify its abandonment of the "first in time" principle by stressing that as a lender, the Bank was initially a voluntary creditor, whereas the government is an involuntary creditor that cannot decline to take on taxpayers as debtors.²⁰⁷ While it may be true that the Bank chose to become a creditor of the McDermotts, it certainly did not choose to be forced to go to court in order to receive payment of its note. Furthermore, judgment creditors include parties holding *any* type of judgment. Certainly the innocent victim of a drunk driving accident does not have the opportunity to choose a debtor, as the Court seemed to imply.

Other equitable and practical considerations justify honoring the "first in time" rule and giving full effect to the notice-filing provision. The most basic reason for following the "first in time" principle is the best reason: it promotes diligence and fairness.²⁰⁸ Article 9 of the

204. See *supra* note 31 (discussing the government's interest in withholding notice).

205. *McDermott*, 113 S. Ct. at 1531; see *supra* note 144 and accompanying text.

206. Granting a federal lien priority on the basis of promoting tax collection has some justification. However, § 6323 applies not only to tax liens, but to federal liens in general. See 26 U.S.C. § 6323 (1988). In keeping with Justice Scalia's logic, that justification does not exist where the federal government is a *voluntary* creditor. The Fourth Circuit recognized this nearly seventy years ago:

No sound principle of public policy can be invoked in support of preference to the federal government and to the states over citizens in the collection of ordinary debts. On the contrary, the contractual obligations of the federal government and of the states have become so extensive and so involved with the business of private citizens that priority to the federal government and to the states, except for taxes, would operate as an oppressive hardship on other creditors

Davis v. Pringle, 1 F.2d 860, 864 (4th Cir. 1924), *aff'd*, 268 U.S. 315 (1925) (emphasis added). For further discussion, see *Plumb, supra* note 23, at 245-48.

207. *McDermott*, 113 S. Ct. at 1531.

208. *McAllen State Bank v. Saenz*, 561 F. Supp. 636, 639-40 (S.D. Tex. 1982). While promoting the FTLA, which incorporated U.C.C. concepts such as "first in time" into federal tax lien law, one member of Congress stated: "The intent of these amend-

U.C.C. incorporates the "first in time" principle and thereby promotes "legitimate business transactions" by allowing creditors to check for past filings so they may make educated credit decisions.²⁰⁹ Indeed, Congress adopted the FTLA to conform to the dictates of the U.C.C.²¹⁰

By abandoning the "first in time" rule for liens on after-acquired property, *McDermott* encourages bad faith attempts by the IRS to shift the financing of tax debtors to unsuspecting private creditors. *McDermott* assures the IRS that when it chooses to forego filing notice, its liens on after-acquired property will not be subordinated to judgment liens. Even if we assume that IRS failures to file notice of tax liens occur for more innocent reasons,²¹¹ a rule that allows the IRS to profit from its lack of diligence is discomfoting.²¹² Quite simply, it is inherently unfair to allow the IRS to conceal its liens, whether intentionally or not, while private lienholders strive to win a perhaps futile race to perfect their liens. The "first in time" rule embodied in the notice-filing provision, therefore, is properly grounded in basic fairness.

D. A Better Solution: Pro Rata Distribution

As the foregoing analysis illustrates, the complete subordination of

ments as they relate to the priority of federal liens is to promote equity and facilitate commerce by making the legal rules governing tax liens more certain and fair." Brief for Respondent, *supra* note 97, at 10 n.8 (citing 112 CONG. REC. H22,227 (daily ed. Sept. 12, 1966) (statement of Rep. Byrnes)).

209. Gallo, *supra* note 71, at 1014-16. As one court further noted:

It is desirable that perfection of interests take place promptly. It is appropriate then to provide that a secured party who fails to file runs the risk of subordination to a later but more diligent party. In this regard it should be pointed out that filing is of particular importance with respect to notice to other parties Some parties may rely on the record in extending credit and obtaining a security agreement in collateral [I]t is entirely possible that they wanted to avoid [a] dispute altogether . . . [and] may have relied on the complete absence of a prior interest perfected or otherwise out of which a dispute could arise. The only way this kind of record expectation can be protected is by prompt perfection of all security interests.

In re Smith, 326 F. Supp. 1311, 1313-14 (D. Minn. 1971) (citing G. GILMORE, SECURITY INTERESTS IN PERSONAL PROPERTY § 34.2 (1965)).

210. See *supra* note 80 and accompanying text.

211. While there was no specific finding of bad faith by the IRS in *McDermott*, it is nevertheless true that the IRS filed its notice nine months after assessing the McDermotts, but only two months after the Bank docketed its judgment. *McDermott*, 113 S. Ct. at 1527; see *supra* notes 93-97 and accompanying text.

212. See Plumb, *supra* note 23, at 258 (urging that the federal government should not be allowed to benefit in situations where it has failed to proceed against executors' distributions to noncreditors).

the Bank's lien in *McDermott* was insupportable and unfair. Yet, because of the unique and compelling interest that the federal government has in tax collection,²¹³ neither should the IRS's lien have been relegated to wholly inferior status. Rather, in cases that, like *McDermott*, involve competing liens that attach simultaneously,²¹⁴ the liens should be satisfied with a pro rata distribution rather than on an all-or-nothing basis.

Although some cases dictate that "all ties go to the government,"²¹⁵ this view dates back to 1951 dictum²¹⁶ and reflects antiquated thinking that ignores modern commercial realities.²¹⁷ At the other extreme, the U.C.C. would grant priority in the order of perfection²¹⁸—with the government being treated like any other creditor—and thereby give inadequate regard to the fundamental need to collect taxes and the higher priority generally afforded the federal government.²¹⁹

Adopting a pro rata approach would effect a fair compromise between these two extremes. Such an approach would ensure that the government could collect at least some of the amount due and would protect holders of private, choate liens. This simple and equitable method should have been followed in *McDermott* in lieu of the severe

213. See *supra* note 44 and accompanying text.

214. The district court in *McDermott* specifically found that in their Agreement, the Bank and the IRS stipulated that both liens attached to the South Street property. *Supra* note 106 and accompanying text; *Zions*, 945 F.2d at 1478. The *McDermott* Court, without explicit reference to the Agreement, concluded that both the Bank's lien and the IRS's lien attached when the McDermotts reacquired the South Street property. 113 S. Ct. at 1530.

215. See, e.g., *United States v. Graham*, 96 F. Supp. 318, 321 (S.D. Cal. 1951), *aff'd sub nom.*, *California v. United States*, 195 F.2d 530 (9th Cir.), *cert. denied*, 344 U.S. 831 (1952); *MDC Leasing Corp. v. New York Property Ins. Underwriting Ass'n*, 450 F. Supp. 179, 181 (S.D.N.Y. 1978), *aff'd without opinion*, 603 F.2d 213 (2d Cir. 1979), and *aff'd sub nom.*, *New York Property Ins. Underwriting Ass'n v. Derrico Co.*, 603 F.2d 214 (2d Cir. 1979).

216. See *Graham*, 96 F. Supp. at 321.

217. The Fifth Circuit elaborated on the weakness of this outdated approach:

In our view, another aspect of choateness that no longer floats, although concededly not specifically addressed by § 6323, is the notion that a tie goes to the government. To the extent that the purpose of the Federal Tax Lien Act was to conform tax liens to [U.C.C.] Article 9 security interests, the way to achieve this goal is to treat the government like any other creditor. Giving the government's filed tax lien priority over a simultaneously recorded security interest would defeat this goal. We do not believe that is what Congress intended.

Southern Rock Inc. v. B & B Auto Supply, 711 F.2d 683, 689 (5th Cir. 1983).

218. U.C.C. § 9-312(5)(a), 3A U.L.A. 350 (1992); see *supra* note 10 and accompanying text.

219. See *supra* note 44 and accompanying text (discussing this important need).

and unfounded action taken by the Court.²²⁰

V. IMPACT

By requiring that a judgment lien on after-acquired property must attach to specific property in order to achieve choateness for purposes of federal lien priority, the *McDermott* ruling has severely undermined the effectiveness of the judgment lien as a method of debt collection.²²¹ Granted, although the judgment lien may now be useless against the federal government, it will still be effective against a competing private creditor. Yet as the Bank in *McDermott* would be quick to point out, this is small consolation. The United States government is a creditor to many, and financially distressed individuals and companies often have large tax liabilities.

For banks, insurance companies, credit agencies, and any other business that extends credit, *McDermott* will greatly increase the costs of lending. As one commentator has suggested, a requirement that a judgment lien must actually attach to specific after-acquired property in order to be choate will force lienholders to monitor their debtor's transactions very closely and act quickly to attach property passing through the debtor's estate.²²² The result will be increased expenses and diminished protection for creditors relying on judgment liens.

In turn, debtors will also suffer, as creditors pass along their increased costs in various ways. First, the credit supply may shrink, albeit slightly, as creditors seek less exposure in potentially subordinated positions. Second, interest rates may increase, as creditors seek to compensate for their increased risk. Finally, creditors may demand greater collateral as security for their exposure. Though all debtors will suffer, perhaps the greatest impact will be felt by poor or marginal credit risks. Such debtors will find it much more difficult to obtain credit because they are the ones most likely to have delinquent federal tax obligations.

While debtors will fall victim to *McDermott*, involuntary creditors

220. This approach has been followed in at least one case with facts similar to those in *McDermott*. In *McAllen State Bank v. Saenz*, 561 F. Supp. 636, 638 (S.D. Tex. 1982), the court weighed the priorities of a federal tax lien and a prior choate judgment lien, both of which claimed rights to the proceeds of a sale of after-acquired real property. As had the Court in *McDermott*, the *McAllen* court concluded that both liens attached at the same time. *See id.* at 639. After rejecting the "tie goes to the government" rule, the *McAllen* court divided the proceeds pro rata. *Id.* *See also* *United States v. Fleming*, 474 F. Supp. 904, 908 (S.D.N.Y. 1979); *Southern Rock*, 711 F.2d. at 689 (both dividing sums on a pro rata basis).

221. *See supra* note 186 and accompanying text.

222. Nickles, *supra* note 10, at 1141 n.10.

will be harmed as well. By failing to allow for those creditors who do not truly “choose” their debtors, the *McDermott* Court extended the force of its ruling to both voluntary creditors, such as the Bank, and involuntary creditors, such as parties holding tort judgments secured by after-acquired property. It appears that the Court did not realize that its decision will have this effect. This shortsighted aspect of *McDermott* will damage even those who assume their “creditor” status unwillingly.

VI. CONCLUSION

Under *McDermott*, a judgment lien covering after-acquired property is by definition inchoate and thus receives no priority over a federal tax lien, regardless of when the IRS files notice. The *McDermott* ruling thus disregards the nature of judgment liens, misinterprets the Court’s earlier decisions, and signals a return to the era of the “secret” federal tax lien. Under *McDermott*, the Internal Revenue Service may opt to conceal its liens, while private lien holders strive to win a race to obtain priority over each other that may ultimately prove worthless. *McDermott* will likely impair the collection of judgment liens of all types and may restrict the credit supply. For all these reasons, the harsh rule of *McDermott* should be overturned by Congress or the Court.

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