BYU Law Review

Volume 1975 | Issue 1 Article 17

5-1-1975

Federal Tax Liens--Assignment of Accounts--The "No Property" Rule Under the 1966 Federal Tax Lien Act and Article 9 of the Uniform Commercial Code--Nevada Rock & Sand Co. v. United States

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the Court stated that this compulsory method may control a taxpayer's income tax consequences. The Court's decision in the instant case may allow a different result where taxpayers are free to choose an acceptable accounting method. For example, the Tax Court has recognized the "incremental overhead method"[86] as clearly reflecting income.[87] Under this method, if a taxpayer does not acquire special tools or machinery for use in self-construction activities, the taxpayer will not capitalize any depreciation on its books. Following the Court's interpretation of the role of section 446, a taxpayer's method of accounting which clearly reflects income would be "almost presumptively controlling of federal income tax consequences."[88] Under this rationale, a taxpayer would not capitalize any depreciation on its books or on its tax return.

Nevertheless, some taxpayers that use the "incremental overhead method" will capitalize construction-related depreciation. For instance, the Idaho Power Company will probably purchase some additional equipment to use in its ongoing large-scale construction activities. On the other hand, much of the automotive equipment involved in the instant case might have been purchased for use in normal operations and used in construction only when it would otherwise be temporarily idle. The incremental overhead analysis is theoretically sounder than the Court's "benefit theory" in determining what self-construction expenses to capitalize.

Federal Tax Liens — Assignment of Accounts — The "No Property" Rule Under the 1966 Federal Tax Lien Act and Article 9 of the Uniform Commercial Code — *Nevada Rock & Sand Co. v. United States,* 376 F. Supp. 161 (D. Nev. 1974).

Coop Oil Products, Inc. (Coop) contracted with Nevada Rock & Sand Co. (NRSC) to perform certain construction work. In exchange for materials to complete its contract, Coop assigned to Witco Chemical Corporation (Witco) all monies due or to become due under the NRSC contract. Notice of the assignment was sent to NRSC which consented to make payment directly to Witco upon completion of Coop's performance. Witco failed to file notice of the Coop assignment as required by Nevada's Uniform Commercial Code. Subsequently, Coop completed performance of the NRSC contract, and approximately $10,000 became due and payable to Witco under the assignment. Prior to payment by NRSC of the amount due, the Internal Revenue Service (IRS) assessed delinquent taxes against Coop and, upon Coop's failure to pay the taxes,

[86] *See* notes 66-67 *supra* and accompanying text.

[87] Fort Howard Paper Co., 49 T.C. 275, 285 (1967).

[88] 94 S. Ct. at 2766.

filed notice of the existence of federal tax liens on Coop's property prior to any filing by Witco of the Coop assignment. Both the IRS and Witco claimed the monies payable by NRSC under its contract with Coop. In response, NRSC filed an interpleader action naming the IRS, Witco, and Coop as defendants and deposited with the court the entire amount due on the Coop account. The United States District Court for the District of Nevada held (1) that Coop possessed a property interest in the contract rights assigned to Witco sufficient to permit a federal tax lien to attach thereto, and (2) that the federal tax lien took priority over Witco's interest as assignee of the contract rights.

I. Background

A. Early Federal Tax Lien Legislation[1]

The first legislation providing for a general federal tax lien[2] was enacted in 1866 and directed that if any taxpayer failed or refused to pay any federal tax after demand for payment was made, the amount of the tax became a lien in favor of the Government "upon all property and

[1]The focus of this case note is on the narrow issue of the current status of the "no property" rule. But to understand the "no property" rule and how and why it developed, it is necessary to briefly examine the general development of the law of federal tax liens during the past century.

[2]The general federal tax lien, now provided for in INT. REV. CODE OF 1954, § 6321, is so named because it can be used to enforce the payment of all federal taxes. United States v. Cleavenger, 325 F. Supp. 871 (N.D. Ind. 1971), *appeal dismissed,* 483 F.2d 1406 (7th Cir. 1973). There are also two special tax liens and a provision giving the federal government priority in nonbankruptcy, insolvency proceedings. The two special tax liens are used to enforce payment of gift and estate taxes and are provided for in INT. REV. CODE OF 1954, § 6324. For a general discussion, see W. PLUMB, FEDERAL TAX LIENS 307–46 (3d ed. 1972) [hereinafter cited as PLUMB]. Federal priority in insolvency proceedings was first provided for in 1789, Act of July 31, 1789, ch. 5, § 21, 1 Stat. 42, and has continued since, directing in essence that "the debts due to the United States shall be first satisfied." 31 U.S.C. § 191 (1970). This priority is often referred to as a "section 3466 priority" because of its placement in the Revised Statutes. REV. STAT. § 3466 (1875). The provision does not create a lien in favor of the United States, but competing interests are often defeated because of failure to meet high standards of perfection and specificity. One commentator described the history and operation of section 3466 in these terms:

> It appears that R.S. 3466 was not originally intended to override prior liens, but only to apply against unsecured creditors. The relative status of the Government and secured creditors was measured by a first-in-time-first-in-right rule. In Spokane County v. United States, 279 U.S. 80 (1929), the Court drew upon dicta in various earlier cases to indicate that prior-in-time liens could be defeated by the statutory priority if not "specific" or "perfected." This test, at least in the dicta of subsequent cases, became increasingly strict, to the point that in United States v. Gilbert Associates, Inc., 345 U.S. 361 (1953), the R.S. 3466 priority could be defeated only if the taxpayer had been divested of either possession or title to the property concerned.

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, 1377 n. 33 (1968) [hereinafter cited as Coogan]. The Supreme Court of the United States has held that the general federal tax lien and the insolvency priority are not governed by the same standards. United States v. Vermont, 377 U.S. 351 (1964). The section 3466 priority is discussed in PLUMB 189–234.

rights to property" owned by the taxpayer.[3] The 1866 legislation, however, was silent in two important areas. First, no provision was made for public filing of notice of the lien; the Government's lien arose as a secret lien. Second, there were no legislative provisions for determining the relative priority of the federal tax lien and any liens asserted by private creditors[4] of the delinquent taxpayer.

The difficulties created for private creditors and purchasers by a secret tax lien were demonstrated in the 1893 case of *United States v. Snyder*[5] where the United States Supreme Court held that a good faith purchaser for value did *not* have priority over a secret federal tax lien arising prior to the sale of the property. In 1913 Congress reacted to this harsh result by enacting legislation providing that a tax lien would not be valid against any mortgagee, purchaser, or judgment creditor until notice of the tax lien was filed in a designated office.[6] However, private claimants not qualifying as mortgagees, purchasers, or judgment creditors continued to acquire interests in property at the peril of having their interests subordinated to secret tax liens.

B. *Priority and the Choateness Doctrine*

The second gap in the 1866 legislative scheme — an absence of guidelines for determining priority — was filled by judicial application of the

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[3]Act of July 13, 1866, ch. 184, § 9, 14 Stat. 107. The Act provided:

> And if any preson, bank, association, company, or corporation, liable to pay any tax, shall neglect or refuse to pay the same after demand, the amount shall be a lien in favor of the United States from the time it was due until paid, with the interest, penalties, and costs that may accrue in addition thereto, upon all property and rights to property belonging to such person, bank, association, company, or corporation. . . .

[4]Oftimes the party opposing the federal government in a case involving federal tax liens is a municipality or county. *See, e.g.,* Spokane County v. United States, 279 U.S. 80 (1929); United States v. City of New Britain, 347 U.S. 81 (1954). The term "private creditors" or "private claimant" as used in this case note includes such nonfederal, public claimants.

[5]149 U.S. 210 (1893).

[6]Act of March 4, 1913, ch. 166, 37 Stat. 1016. Section 3186 of the Act provided:

> If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount shall be a lien in favor of the United States from the time when the assessment list was received by the collector, except when otherwise provided, until paid, with the interest, penalties, and costs that may accrue in addition thereto upon all property and rights to property belonging to such person: *Provided, however,* That such lien shall not be valid as against any mortgagee, purchaser, or judgment creditor until notice of such lien shall be filed by the collector in the office of the clerk of the district court of the district within which the property subject to such lien is situated: *Provided further,* Whenever any State by appropriate legislation authorizes the filing of such notice in the office of the registrar or recorder of deeds of the counties of that State, or in the State of Louisiana in the parishes thereof, then such lien shall not be valid in that State as against any mortgagee, purchaser, or judgment creditor, until such notice shall be filed in the office of the registrar or recorder of deeds of the county or counties, or parish or parishes in the State of Louisiana, within which the property subject to the lien is situated.

In 1939 the list of those protected against an unfiled federal tax lien was expanded to include pledgees. Int. Rev. Code of 1939, ch. 36, § 3672, 53 Stat. 882.

common law rule that the first in time is the first in right.[7] Yet as the courts applied the first-in-time-first-in-right rule, they required, at an early date, that private liens be specific and complete in order to prevail over subsequently arising federal tax liens. The Supreme Court in the 1929 case of *Spokane County v. United States*[8] held that a county's lien for unpaid personal taxes did not prevail over a subsequent federal claim in an insolvency proceeding since the county's lien was not sufficiently "specific" and "perfected." After *Spokane County*, the Court expanded the requirement of specificity and perfection to the point where a prior-in-time private lien, to be protected under the traditional first-in-time-first-in-right doctrine, was required to be definite as to the identity of the lienor, the amount of the lien, and the property subject to the lien.[9] This judicially imposed requirement of specificity and perfection became known as the choateness doctrine.[10] In the 1950 case of *United*

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[7]*See* United States v. City of New Britain, 347 U.S. 81, 85 (1954), where the court said:

> We believe that priority of these statutory liens is determined by another principle of law, namely, "the first in time is the first in right." As stated by Chief Justice Marshall in *Rankin v. Scott, supra*:
>
> > The principle is believed to be universal, that a prior lien gives a prior claim, which is entitled to prior satisfaction, out of the subject it binds, unless the lien be intrinsically defective, or be displaced by some act of the party holding it, which shall postpone him in a Court of law or equity to a subsequent claimant. 12 Wheat., at 179.
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> This principle is widely accepted and applied, in the absence of legislation to the contrary.

Cases applying the first-in-time-first-in-right principle are collected at Comment, *Federal Tax Liens and Assignees of Accounts Receivable: Priority Without Reason,* 29 U. CHI. L. REV. 548 n. 3 (1962) [hereinafter cited as Comment, *Priority Without Reason*]. *See also* United States v. Pioneer Am. Ins. Co., 374 U.S. 84 (1963).

[8]279 U.S. 80 (1929).

[9]Although the three requirements of perfection and specificity originated in different cases, they were stated as a single requirement in Illinois *ex. rel.* Gordon v. Campbell, 329 U.S. 362, 375 (1946):

> The long-established rule requires that the lien must be definite, and not merely ascertainable in the future by taking further steps, in at least three respects as of the crucial time. These are: (1) the identity of the lienor, *United States v. Knott,* 298 U.S. 544, 549–551; (2) the amount of the lien, *United States v. Waddill Co.,* 323 U.S. at 357–358; and (3) the property to which it attaches, *United States v. Waddill Co., supra; United States v. Texas, supra* [314 U.S. 480 (1941)]; *New York v. Maclay, supra* [288 U.S. 290 (1932)]. It is not enough that the lienor has power to bring these elements, or any of them, down from broad generality to the earth of specific identity.

See also United States v. City of New Britain, 347 U.S. 81, 84 (1954).

[10]There has been extensive scholarly attention directed to the choateness doctrine and federal tax lien priorities. *See, e.g.,* Kennedy, *From Spokane County to Vermont: The Campaign of the Federal Government Against the Inchoate Lien,* 50 IOWA L. REV. 724 (1965); Kennedy, *The Relative Priority of the Federal Government: The Pernicious Career of the Inchoate and General Lien,* 63 YALE L.J. 905 (1954); Wolson, *Federal Tax Lien — A Study in Confusion and Confiscation,* 43 MARQ. L. REV. 180 (1959); Comment, *Priority Without Reason, supra* note 7; Note, *Applicability of the "General and Unperfected Lien" Doctrine to Contractual Liens,* 43 MINN. L. REV. 755 (1959).

States v. Security Trust & Savings Bank,[11] the choateness doctrine was extended to private liens competing with the *general* federal tax lien,[12] and thereafter the doctrine of choate liens was employed to defeat a wide variety of private liens and interests.[13]

A major extension of the choateness doctrine occurred in the 1958 case of *United States v. R. F. Ball Construction Co.*[14] when the Supreme Court employed the doctrine to subordinate a security interest in accounts receivable to a federal tax lien. Since the holder of such a security interest was considered a "mortgagee" and therefore a member of the class of creditors expressly protected by the 1913 legislation,[15] *Ball* meant that the legislatively protected interests were vulnerable if not "perfected in the federal sense."[16] After the Court's decision in *Ball,* concern became acute among creditors that no security interest could be framed so as to successfully meet the stringent requirements of the choateness doctrine.[17] Indeed, the doctrine of choate liens had by 1960

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[11]340 U.S. 47 (1950).

[12]Prior to the case of United States v. Security Trust & Sav. Bank, 340 U.S. 47 (1950), the application of the choateness doctrine was confined to insolvency proceedings. *See, e.g.,* Illinois *ex. rel.* Gordon v. Campbell, 329 U.S. 362 (1946); New York v. Maclay, 288 U.S. 290 (1933); Spokane County v. United States, 279 U.S. 80 (1929); Kennedy, *The Relative Priority of the Federal Government: The Pernicious Career of the Inchoate and General Lien,* 63 YALE L.J. 905, 907–25 (1954) [hereinafter cited as Kennedy].

[13]The choateness doctrine was used to defeat mechanic's liens (United States v. White Bear Brewing Co., 350 U.S. 1010 (1956), *rev'g* 227 F.2d 359 (7th Cir. 1955)), landlord's liens (United States v. Scovil, 348 U.S. 218 (1955)), equitable vendor's liens (United States v. Morrison, 247 F.2d 285 (5th Cir. 1957)), attorney's liens (United States v. Pay-O-Matic Corp., 162 F. Supp. 154 (S.D.N.Y.), *aff'd sub nom.* United States v. Goldstein, 256 F.2d 581 (2d Cir.), *cert. denied,* 358 U.S. 830 (1958)), attachments before judgment (United States v. Acri, 348 U.S. 211 (1955)), and other private interests. *See* cases collected at Comment, *Priority Without Reason, supra* note 7, at 548 n. 1.

[14]355 U.S. 587 (1958), *rev'g* 239 F.2d 384 (5th Cir.), *aff'g* 140 F. Supp. 60 (W. D. Tex. 1956).

[15]*See* note 6 *supra.*

[16]Lower courts viewed the *Ball* decision as extending the choate requirement to the interests of those specifically protected against the tax lien by statute: purchasers, mortgagees, pledgees, and judgment lien creditors. *See* Arthur Co. v. Chicago Paints, Inc., 175 F. Supp. 50 (D. Minn. 1959); cases collected at Comment, *Priority Without Reason, supra* note 7, at 553 n. 23. It has been said of Crest Finance Co. v. United States, 368 U.S. 349 (1961), a Supreme Court case following the *Ball* decision, that it "leaves no doubt that the perfected lien theory is equally applicable to section 6323 [mortgagees', purchasers', pledgees', judgment creditors'] interests." *Id.* at 563 n. 71. This extension of the choate doctrine was generally criticized by the commentators. *See, e.g., Id.* at 563; Cross, *Federal Tax Claims: Nature and Effect of the Government's Weapons for Collection,* 27 FORDHAM L. REV. 1 (1958); Maclachlan, *Improving the Law of Federal Lien & Priorities,* 1 BOSTON COLLEGE IND. & COMM. L. REV. 73 (1959).

[17]One commentator remembered the consequences of the *Ball* decision in these terms:

> After *Ball,* there was a flurry of cases in which one security interest after another was subordinated to a tax lien. Some good lawyers wondered whether any security interest in contract rights, inventory, or accounts which were indefinite at any point as to amount of debt or identity of security could compete with a federal tax lien, even if on the fatal day on which the tax lien was filed the debt secured was measurable and the property at that moment was identifiable. These fears were twofold: first, this kind of collateral neces-

carried the Government's tax lien to a position of "virtual omnipotence."[18]

C. *The "No Property" Rule*

In the early 1960s the courts, primarily to afford private creditors some relief from the harsh results generated by the choateness doctrine, developed and applied the "no property" rule.[19] Based on section 6321 of the Internal Revenue Code of 1954, which provides for a tax lien on "all property and rights to property" of a delinquent taxpayer,[20] the rule operates to defeat attachment of the Government's lien if the taxpayer, at the time the federal tax lien arises and thereafter, has no interest or rights in the subject property. On principles of comity, the courts concluded that whether the taxpayer has property or rights to property is a question of state law.[21] Accordingly, federal tax liens are dismissed

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> sarily "floated" or changed its character and amount frequently; second, an assignee of accounts or contract rights or one who had a factor's lien on inventory might be held to be neither a purchaser, mortgagee, or pledgee under section 6323(a).

Coogan, *supra* note 2, at 1379 (citations omitted). *See also* Comment, *Priority Without Reason, supra* note 7; Note, *Applicability of the "General and Unperfected Lien" Doctrine to Contractual Lien,* 43 MINN. L. REV. 755 (1959).

[18]Comment, *Priority Without Reason, supra* note 7, at 548.

[19]Comprehensive treatment of the "no property" rule is found in Comment, *The No Property Rule in Federal Tax Lien Litigation,* 24 MD. L. REV. 310 (1964); Note, *The Federal Tax Lien — A Practitioner's Guide to the Resolution and Avoidance of Priority Problems,* 36 N.Y.U.L. REV. 1316 (1961). *See also* Myers, *The Fall and Rise of the Security Interest,* 6 PRAC. LAW, DEC. 1960, at 60; Shanks, *The Tax Lien Tamed,* 8 U.C.L.A.L. REV. 339 (1961).

The "no property" rule is severly critized at 2 G. GILMORE, SECURITY INTERESTS IN PERSONAL PROPERTY 1070–71 (1965).

[20]INT. REV. CODE OF 1954, § 6321 presently reads:

> 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.

Under present Code procedures, the IRS assesses the taxpayer's liability and soon thereafter makes a formal demand. INT. REV. CODE OF 1954, § 6303(a). *See also* Treas. Reg. § 301.6303-1 (1954). The Government's lien arises upon the taxpayer's neglect or refusal to pay the amount demanded, INT. REV. CODE OF 1954, § 6321, and relates back to the date of the assessment, INT. REV. CODE OF 1954, § 6322. The federal tax lien attaches not solely to property owned by the taxpayer at the time the lien arises but also to all property the taxpayer may thereafter acquire during the lifespan of the lien. Glass City Bank v. United States, 326 U.S. 265 (1945).

The Federal Tax Lien Act of 1966, Pub. L. 89–719, 80 Stat. 1125, left section 6321 unmodified.

[21]The case most responsible for the currency of the "no property" rule is Aquilino v. United States, 363 U.S. 509 (1960). There, the United States Supreme Court declared:

> The threshold question in this case, as in all cases where the Federal Government asserts its tax lien, is whether and to what extent the taxpayer had "property" or "rights to property" to which the tax lien could attach. In answering that question, both federal and state courts must look at *state law,* for it has long been the rule that "in the applica-

whenever it can be determined as a matter of state law either that the taxpayer, prior to attachment of the federal lien, sufficiently alienated his property to his creditors so as to retain no interest therein,[22] or that the property never vested in the taxpayer initially.[23]

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tion 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."

Id. at 512–13.

The Court went on to declare that the issues of perfection and priority were still to be resolved by application of federal law.

> However, once the tax lien has attached to the taxpayer's state-created interests, we enter the province of federal law, which we have consistently held determines the priority of competing liens asserted against the taxpayer's "property" or "rights to property."

Id. at 513–14 (citations omitted).

The Court explained why state law is applicable to determine whether the taxpayer has property interests while federal law is applied to resolve questions of priority in tax lien litigation.

> The application of state law in ascertaining the taxpayer's property rights and of federal law in reconciling the claims of competing lienors is based both upon logic and sound legal principles. This approach strikes a proper balance between the legitimate and traditional interest which the State has in creating and defining the property interest of its citizens, and the necessity for a uniform administration of the federal revenue statutes.

Id. at 514.

Operation of the "no property" rule can perhaps best be understood by examination of the facts in *Aquilino* and the Court's disposition of the case. The taxpayer-general contractor agreed to remodel a restaurant. Aquilino and others, subcontractors, entered into a subcontract with the taxpayer to supply labor and materials for the remodeling job. The subcontractors performed their obligations under the subcontract but were not fully compensated by the general contractor. Both the subcontractors and Government came forward to claim the money that the owner still owed under the general contract. The Government's claim was based on an assessment of tax deficiencies against the general contractor and filing of notice thereof, which occurred before the subcontractors completed their contract. It appeared the Government's lien would prevail on a simple first-in-time-first-in-right approach regardless of any finding of inchoateness in the subcontractor's lien. The United States Supreme Court, however, required an initial determination of whether the taxpayer held rights to the property to which a federal tax lien could attach. The subcontractors argued that under New York law the general contractor had no equitable interest in the fund as yet unpaid under the general contract since that fund was a true trust of which the subcontractors were the beneficiaries. The general contractor only had rights in whatever amount remained after the claims of the subcontractors were satisfied. The Supreme Court declined to resolve this state law issue and remanded. On remand, the New York Court of Appeals held the fund to be a true trust in which the taxpayer had no rights and therefore the federal tax lien could not and did not attach to the fund. Aquilino v. United States, 10 N.Y.2d 271, 176 N.E.2d 826, 219 N.Y.S.2d 254 (1961).

On the same day the Court remanded the *Aquilino* case, it used the "no property" rule to defeat a federal tax lien in United States v. Durham Lumber Co., 363 U.S. 522 (1960). In *Durham* there was no need to remand; the Fourth Circuit Court of Appeals had anticipated the "no property" approach taken by the Supreme Court and already determined that under North Carolina law the taxpayer–debtor had no rights to or interest in the property being claimed by the Government. United States v. Durham Lumber Co., 257 F.2d 570 (4th Cir. 1958). The Supreme Court affirmed on the basis of the lower court's determination of state law.

[22]*See, e.g.*, Monroe Banking & Trust Co. v. Allen, 285 F. Supp. 201 (N.D. Miss. 1968); United States v. Lebanon Woolen Mills Corp., 241 F. Supp. 393 (D.N.H. 1964); Chicago Fed. Sav. & Loan Ass'n v. Cacciatore, 33 Ill. App. 2d 888, 178 N.E.2d 888 (1961), *aff'd* 25 Ill. 2d 535, 185 N.E.2d 670 (1962).

[23]*See, e.g.*, *In re* Halprin, 280 F.2d 407 (3d Cir. 1960); Fidelity & Deposit Co. v. New York

D. The UCC and the Federal Tax Lien Act of 1966

While the courts were struggling to devise a set of priority rules for tax liens, an increasing number of states were adopting the Uniform Commercial Code (UCC),[24] which includes detailed provisions for determining priority between competing private creditors.[25] The UCC relies primarily on a notice-filing system to determine the relative priority of competing claims.[26] As the courts' application of the choateness doctrine became an increasing threat to the security of many business transactions, Congress responded with the Federal Tax Lien Act of 1966 (FTLA),[27]

Housing Authority, 241 F.2d 142 (2d Cir. 1957); Fidelity and Cas. Co. v. Dykstra, 208 F. Supp. 717 (D. Minn. 1962).

[24]The first state to adopt the Code was Pennsylvania in 1953. Act No. 1, Pennsylvania Acts of 1953, p. 3. By 1968, the UCC was the law of every American jurisdiction except Louisiana. 1 UNIFORM LAWS ANNOTATED xxxxvii (1968).

[25]UNIFORM COMMERCIAL CODE § 9-301 to § 9-316. Hereinafter sections of the *Uniform Commercial Code* will be cited as "UCC" followed by the section number (*e.g.*, UCC § 9-311). The numbering of the UCC as codified in the *Nevada Revised Statutes* will not be used. All sections of the UCC cited herein have been adopted, with no substantial modifications, by Nevada. No variation in application of Nevada's UCC and the Official Text results.

In the *Nevada Revised Statutes*, each section of the UCC is preceded by the chapter designation 104, and the dash is omitted from the section number; thus, UCC § 1-101 is NEV. REV. STAT. § 104.1101.

Unless otherwise indicated, all references to the UCC are to the 1966 version.

[26]There have been extensive writings providing a basic explanation of article 9 of the UCC. Among those with a particular emphasis on the filing provisions are Coogan, *Public Notice Under the Uniform Commercial Code and Other Recent Chattel Security Laws, Including "Notice Filing,"* 47 IOWA L. REV. 289 (1962); Goodwin, *Priorities in Secured Transactions — Article 9, Uniform Commercial Code*, 20 BUS. LAW. 877 (1965); Greene, *The Uniform Commercial Code in Minnesota: Article 9 — Secured Transactions, Sales of Accounts, Contract Rights and Chattel Paper*, 50 MINN. L. REV. 311 (1965); Welsh, *Judicial Interpretations of the Filing Requirements Under Article Nine of the Code*, 37 TENN. L. REV. 273 (1970); Wiseman & King, *Perfection, Filing and Forms Under Article 9 of the Uniform Commercial Code*, 9 WAYNE L. REV. 580 (1963); *Symposium — Secured Financing Under Article 9 of the Uniform Commercial Code — Perfection of the Security Interest*, 19 S. CAR. L. REV. 700 (1967).

The legislative efforts to write priority rules understandably resulted in a scheme far different from the one produced by judicial efforts in the tax lien area.

> Quite by accident, at the same time that the UCC provisions on priorities were being written, the Supreme Court was forced to evolve a set of priority rules for tax liens. On hindsight, it is not surprising that both the Court and the UCC draftsmen produced some confusion in the process, and neither devised a perfect solution.

Coogan, *supra* note 2, at 1377.

[27]Pub. L. 89-719, 80 Stat. 1125 (1966), codified in scattered sections of 26 U.S.C. (1970). The most important provisions are codified in INT. REV. CODE OF 1954, § 6323.

The standard treatise on federal tax lien law after the FTLA is PLUMB, *supra* note 2. Other writings on the FTLA include Coogan, *supra* note 2; Creedon, *The Federal Tax Lien Act of 1966*, 20 A.B.A. TAX SECTION BULL., Jan. 1967, at 101; Plumb, *Federal Liens and Priorities — Agenda for the Next Decade* (pts. 1-3), 77 YALE L.J. 228, 605, 1104 (1968); Plumb, *The New Federal Tax Lien Law (I) & (II)*, 13 PRAC. LAW., Mar. 1967, at 63, Apr. 1967, at 67; Young, *Priority of the Federal Tax Lien*, 34 U. CHI. L. REV. 723 (1967); Comment, *The Federal Tax Lien Act of 1966: A Correlation with Pennsylvania Law*, 72 DIC. L. REV. 144 (1967); Note, *Choateness and the 1966 Federal Tax Lien Act*, 52 MINN. L. REV. 198 (1967) [hereinafter cited at Note, *Choateness & the FTLA*].

which, in many cases, effectively substitutes the priority rules of the UCC for the priority rules of the choateness doctrine and grants priority to those lienors and holders of security interests protected under local law against certain types of private third-party claimants.[28]

After passage of the FTLA, the courts were slow to grasp the import of the new legislation and continued to apply the choateness doctrine,[29] despite the conclusions of some commentators that the doctrine was largely supplanted by the FTLA.[30] In more recent decisions, however, the courts have begun to recognize that application of the FTLA eliminates or at least emasculates the importance of the concept of choate liens.[31] Whether application of the FTLA likewise modifies or clarifies

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[28]INT. REV. CODE OF 1954, § 6323(a), (h)(1), (6). *See also* Note, *Choateness & the FTLA, supra* note 27, at 204–17, 219. The report accompanying the proposed FTLA stated:

> The Federal Tax Lien bill of 1966 represents the first comprehensive revision and modernization of the provisions of the internal revenue laws concerned with the relationship of Federal tax liens to the interests of other creditors.
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> 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 an attempt to take into account these changed commercial transactions, and to secure greater uniformity among the several States, a Uniform Commercial Code was promulgated somewhat over 10 years ago by the American Law Institute and the National Conference of Commissioners on Uniform State Laws. A revised version of this code is already law in over 40 States and could well be adopted by many of the remaining States in the near future. Under the Commercial Code, priority now is afforded new types of commercial secured creditors not previously protected.
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> *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.* It represents an effort to adjust the provisions in the internal revenue laws relating to the collection of taxes of delinquent persons to the more recent developments in commercial practice (permitted and protected under State law) and to deal with a multitude of technical problems which have arisen over the past 50 years. The bill represents the culmination of a project initiated approximately 10 years ago by those concerned with the relationship of the tax lien provisions to the interests of other creditors. Since that time, the suggestions and ideas of various groups have been studied and analyzed carefully, both by the groups themselves and by the staffs of the Treasury Department and the congressional committees.

H.R. REP. No. 1884, 89th Cong., 2d Sess. 102 (1966) (emphasis added).

Legislative history also indicates that reform of the choateness doctrine and elimination of the inequities and impediments to business transactions created by that doctrine was a major purpose of the FTLA. *Hearings on H.R. 11256 and H.R. 11290 Before the House Comm. on Ways and Means,* 89th Cong., 2d Sess. 64 (1966).

[29]*See, e.g.,* Dugan v. Missouri Neon & Plastic Advertising Co., 472 F.2d 944 (8th Cir.), *cert. denied,* 410 U.S. 929 (1973); Texas Oil & Gas Corp. v. United States, 466 F.2d 1040 (5th Cir. 1972), *cert. denied,* 410 U.S. 929 (1973) (criticized for unnecessary application of choateness doctrine in 86 HARV. L. REV. 1570 (1973)); United States v. Hunt, 373 F. Supp. 1079 (D. Wyo. 1974); Continental Finance, Inc. v. Cambridge Lee Metal Co., 100 N.J. Super. 327, 241 A.2d 853 (1968), *aff'd* 105 N.J. Super 406, 252 A.2d 417 (1969); 56 N.J. 148, 265 A.2d 536 (1970) (termed "dead wrong" in R. SPEIDEL, R. SUMMERS & J. WHITE, COMMERCIAL TRANSACTIONS 360 (1st ed. 1969)).

[30]*See, e.g.,* Note, *Choateness & the FTLA, supra* note 27.

[31]Donald v. Madison Industries, Inc., 483 F.2d 837 (10th Cir. 1973); James Talcott, Inc. v.

the "no property" rules has received limited judicial attention. The current status of the "no property" rule under the FTLA and the UCC was, however, the primary issue before the court in the instant case.

II. Treatment of the "No Property" Rule in the Principal Case

The crucial issue as framed by the court was whether Coop, the assignor, retained any right to or interest in the assigned NRSC account sufficient to enable a federal tax lien to attach thereto.[32] The court recognized this issue as a question of state law[33] and concluded that article 9 of Nevada's UCC governed inasmuch as an assigment of accounts constitutes an article 9 secured transaction.[34] Under article 9 a third-party

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Roto American Corp., 123 N.J. Super, 183, 302 A.2d 147 (1973).

The court in the latter case stated:

> The court is aware of the fact that one of the purposes of the Federal Tax Lien Act of 1966, Public Law 89-719, was apparently to eliminate or at least emasculate the importance of the concept of choate liens. . . .
>
> Accordingly, the test would seem to be one of whether the lien satisfies the definition of a protected interest under section 6323, and not whether the lien is "choate" or "inchoate."

Id. at 152–53.

[32]Witco urged that Coop had no rights to property in the NRSC account, that the assignment constituted a complete alienation of all of Coop's interest in and rights to the proceeds of the NRSC contract. Relying on section 9-201 of Nevada's UCC, Witco argued that the assignment was binding between Witco and Coop, that Coop could assert no right to the NRSC account against Witco, and that this was so regardless of any compliance on Witco's part with the filing statutes. Witco further maintained that the IRS could only assert those rights to the proceeds of the NRSC contract which Coop could assert. Since Coop could not successfully assert rights in the property against Witco, the IRS likewise could not. At the making of the assignment, Coop ceased to have any rights to property. There was nothing to which the tax lien could attach.

In opposition, the Government presented a tripartite argument. First, the Government urged that the assignment to Witco of Coop's contract rights was a transaction within the scope of article 9 of Nevada's UCC. The UCC was therefore the body of state law applicable for resolution of the "no property" issue: whatever interest, if any, Coop retained in the NRSC account would be identified and defined in the UCC. Second, section 9-301 of the UCC provides that an unperfected security interest is subordinate to the rights of certain third-party claimants such as a person who becomes a lien creditor before perfection of the security interest. Witco's failure to file left its security interest unperfected. The IRS became a lien creditor upon filing its assessment against Coop and, as a lien creditor, was entitled to priority over Witco — if Coop was found to have property rights in the assigned contract. In asserting that the role of the IRS was that of a lien creditor, the Government repudiated the argument that the IRS merely stood in the shoes of the taxpayer-assignor. Third, since the property interest remaining in the assignor of the assigned account was sufficient to permit a subsequent lien creditor of Coop's to take priority over the unperfected security interest of the assignee, that same property interest remaining in Coop was of a sufficient nature to permit attachment of a federal tax lien.

[33]In treating the issue as a question of state law, the court in the principal case was consciously following the guidelines set forth in Aquilino v. United States, 363 U.S. 509 (1960). *See* note 21 *supra.*

[34]Since the court found the Coop-Witco assignment to be a secured transaction within the scope of article 9, definitions and terminology from that article will be used hereinafter. Thus, the assignment of the NRSC account is a security agreement. UCC § 9-105(1)(h). *See also*

claimant such as a lien creditor of an assignor (debtor) may assert rights in the assigned accounts (collateral) which take priority over the claim of an assignee (secured party) who fails to perfect his security interest by filing notice thereof.[35] The court reasoned that since the interests of third-party creditors are entitled to priority over unperfected security interests and are "derived through" the debtor, under article 9 the rights of the debtor in the collateral are not completely alienated if the secured party has not perfected his interest.[36] Implicit in the court's reasoning is the premise that the UCC's grant of rights to certain third-party claimants, when a secured party fails to file, constitutes a statutory recognition that the debtor retains property rights in the collateral.[37]

Because of conflicting authority marshaled by the opposing parties, the court encountered some difficulty in applying its conclusions regarding the retained property rights of an article 9 debtor to a situation where the IRS was the creditor claiming rights in the collateral. One line of cases declares that the IRS stands in the shoes of the taxpayer, and thus is able to assert only those rights the delinquent taxpayer may assert against the transferred property. On this basis, the taxpayer, having transferred his property via an irrevocable and otherwise enforceable agreement, retains no rights in the property to which a tax lien can

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UCC § 9-102. Witco is the secured party or holder of a security interest. UCC § 9-105(1)(i). Coop is the debtor. UCC § 9-105(1)(d). The NRSC account is the collateral. UCC § 9-105(1)(c). Formerly, "account" meant any right to payment for goods already sold or for services already rendered. "Contract right" meant any right to payment under a contract not yet earned by performance. UCC § 9-106. Under these definitions, Coop assigned to Witco a contract right which became, after Coop completed performance of the NRSC contract, an account. The 1972 revision of article 9 eliminates the distinction by dropping all references to "contract rights" and by expanding the definition of "accounts" to mean any right to payment for goods sold or for services rendered, whether or not it has been earned by performance. UCC § 9-106 (1972). Nevada has adopted the modification. Acts of 1973 at 941 (effective date: July 1, 1975). The term *accounts* is used herein with the meaning given in the 1972 revision.

[35] *See* note 44 *infra*.

[36] The court seemed hesitant to state its conclusion directly.

> In delineating that point at which property of an individual is deemed to have been sufficiently alienated, in transactions within the terms of Article 9, such that subsequent claimants, whose claims are derived through that individual, are not entitled to look to the transferred property for satisfaction of their claims, the U.C.C. has devised a priority system based in large measure on notice filing.

376 F. Supp at 171.

[37] This implicit premise is made explicit in the recent tax lien case of Babb v. Schmidt, 496 F.2d 957 (9th Cir. 1974). The wife of the delinquent taxpayer claimed that under California community property law her husband held no rights to her share of the community property. The Ninth Circuit Court of Appeals observed that state law made the wife's share of the community property available to the creditors of her spouse and concluded that:

> If California law makes the wife's share of the community property available to creditors of the husband, California law has by the same rule implicitly given the husband rights in that property sufficient to meet the requirements of 26 U.S.C. § 6321.

Id. at 960 (citation omitted).

attach.[38] The contrary cases conclude that the IRS is an independent third-party claimant with rights equivalent to those held by private third-party creditors generally and that, because the taxpayer's creditors are granted rights in the transferred property, the taxpayer retains rights to which a tax lien can attach.[39]

Faced with this conflicting authority, the court identified the dispositive question as the role to be accorded the IRS: does the IRS stand in the shoes of the taxpayer-transferor or is the IRS an independent third-party creditor under the UCC? Because of the paramount federal interest in uniformity in the tax collection system, the court concluded that the role of the IRS was a question of federal law. Referring to the FTLA, the court held that the IRS is an independent third-party claimant, the equivalent of a private judgment lien creditor or a subsequent purchaser without knowledge. In that role the IRS may look to the UCC for a definition of its rights.[40] Having determined that the IRS was an independent third-party claimant, the court concluded that the UCC entitles the claim of the IRS to priority over Witco's unperfected security interest; that this express grant of rights to the IRS evidences a state law

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[38]City of New York v. United States, 283 F.2d 829 (2d Cir. 1960); Stuart v. Willis, 244 F.2d 925 (9th Cir. 1957); United States v. Winnett, 165 F.2d (9th Cir. 1947); United States v. Lester, 235 F. Supp. 115 (S.D.N.Y. 1964); United States v. Lebanon Woolen Mills Corp., 241 F. Supp. 393 (D.N.H. 1964).

[39]United States v. Trigg, 465 F.2d 1264 (8th Cir. 1972), *cert. denied*, 410 U.S. 909 (1973); L. B. Smith, Inc. v. Foley, 341 F. Supp. 810 (W.D.N.Y. 1972).

The reasons for the patent inconsistency between the two lines of cases emerge on close examination. Under the line of cases cited at note 38 *supra*, if a taxpayer transfers his property or rights to property via an irrevocable and otherwise enforceable agreement, he retains no property rights to which a tax lien can attach. This is so regardless of any rights creditors of the taxpayer may have against the property under state law. These third-party creditors are viewed as having rights against the transferred property by force of statute and not because the debtor-transferor is deemed to have retained rights in the property. United States v. Lester, 235 F. Supp. 115, 119, 121 (S.D.N.Y. 1964).

Under the second approach, the statutory grant to creditors of the taxpayer of rights against the property is taken as evidence that the taxpayer retains rights in the property. Babb v. Schmidt, 496 F. 2d 957, 960 (9th Cir. 1974); United States v. Trigg, *supra* at 1268–69.

In simplest terms, the conflict becomes this: Is the fact that the taxpayer's creditors have rights in the transferred property evidence that the taxpayer has rights therein? Courts viewing the IRS as a third-party creditor with corresponding rights answer the foregoing question in the affirmative. Babb v. Schmidt, *supra*; United States v. Trigg, *supra*; L. B. Smith, Inc. v. Foley, *supra*. Courts viewing the IRS as standing in the shoes of the taxpayer, and therefore able to assert only rights the taxpayer may assert, answer in the negative. Cases cited note 38 *supra*.

The FTLA directs the status to be accorded the IRS. *See* text accompanying notes 63–64 *infra*. Even more importantly, the UCC clarifies the meaning to be given the statutory grant of rights to third-party creditors. *See* text accompanying note 59 *infra*.

[40]The court stated in relevant part:

> Not unexpectedly, the state law question as to "property interest" — a by-product of the choate doctrine — can also be readily answered by reference to the U.C.C. The only impediment to such use of the U.C.C. is isolating the position to be accorded the IRS; is it to be that of the taxpayer-transferor, or that of a third party claimant?

recognition of retained property rights held by the delinquent taxpayer; and that whatever rights Coop retains in the NRSC account are sufficient to permit attachment of a federal tax lien.[41]

III. Analysis

A. *The Scope of Article 9*

The court determined initially that the Coop-Witco assignment constituted a security agreement or secured transaction within the scope of article 9 of the UCC. That determination, undoubtedly correct, evidences the breadth of the article which applies not only to transactions intended to create a security interest but also to any sale of accounts, contract rights, or chattel paper regardless of the intent of the contracting parties.[42] One of several consequences flowing from the execution of an article 9 security agreement is that the holder of the security interest must, with few exceptions, file a financing statement containing a description of the collateral if he is to protect his interest against subse-

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The public policy which seeks uniformity of tax lien application while according the states proper authority to regulate the incidents of property (see Aquilino v. United States, *supra*) suggests that assignment of the role to be assumed by the IRS in its tax collection is a federal question. The goal of uniformity can thus be advanced without undue injury to state interests. Congress, in looking at this issue as it arises when purchasers or holders of a security interest compete with tax collection efforts, relegated the IRS to the position of a subsequent purchaser without notice or a judgment lien creditor. 26 U.S.C. § 6323 (h) (1) and (6). In such circumstances, then, the federal question has been answered by the FTLA.

. . . Yet, as a "judgment lien creditor" under the FTLA, the IRS may look to the U.C.C. for a definition of its rights.

376 F. Supp at 171.

[41]The court ended its analysis of the IRS's role with this conclusion:

Viewing the IRS as a third party lien creditor, then the argument presented by the IRS in this case as outlined above, must prevail. With the IRS entitled to priority under Nevada's U.C.C., whatever "interest in property" is deemed present in COOP regarding the accounts denoted in the unrecorded WITCO assignment, that interest granted by state law is adequate to negate the argument that the accounts were sufficiently alienated from COOP to avoid attachment of the tax liens.

Id. at 172 (citations omitted).

[42]UCC § 9-102(1)(a), (b) (1972) provides:

(1) Except as otherwise provided in Section 9-104 on excluded transactions, this article applies

(a) to any transaction (regardless of its form) which is intended to create a security interest in personal property or fixtures including goods, documents, instruments, general intangibles, chattel paper or accounts; and also

(b) to any sale of accounts or chattel paper.

See also UCC § 9-105(1)(m) where a "secured party" is defined as one to whom accounts or chattel paper have been sold. There lies a pitfall for the unwary in the fact that the sale of accounts, contract rights, or chattel paper constitutes an article 9 secured transaction even absent an intent to create a security interest. A party who purchases accounts, for example, with no intention that the accounts secure an obligation of the vendor, may be unaware that he holds a security interest and therefore fail to take the precautionary steps taken as a matter of course in a transaction intended as a secured transaction.

quent security interests in the same collateral and unsecured creditors of the debtor.[43] If the secured party fails to file or otherwise perfect his interest in the collateral, the priority rules of UCC section 9-301 subordinate that interest to the rights of certain third-party claimants of the debtor.[44] Viewed in another way, the UCC grants rights to third-party claimants when the secured party fails to perfect his interest.

B. *Creditors' Rights as Evidence of Debtor's Retained Property Rights*

The question considered crucial by the court in the principal case was whether this grant of rights to third-party claimants signifies that the debtor retains an attachable interest in the collateral. Anticipating that the court might respond in the affirmative, Witco argued strenuously that the grant to third-party claimants of rights in the collateral has no bearing on whether Coop retained any interest in the same property.[45] Witco acknowledged that the UCC grants rights in the collateral to certain third-party claimants but maintained that it does not necessarily follow from that fact that there are or must be rights in the debtor. Witco's argument clearly has merit.

Arguably, third-party claimants receive rights in the collateral when a secured party fails to perfect his interest, *not* because the debtor retains any interest therein, but because of the operation of sanctions incorporated in the UCC's notice-filing scheme and designed to induce compliance with that scheme. This argument is supported by an analogy that can be drawn from the real property context. If *A* conveys Blackacre to *B*, who fails to record his deed, and *A* thereafter conveys Blackacre to good faith purchaser *C*, who promptly records, *C* takes Blackacre in most jurisdictions.[46] The courts do not, because *B* fails to record, treat *A* as retaining an interest in Blackacre which he can then convey to *C*. Rather

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[43]UCC § 9-302(1). *See* note 44 *infra*.

[44]UCC § 9-301 (1)(b) provides in relevant part:

> (1) . . . [A] n unperfected security interest is subordinate to the rights of
> . . . .
> (b) A person who becomes a lien creditor without knowledge of the security interest and before it is perfected.

UCC § 9-302(1) provides that:

> A financing statement must be filed to perfect all security interests except the following. . . .

The remainder of section 9-302 identifies the secured transactions that are perfected by methods other than filing. There is no filing requirement for an assignment of accounts which does not, alone or in conjunction with other assignments to the same assignee, transfer a significant part of the outstanding accounts of the debtor. UCC § 9-302(1)(e). Such an assignment becomes fully perfected at the time the parties execute the security agreement. *See* Standard Lumber Co. v. Chamber Frames, Inc., 317 F. Supp. 837 (E. D. Ark. 1970). In the present case, however, the parties stipulated that the NRSC account constituted a significant part of the outstanding accounts of Coop. 376 F. Supp. at 162.

[45]*See* Post-Trial Brief of Witco at 6.

[46]*See* 8A G. THOMPSON, COMMENTARIES ON THE MODERN LAW OF REAL PROPERTY 121-75 (1973 repl.).

the first deed is deemed to divest *A* of all interest in the property.[47] *C* prevails over *B* because, in the language of most recording statutes, the first conveyance is void as against the subsequent purchaser.[48] The obvious purpose of such a scheme is to give force to the recording statutes. The provisions which subordinate *B*'s claim to *C*'s deed constitute a sanction or penalty designed to encourage compliance with notice-filing requirements.[49] The contrary explanation that *C* takes because *A* retained property rights in Blackacre which *A* thus conveyed to *C* comes very close to being a fiction.

The Blackacre example above is one of an absolute conveyance. However, the same analysis obtains where a mortgage or security interest is conveyed. If *A* gives a mortgage on Blackacre to *B, A* would generally be considered to have retained rights in the property, even in title theory jurisdictions.[50] *A* conveyed to *B* some rights and not the entire bundle of rights which constitutes an unencumbered fee simple absolute. If *B* fails to record his mortgage and *A* later conveys to bona fide purchaser *C, C* takes free of *B*'s mortgage.[51] *C* takes, in fact, the complete bundle of rights of an unencumbered fee simple absolute. Does *C* take those rights

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[47]In an early case, the Supreme Judicial Court of Massachusetts declared that the seller divests himself of seisin with the first conveyance even though the deed remains unrecorded; however, the seller retains "apparent seisin [which] is not divested or affected by any unknown and unrecorded deed. . . ." Earl v. Fiske, 103 Mass. 491, 492-93 (1870). *But compare,* Aigler, *Operation of the Recording Acts,* 22 MICH. L. REV. 405, 415 (1924) where the author states that the first transferee, by his failure to record, confers upon the grantor "a statutory power to displace the interest vested by the execution of the instrument [conveying to the first transferee]."

Other views on the effect of the first conveyance on the grantors' right are discussed at G. OSBORNE, HANDBOOK ON THE LAW OF MORTGAGES 342-43 (2d ed. 1970) [hereinafter cited as OSBORNE].

[48]*See, e.g.* CAL. CIVIL CODE § 1214 (West 1954).

[49]*See* OSBORNE, *supra* note 47, at 343–44, where the author states:

> There is no doubt that recording systems were established to provide a substitute for the publicital element of livery of seisin and the protection it afforded to subsequent purchasers. The achievement of this general objective involved the provision and preservation of a history of the title available to the public by which a purchaser might, in considerable degree at least, determine the risk he ran in taking a title. This is basic in all American recording systems. *To accomplish this fundamental purpose the immediate end was to force prompt recordation of each successive conveyance.* One means of accomplishing this result would have been to give no force or efficacy at all to any conveyance unless and until it has been recorded. This method, as has been seen, was not adopted in most jurisdictions. Instead, the device of divesting an unrecorded conveyance in favor of a subsequent purchaser was utilized for that purpose. In addition to this incentive in the form of a stick, a carrot was held out to those grantees whose interests were of a sort that might be divested by a sale to a bona fide purchaser: proper recordation was made constructive notice to all subsequent takers. This latter effect of recordation has been regarded by many American authorities as the chief purpose of recording but this view has been criticized.

Id. (citations omitted) (emphasis added).

[50]*Id.* at 23-24.

[51]*Id.* at 319-20. *See also* note 46 *supra.*

because *A* had such to convey? Obviously not. *C* takes rights not held by his grantor because of the operation of those statutory sanctions designed to encourage compliance with notice-filing requirements. It would be erroneous to maintain that *C*'s complete bundle of rights is evidence that such was held by *A*.

The analysis used in the above examples is applicable to the present case. Since *C* took rights not held by his grantor, *A*, third-party claimants may be viewed as receiving under article 9 rights in the collateral even though their debtor held none. Such claimants receive those rights because of the operation of the statutory provisions, particularly UCC section 9-302(1),[52] designed to induce compliance with the notice-filing requirements of article 9. This argument does not absolutely preclude the possibility that the debtor does retain rights in the collateral, even after an absolute conveyance of accounts, but at the very least the real property analogies should make one wary of taking the rights of third-party claimants as conclusive evidence of the existence of a debtor's retained property rights.[53] Yet the court in the present case read the UCC's grant of rights to third-party claimants as necessarily implying that the debtor retains an interest in the collateral.[54]

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[52]*See* note 44 *supra*.

[53]By way of counter-argument, one may employ the above real property analogies, particularly the one involving a mortgage, to demonstrate that under the traditional view of a mortgage (security interest) the mortgagor (debtor) is always deemed to retain a property interest in Blackacre (collateral). But it must be remembered that an absolute, irrevocable assignment or sale of accounts is a "secured transaction" giving rise to a "security interest" only because the UCC by definition says it is. UCC § 9-102(1)(b). In its fundamental nature, a sale of accounts may still be equivalent to an absolute conveyance.

The drafters of the UCC included all sales of accounts, regardless of the intent of the parties, within the scope of article 9 primarily to avoid difficult evidentiary problems and for convenience. UCC § 9-102, Comment 2 states:

> An assignment of accounts or chattel paper as security for an obligation is covered by subsection (1) (a). *Commercial financing on the basis of accounts and chattel paper is often so conducted that the distinction between a security transfer and a sale is blurred, and a sale of such property is therefore covered by subsection* (1) (b) *whether intended for security or not,* unless excluded by Section 9-104. The buyer then is treated as a secured party, and his interest as a security interest. See Sections 9-105(1)(m), 1-201(37).

Id. (emphasis added).

Yet after including within the scope of article 9 all sales of accounts, the drafters provided specific exceptions. UCC § 9-104(1)(f) states that article 9 does *not* apply:

> to a sale of accounts or chattel paper as part of a sale of the business out of which they arose, or an assignment of accounts or chattel paper which is for the purpose of collection only, or a transfer of a right to payment under a contract to an assignee who is also to do the performance under the contract or a transfer of a single account to an assignee in whole or partial satisfaction of a preexisting indebtedness. . . .

See also Lyon v. Ty-Wood Corp., 212 Pa. Super. 69, 239 A.2d 819 (1968); Spurlin v. Sloan, 368 S.W.2d 314 (Ky. 1963).

[54]375 F. Supp. at 171. *See* note 36 *supra*.

The cases upon which the court relies as precedent likewise fail to fully justify the view that article 9, particularly UCC § 9-301, grants to the debtor rights in the collateral. *See* United

C. *UCC Section 9-311*

Even though the rationale of the court's holding may be subject to criticism, the holding itself appears to be correct. As a matter of state law, all article 9 debtors apparently hold property rights in the collateral: the issue has been resolved by express statutory provisions of which the court, seemingly, was unaware.[55] Section 9-311 of the UCC provides that the article 9 debtor, even after creation of a security interest, has an interest in the collateral that can be alienated:

> The debtor's rights in collateral may be voluntarily or involuntarily transferred (by way of sale, creation of a security interest, attachment, levy, garnishment or other judicial process) notwithstanding a provision in the security agreement prohibiting any transfer or making the transfer constitute a default.[56]

Even more directly, the Official Comment to section 9-311 declares that the purpose of the section is:

> To make clear that in all security transactions under this Article, the debtor has an interest (whether legal title or an equity) which he can dispose of and which his creditors can reach.[57]

States v. Trigg, 465 F. 2d 1264 (8th Cir. 1972), *cert. denied,* 410 U.S. 909 (1973); L. B. Smith, Inc. v. Foley, 341 F. Supp. 810 (W.D.N.Y. 1972). In the *Trigg* case, *supra,* the Eighth Circuit Court of Appeals recognized that the UCC does not classify the debtor's rights in the collateral securing the debt as "right to property" in any traditional sense, and further that the UCC focuses on the rights and duties of secured parties, debtors, and third parties rather than on the location of title. United States v. Trigg, *supra* at 1268. The *Trigg* court observed:

> If the secured party fails to perfect his interest, the UCC grants rights against the collateral to third party creditors *regardless of the legal interest held by either the secured party or the debtor.*

Id. (emphasis added). Nevertheless, because a private lien creditor can reach collateral securing an unperfected security interest, the court declared that the collateral is not beyond the reach of the federal tax lien. The *Trigg* court did not explain, however, why the debtor must be deemed to retain rights in the collateral. As noted, the court itself observed that third-party creditors are granted rights against the collateral *regardless* of any legal interest held by the debtor. This observation would seem to preclude the argument that creditors' rights are evidence of a retained property right in the debtor.

However, only one federal tax lien case decided subsequent to 1966 holds that an assignment of accounts leaves no rights to property in the assignor. Monroe Banking & Trust Co. v. Allen, 286 F. Supp. 201 (N.D. Miss. 1968). A reading of the case reveals that the court applied pre-Code state law because the UCC did not become effective in Mississippi until March 31, 1968, Laws of 1966, ch. 316, only several months prior to the decision in the *Allen* case.

[55]The court never mentioned or alluded to section 9-311 in its opinion. However, a brief filed early in the litigation by the Government refers to the section as establishing conclusively that, under the law of Nevada, Coop retained an interest or property right in the NRSC account. *See* Trial Brief for the Defendant United States of America at 5. The court seems to have relied exclusively on the Government's posttrial brief in presenting and sustaining the Government's argument.

[56]UCC § 9-311.

[57]UCC §9-311, Comment 1.

Although the official comment to section 9-311 states much more plainly and unambiguously than section 9-311 itself that the article 9 debtor always retains an interest in the col-

Since the delinquent taxpayer need only have "rights to property" and not a certain *quantum* of rights before a federal tax lien can attach,[58] the "rights" of all article 9 debtors referred to in section 9-311 should be deemed sufficient to permit attachment of a tax lien. Indeed, the importance of section 9-311 to all federal tax lien litigation rests in its clear implications that an article 9 secured transaction never succeeds in completely divesting a delinquent taxpayer of all his rights to property so as to prevent subsequent attachment of a federal tax lien.[59]

D. The Role of the IRS

A second question facing the court was whether the IRS is a "creditor" in the same sense and with the same rights as a private creditor. Pre-FTLA cases rather uniformly held that for tax collection purposes the Government's interest in the taxpayer's property extends no further than the interest of the taxpayer himself.[60] This general principle precludes the IRS from satisfying its claim since the debtor generally has no rights in the property he can successfully assert against the holder of even an unperfected security interest.[61] Private creditors, however, have uniformly been allowed to reach the collateral to satisfy their claims if the secured party fails to perfect his interest.[62]

The court in the present case rejected this discriminatory treatment of the IRS and declared that Congress, through the FTLA, accorded the IRS the same role, with the same rights in collateral, as a judgment lien

lateral securing the security interest, caution should be used to avoid placing too much confidence in or reliance on the comment. Section 9-311 is the legislation; the comment is not. *See* J. WHITE & R. SUMMERS, HANDBOOK OF THE LAW UNDER THE UNIFORM COMMERCIAL CODE 11–13 (1973).

[58]Any right whatsoever in the delinquent taxpayer has been deemed sufficient to permit attachment of a federal tax lien. As stated in United States v. Overman, 424 F.2d 1142, 1145 (9th Cir. 1970):

> [A]ll that Section 6321 requires is that the interest [of the delinquent taxpayer] be "property" or "rights to property." *It is of no statutory moment how extensive may be those rights under state law,* or what restrictions exist on the enjoyment of those rights.

Id. (emphasis added).

[59]The courts can rely on section 9-311 in future cases to resolve the "no property" issue and avoid the difficult conceptualizations employed by the court in the instant case. In all cases where the delinquent taxpayer allegedly alienated his rights to property via an article 9 security agreement, the courts can answer the threshold question of whether the delinquent taxpayer has rights to property by referring to section 9-311.

[60]Cases cited note 38 *supra.*

[61]A security agreement is effective according to its terms between the parties (*i.e.,* the debtor and the secured party), UCC § 9-201, if the collateral is in the possession of the secured party or the debtor has signed a security agreement which contains a description of the collateral. UCC § 9-302(1)(a), (b). In the present case, Coop signed a security agreement.

If the security agreement constitutes an absolute assignment of accounts, the debtor is effectively precluded from asserting any rights whatsoever in the collateral against the secured party.

[62]UCC § 9-301.

creditor or subsequent purchaser without notice has under the UCC.[63] The FTLA thus grants priority to security interests competing with federal tax liens only if those interests are protected by local law against private creditors. Conversely, the federal tax lien prevails over the security interest only if a private third-party creditor would also prevail. The court correctly determined that Congress intended that the IRS, in cases where the delinquent taxpayer allegedly transferred his property via a security agreement, be accorded the same rights against the collateral as the UCC grants to the holder of a subsequent judgment lien arising out of an unsecured obligation.[64]

E. *Manipulation of the "No Property" Rule*

There remains the question of why the role or position of the IRS should have been given attention in determining whether the delinquent taxpayer retains rights in the subject property.[65] There is no logical relation between the ownership of property rights by the taxpayer and

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[63]376 F. Supp. at 171. *See* note 40 *supra*.

[64]INT. REV. CODE OF 1954, § 6323(h)(1) provides in relevant part:

> A security interest exists [is protected against a federal tax lien] 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. . . .

One involved in drafting the FTLA recalls:

> The Treasury was insistent that some standard of perfection be imposed upon security interests, since those that had not achieved such dignity that they would be protected under local law were not thought worthy of protection against federal tax liens. But *against whom* must the interest be "protected"? In whose hypothetical shoes is the tax collector to stand? For certain purposes of the Act, he is (somewhat anomalously), treated as if he were a "subsequent purchaser without actual notice," but that standard would not do in the case of security interests, at least in inventory and obligations, which in some circumstances can be sold free of existing commercial security interests. Therefore, following substantially the pattern of the Bankruptcy Act, the federal tax collector was, with respect to security interests, placed in the shoes of a holder of "a subsequent judgment lien arising out of an unsecured obligation."

Plumb, *Federal Liens and Priorities — Agenda for the Next Decade II*, 77 YALE L.J. 605, 658 (1968) (citations omitted).

Several courts in applying the FTLA have recognized that the legislation accords the IRS the same rights held by specified private creditors under state law. The court in Continental Oil Co. v. United States, 326 F. Supp. 266, 271 (S.D.N.Y. 1971), declared:

> Thus, revised Section 6323(h)(6) [of the INT. REV. CODE OF 1954; Section 6323(h)(1) could also be included] modifies the doctrine, oft-repeated in this circuit, that the government has no greater right to property than that accorded the taxpayer. *City of New York v. United States, supra* [283 F.2d 829 (2d Cir. 1960)], *Lester v. United States, supra*, 235 F. Supp. [115 (S.D.N.Y. 1964)] at 119 . . . [T]he government's rights are no longer so limited.

See, e.g., United States v. Trigg, 465 F.2d 1264 (8th Cir. 1972), *cert. denied*, 410 U.S. 909 (1973); L. B. Smith, Inc. v. Foley, 341 F. Supp. 810 (W.D.N.Y. 1972).

[65]Pre-FTLA cases, as well as the principal case, referred to the role to be accorded the IRS as the dispositive issue in determining whether the debtor retained any rights in transferred property. *See* 376 F. Supp. at 170–71; cases cited at note 38 *supra*.

the role of the IRS in its tax collection efforts. In explanation, it is suggested that the courts in pre-FLTA cases manipulated the role of the IRS and the larger "no property" issue in order to give effect to policies and equitable considerations the courts perceived as important. This thesis is consistent with the generally accepted view that the "no property" rule was developed not only to give effect to statutory prescriptions but to achieve a wider purpose: avoidance of the harsh and inequitable results of the choateness doctrine.[66]

The suggestion that the courts manipulated the "no property" rule is supported by an examination of the pre-1966 cases, where the rule was applied to effect widely disparate policies. For example, in some cases the courts were hesitant to allow the IRS to benefit from a secured party's failure to comply with state notice-filing requirements because the IRS is not a reliance creditor:[67] the IRS assesses taxes and brings federal tax liens into existence regardless of the amount of property the public records show the taxpayer as owning.[68] Concern with the anomaly of affording the benefits of a notice-filing scheme to a nonreliance creditor and avoidance of that anomaly by application of the "no property" rule are demonstrated in the notable pre-FTLA case of *United States v. Lebanon Woolen Mills Corp.*[69] In the *Lebanon Woolen Mills* case, the IRS filed notice of the existence of federal tax liens on the property of a delinquent taxpayer who earlier had purchased an automobile under a conditional sales contract. The vendor of the automobile failed to file notice of the contract until after tax lien filing. The court treated the conditional vendor as the holder of a security interest and concluded not only that an unfiled security interest is perfected as against the IRS, a nonreliance creditor, but also that such a security agreement succeeds in alienating all of the debtor's rights to the collateral.[70]

Pre-FTLA courts also manipulated the "no property" rule to avoid

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[66] *See* note 19 *supra.*

[67] *See, e.g.,* United States v. Lebanon Woolen Mills Corp., 241 F. Supp. 393 (D.N.H. 1964); Gauvey v. United States, 291 F.2d 42 (8th Cir. 1961); United States v. R. F. Ball Constr. Co., 355 U.S. 587, 594 (dissenting opinion) (1958).

[68] United States v. Lebanon Woolen Mills Corp., 214 F. Supp. 393, 399 (D.N.H. 1964).

Prior to passage of the FTLA there was substantial controversy and uncertainty over whether a security interest, to be perfected against a federal tax lien, was required to be perfected under applicable state law against private creditors and lienors. *Compare* United States v. Lebanon Woolen Mills Corp., *supra,* (no) *with* Sams v. Redevelopment Authority, 436 Pa. 524, 261 A.2d 566 (1970) (yes) *and* 2 G. GILMORE, SECURITY INTERESTS IN PERSONAL PROPERTY 1068 (1965) (yes).

In essence, the question of whether a security interest is perfected in "the federal sense," if not perfected under state law, is a choateness issue and hence a priority issue. The *Lebanon Woolen Mills* case, however, treats the issue as a "no property" question.

Id. at 400–02.

[69] 241 F. Supp. 393 (D.N.H. 1964).

[70] *Id.* at 400–02.

what they perceived as the inequity of allowing the IRS to satisfy the delinquent taxes of one taxpayer by taking a fund created entirely or substantially by a third party.[71] In the present case, for example, the NRSC account was made possible, even "created" in a sense, by the money and material advanced to Coop by Witco. In similar circumstances, the Third Circuit Court of Appeals in the pre-FTLA case of *In re Halprin*[72] avoided the perceived inequity by holding that the party "creating" the fund was the owner thereof; the delinquent taxpayer held no property rights in the fund, thus precluding the attachment of a federal tax lien.[73]

The court in the instant case correctly held that, under the FTLA and the UCC, the holder of a security interest must file a financing statement or otherwise perfect his interest to protect that interest against a federal tax lien, even though the IRS is a nonreliance creditor.[74] Also, an assignee who takes an assignment of accounts yet to be earned by the assignor through use of a fund "created" by the assignee is, under the UCC, not the owner of that fund but merely the holder of a security interest therein.[75] The assignor, or debtor in UCC terminology, retains an interest in the assigned account to which a federal tax lien can

[71]*In re* Halprin, 280 F.2d 407 (3d Cir. 1960); Harter v. District Director, 68-2 U.S. Tax Cas. ¶ 9485 (E.D. Wash. 1968); Raffaele v. Granger, 196 F.2d 620 (3d Cir. 1952).

[72]280 F.2d 407 (3d Cir. 1960).

[73]*Id.* at 410–11.

[74]*See* text accompanying note 64 *supra.*

Thoughout this case note, the Coop-Witco assignment has been treated as a secured transaction giving rise to a security interest in Witco. The transaction was so treated by the court in the instant case; an assignment of accounts is clearly a secured transaction under article 9. UCC § 9-102(1)(b). However, the FTLA definition of "security interest" is more narrow than that of the UCC. INT. REV. CODE OF 1954, § 6323(h)(1) provides in relevant part that:

> 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.

Since the UCC treats as a secured transaction "any transaction (regardless of form) which is intended to create a security interest," UCC § 9-102(1)(a), *and* any sale of accounts or chattel paper, UCC § 9-102(1)(b), a sale of accounts intended as an absolute conveyance and *not* as security for a performance arguably does not give rise to a security interest under the FTLA, though it obviously does under the UCC.

But this argument will be of little avail to the buyer of accounts who failed to perfect his UCC security interest. If he is not the holder of a "security interest" under the FTLA, INT. REV. CODE OF 1954, § 6323(h)(1), he is obviously a "purchaser." A purchaser under the FTLA protects his purchased property against federal tax liens by taking all steps necessary under local law to protect his interest against subsequent purchasers without actual notice. INT. REV. CODE OF 1954, § 6323(h)(6). To protect his interest under local law (*i.e.,* the UCC) against subsequent *bona fide* purchasers, the buyer of *accounts* must perfect his interest, UCC § 9-301(1)(d), by filing a financing statement, UCC § 9-302.

As the court recognized in the instant case, to treat Witco as a purchaser, rather than as a holder of a security interest, would have no effect on the outcome. Because Witco failed to file a financing statement, the federal tax lien both attaches to the NRSC account and takes priority over Witco's interest therein. 376 F. Supp. at 170.

[75]*See* note 42 *supra.*

attach.[76] After passage of the FTLA, commentators speculated that the reasoning in such cases as *Lebanon Woolen Mills* and *In re Halprin* might still be viable.[77] The court in the instant case, however, accurately interpreted the legislative scheme of both the FTLA and the UCC and determined that such reasoning could not be applied consistent with the FTLA.[78]

F. Narrowing the Application of the "No Property" Rule

There are ample reasons for applauding the court's ultimate disposition of both the issue of the role of the IRS and the larger "no property" issue, and for hoping that future judicial application of the FTLA in cases involving holders of security interests follows similar lines. The "no property" rule should not be broadly applied by the courts. The rule was developed as a tool to reach equitable results at a time when broad application of the choateness doctrine created inequity in the law of federal tax liens.[79] But passage of the FTLA in 1966 resulted in a much more equitable tax lien law,[80] primarily because the legislation in large measure emasculated the doctrine of choate liens.[81] The FTLA provides the means whereby the holder of a security interest can insure the priority of his interest over subsequently arising federal tax liens and, indeed, often protects private liens and interests which do not comply with the requirements of the choateness doctrine.[82] In the instant case, for example, Witco could have protected its security interest in the NRSC account against subsequent and competing federal tax liens merely by meeting the minimal burden of filing a financing statement. In sum, the FTLA — primarily by providing the means whereby private creditors can secure protection against subsequently arising federal tax liens — has changed the law of federal tax liens to make it more equitable.

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[76] *See* text accompanying notes 58-59 *supra*.

[77] *See* PLUMB, *supra* note 2, at 99. *But see* Young, *supra* note 27, at 743-52.

[78] 376 F. Supp. at 171.

[79] *See* note 19 *supra*.

[80] Plumb, *Federal Liens and Priorities — Agenda for the Next Decade III*, 77 YALE L.J. 1104, 1188–89 (1968).

It has been generally observed that the FTLA scheme, though not the ultimate panacea, is a program businessmen can live with, something they could not do with the choateness doctrine and pre-FTLA priority rules.

[81] *See* note 31 *supra*.

[82] Under the FTLA a security interest may prevail over a federal tax lien even though it is not otherwise perfected by choateness doctrine standards:

> [V]arious types of secured creditor interests . . . are specifically defined, and . . . where those interests qualify under the definitions they are to be accorded this priority status whether or not they are in all other respects definite and complete at the time notice of the tax lien is filed.

112 CONG. REC. 26, 477 (1966). *See Hearings on H.R. 11256 and H.R. 11290, supra* note 28, at 38. *See also*, Note, *Choateness & the FTLA, supra* note 27, at 204–17.

The conditions, therefore, that created the need for a broadly applied "no property" rule are no longer present.

There is an additional, perhaps more compelling reason for limiting the application of the "no property" rule. The FTLA is aimed at accommodating both the interests of private creditors and purchasers and the interests of the federal government in its tax collection efforts. Indeed, the FTLA was the result of over ten years of intensive and cooperative drafting among the American Bar Association and other groups, representing the interests of private creditors, and the Treasury Department, representing the interests of the IRS.[83] The scheme of accommodation forged in that cooperative effort and given the congressional imprimatur can be unbalanced and federal tax collection efforts severely hampered if the courts expand the "no property" rule to protect those private creditors who fail to avail themselves of the protection afforded them by the FTLA.

IV. Conclusion

In 1961, when the "no property" rule was being widely applied, practitioners were advised that they could "protect banks, sureties, and even [their] own interest in a fee for services rendered . . . by means of a bona fide assignment of the contract proceeds in payment or to secure payment."[84] Such is surely not the case today. In order to protect his clients, a practitioner in these post-FTLA, post-UCC days must recognize that an assignment of contract rights or accounts, taken for whatever purpose and with whatever intent, constitutes a secured transaction.[85] A holder of the security interest protects himself against subsequently arising federal tax liens by compliance with UCC requirements of perfection, primarily the filing of a financing statement.[86] With the ever-increasing use of the section 6321 tax lien to enforce payment of tax delinquencies, full compliance with UCC perfection requirements becomes imperative for all holders of security interests.

[83] *See Hearings on H.R. 11256 and H.R. 11290, supra* note 28 at 64-65; H.R. Report No. 1884, *supra* note 28, at 1-2.

[84] Note, *The Federal Tax Lien — A Practitioner's Guide to the Resolution and Avoidance of Priority Problems,* 36 N.Y.U.L. Rev. 1316, 1341 (1961).

[85] UCC § 9-102(1)(b).

[86] UCC §§ 9-301 to 316; Int. Rev. Code of 1954, § 6323(h)(1), (6).