



**PennState**  
Dickinson Law

**DICKINSON LAW REVIEW**  
PUBLISHED SINCE 1897

---

Volume 72  
Issue 1 *Dickinson Law Review - Volume 72,*  
*1967-1968*

---

10-1-1967

## The Federal Tax Act of 1966: A Correlation with Pennsylvania Law

Gerald K. Morrison

Follow this and additional works at: <https://ideas.dickinsonlaw.psu.edu/dlra>

---

### Recommended Citation

Gerald K. Morrison, *The Federal Tax Act of 1966: A Correlation with Pennsylvania Law*, 72 DICK. L. REV. 144 (1967).

Available at: <https://ideas.dickinsonlaw.psu.edu/dlra/vol72/iss1/5>

This Comment is brought to you for free and open access by the Law Reviews at Dickinson Law IDEAS. It has been accepted for inclusion in Dickinson Law Review by an authorized editor of Dickinson Law IDEAS. For more information, please contact [lja10@psu.edu](mailto:lja10@psu.edu).

## THE FEDERAL TAX LIEN ACT OF 1966: A CORRELATION WITH PENNSYLVANIA LAW

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.

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 ten 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 forty 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.

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 fifty years.<sup>1</sup>

The Federal Tax Lien Act of 1966<sup>2</sup> was enacted with the aim of bringing the federal government into a more realistic competitive position with those persons holding liens and security interests under local law. The "multitude of technical problems" is most directly attributable to the "choate test" imposed by the Supreme Court for determining relative priorities among competing private and federal tax liens.<sup>3</sup> Under the choate test, for a private lien to prevail over a competing federal tax lien the private lien had to be choate—the identity of the lienor, of the property bound, and the amount of the lien all had to be fixed beyond possibility of

---

1. H.R. REP. NO. 1884, 89th Cong., 2d Sess. 1, 2 (1966). Since Treasury Regulations interpreting the Lien Act have not yet been published, the House and Senate Committee reports are of the utmost importance.

2. INT. REV. CODE of 1954, § 6323, *as amended*, 26 U.S.C. § 6323 (Supp. II 1966) [hereinafter cited as Federal Tax Lien Act of 1966].

3. See *United States v. New Britain*, 347 U.S. 81 (1954).

change or dispute.<sup>4</sup> Since the amount of the lien could not be fixed with certainty prior to a judicial determination, a secured party, regardless of his degree of perfection under the Uniform Commercial Code, could not prevail over the federal tax lien unless his lien had been reduced to judgment. This result stifled the basic purposes of article 9 of the Uniform Commercial Code and created the clamor of protest which brought about the present legislation.<sup>5</sup>

A striking characteristic of the Lien Act is its overall dependence upon the local law of each state for its interpretation and manner of operation within that state. The purpose of this Comment is to set forth the relevant law of Pennsylvania, to correlate that law with the Lien Act provisions, and to analyze the effect of the Lien Act upon the secured party in Pennsylvania.<sup>6</sup> The scope is necessarily limited to those Lien Act provisions placing specific reliance upon local law.

The first section of the Lien Act, 6323(a), appears to be the least complex and yet is probably the most difficult provision to apply. It provides that if the government does not give notice of its tax lien by filing first, interests arising in a purchaser, holder of a security interest, mechanics lienor and judgment lien creditor will be given priority over the tax lien.<sup>7</sup> The difficulty in application arises because each class of interest holder must be considered first in light of its Lien Act definition<sup>8</sup> and secondly in light of its treatment under Pennsylvania law.

#### RIGHTS OF PURCHASERS

A "purchaser" is defined by the Lien Act as one "who, for adequate and full consideration in money or money's worth, acquires an interest (other than a lien or security interest) in property which is valid under local law against subsequent purchasers without actual notice."<sup>9</sup> The specific interests referred to are leaseholds, executory contracts to purchase or lease, options to purchase or lease, and options to renew or extend a lease.<sup>10</sup>

The Uniform Commercial Code defines a purchaser as one who takes by sale, discount, negotiation, mortgage, pledge, lien, issue or re-issue, gift, or any other voluntary transaction creating an inter-

---

4. See *United States v. Pioneer American Life Ins. Co.*, 374 U.S. 84 (1963); *United States v. New Britain*, 347 U.S. 81 (1954); *In re Lehigh Valley Mills, Inc.*, 341 F.2d 398 (3d Cir. 1965).

5. The choate test has not been judicially or legislatively eliminated and apparently will still be used when the private party fails to meet Lien Act requirements.

6. The Uniform Commercial Code became effective in Pennsylvania on July 1, 1954. PA. STAT. ANN. tit. 12A, § 10-101 (1954).

7. Federal Tax Lien Act of 1966, § 6323(a).

8. Federal Tax Lien Act of 1966, § 6323(h).

9. Federal Tax Lien Act of 1966, § 6323(h)(6).

10. Federal Tax Lien Act of 1966, § 6323(h)(6).

est in property.<sup>11</sup> Although this definition is broad, when one is competing against a tax lien, whether he will be accorded the status of a purchaser must be determined by section 6323(h)(6) of the Lien Act. Pennsylvania law and the Uniform Commercial Code, however, become important in answering the question posed by sections 6323(a) and 6323(h)(6): whether a subsequent purchaser without actual notice will prevail over one holding a prior leasehold, option to purchase or lease, option to renew or extend a lease, or an executory contract right to purchase or lease the same property. If a subsequent purchaser without actual notice will prevail under Pennsylvania law over the holder of one of these interests, then that interest holder is not a "purchaser" within the Lien Act definition<sup>12</sup> and will not be accorded priority over the federal tax lien under section 6323(a).

Since the Pennsylvania law in this area is based on its recording statutes,<sup>13</sup> it is unclear whether a subsequent purchaser without actual notice will prevail over a prior interest holder in Pennsylvania.

A purchaser's title to realty could be affected only with what he actually or *constructively* knew at the time of the purchase, necessarily by what he could have learned by inquiry from the person in possession and of others who he had reason to believe knew of facts which might affect title, and by what appeared in appropriate indexes in the office of recorder of deeds and in various courts of record whose territorial jurisdiction embraced the land.<sup>14</sup>

The policy of the Pennsylvania courts is to protect purchasers for value and without notice from adverse titles and interests.<sup>15</sup> The cases uniformly hold that an "innocent purchaser of realty for value and without actual or *constructive* knowledge of third parties' claims holds title acquired free of any secret equities."<sup>16</sup> The basis of the Pennsylvania decisions, however, lies in the requirement of the recording statutes that all writings passing or creating an interest or right of any kind in land must be recorded or the interest will be void against subsequent bona fide purchas-

---

11. PA. STAT. ANN. tit. 12A, § 1-201(33) (1954).

12. Federal Tax Lien Act of 1966, § 6323(h)(6).

13. PA. STAT. ANN. tit. 21, § 444 (1955); PA. STAT. ANN. tit. 68, § 700.501 (1965).

14. *Lund v. Heinrich*, 410 Pa. 341, 189 A.2d 581, 582 (1963) (emphasis added) (quoting from unofficial syllabus). See *Kepler v. Kepler*, 330 Pa. 441, 199 A. 198 (1938); *Haggerty v. Moyerman*, 321 Pa. 555, 184 A. 654 (1936); *Puharic v. Novy*, 317 Pa. 199, 176 A. 233 (1935); *Salvation Army Trustees, Inc. v. Lawson*, 293 Pa. 459, 143 A. 113 (1928).

15. 32 P.L.E. *Sales of Realty* § 141 (1960).

16. *Lund v. Heinrich*, 410 Pa. 341, 189 A.2d 581, 582 (1963) (emphasis added) (quoting from unofficial syllabus). See *Dorsey v. Kline*, 10 Pa. D. & C.2d 440 (C.P. Lanc. Co. 1951); *Dusick v. Morgan*, 25 Northumb. 18 (C.P. Pa. 1953); *Dorr v. Leippe*, 16 Berks 207 (C.P. Pa. 1924).

ers.<sup>17</sup> The recording of the sale, lease, or option gives constructive notice to all and prevents anyone later purchasing the same interest from claiming the status of a bona fide purchaser. If there is no recording, the subsequent purchaser will prevail unless the prior interest holder can prove that the subsequent purchaser had actual notice. The Lien Act test, based on the rights of a subsequent purchaser without *actual* notice, and the Pennsylvania law defining these rights will be in conflict when the prior interest is recorded, giving constructive notice, but the subsequent purchaser has no actual notice. The constructive notice would foreclose the subsequent purchaser's rights in Pennsylvania. Of course, if there were no recording and the subsequent purchaser had no actual notice, then his purchase would cut off the rights of the prior interest holder.

Correlating the Lien Act provisions of sections 6323(a) and 6323(h) (6) with Pennsylvania local law, it appears that if a person acquires a lease of property, a written or executory contract to purchase or lease property, an option to purchase or lease property or any interest therein, or an option to renew or extend a lease of property *and records his interest*, a subsequent purchaser without actual notice of the first holder's interest will take subject to the constructive notice provisions of the recording statutes. The subsequent purchaser will not prevail under local law; hence the first holder may be accorded the Lien Act status of "purchaser." If he acquires and records his interest prior to the filing of the federal tax lien, he will achieve priority under section 6323 (a).

This result seems consistent with the intent of the Lien Act: "Thus, for example, the holder of an option is not to lose the right to acquire the property at the option price."<sup>18</sup> It must be emphasized, however, that the section 6323 (h) (6) "purchaser" must record his interest in order to successfully compete with the tax lien. If the purchaser does not record his interest, he apparently would be subject to the choate test to determine his priority.

#### RIGHTS OF HOLDERS OF SECURITY INTERESTS

One holding a "security interest" may also be accorded priority over the federal tax lien under section 6323(a).<sup>19</sup> The Uniform Commercial Code defines security interest as "an interest in personal property or fixtures which secures payment or performance of an obligation. The term also includes any interest of a buyer of accounts, chattel paper or contract rights."<sup>20</sup> The Lien Act def-

---

17. PA. STAT. ANN. tit. 21, § 444 (1955); PA. STAT. ANN. tit. 21, § 351 (1955); see *Pennsylvania Range Boiler Co. v. Philadelphia*, 344 Pa. 34, 23 A.2d 723 (1942). Because Pennsylvania has had recording statutes since 1775, there is no body of pre-recording act decisions.

18. S. REP. NO. 1708, 89th Cong., 2d Sess. 4 (1966).

19. Federal Tax Lien Act of 1966, § 6323(a).

20. PA. STAT. ANN. tit. 12A, § 1-201(37) (1954).

inition again differs from the Uniform Commercial Code. By embracing real estate mortgages and deeds of trust as well as all forms of commercial security,<sup>21</sup> the Lien Act broadens the Code definition. At the same time, however, the Act greatly narrows the scope of "security interest" for purposes of section 6323(a) by limiting the term to perfected security interests.

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.<sup>22</sup>

According to the section 6323(h) definition, if the security interest is not protected under local law against a subsequent judgment lien, it does not exist. The Uniform Commercial Code provides that only perfected security interests will be protected against subsequent judgment liens.<sup>23</sup> Therefore, the "security interest" given priority by Lien Act sections 6323(a) and 6323(h)(1) cannot include a security interest which is not perfected under the Code. Unperfected security interests competing against federal tax liens will remain subject to the choate test; only perfected security interests, filed mortgages and deeds of trust arising before the tax lien is filed will prevail under 6323(a).<sup>24</sup>

#### RIGHTS OF JUDGMENT LIEN CREDITORS

A complete understanding of the rights of a judgment lien creditor under Pennsylvania law is vital to a proper application of the Lien Act. Under section 6323(a), one who is a "judgment lien creditor" will prevail over a later filed federal tax lien. Further, as a test of Lien Act priorities under sections 6323(a) (holder of a security interest) and 6323(c) and (d) (commercial transactions financing agreements), whether a party holding one of these

---

21. Plumb, *The New Federal Tax Lien Law*, PRAC. LAW, March 1967, at 66.

22. Federal Tax Lien Act of 1966, § 6323(h)(1) (emphasis added).

23. PA. STAT. ANN. tit. 12A, §§ 9-301(1)(b), 9-312(5) (1954). See also *Industrial Packaging Prod. Co. v. Fort Pitt Packaging Co.*, 399 Pa. 643, 161 A.2d 19 (1960); 2 ANDERSON, COMMENTS TO THE UNIFORM COMMERCIAL CODE § 9-301, at 539 (1961) (the Code category of lien creditor embraces any creditor who has obtained a lien on property by judicial process).

24. See S. REP. No. 1708, 89th Cong., 2d Sess. 4 (1966): "For Federal tax purposes, a security interest is not considered existing until conditions set forth here are met even though local law may relate a security interest back to an earlier date and even though it might be an effective security interest as of the earlier date under the Uniform Commercial Code."

interests will prevail under local law over a judgment lien creditor determines whether they will prevail over the tax lien. Thus it is in both the direct context of 6323(a) and the indirect applications of 6323(a), (c) and (d) that the rights of the judgment lien creditor under Pennsylvania law must be viewed.

One enjoying the status of a "judgment lien creditor" may prevail over the federal tax lien if he acquires this standing prior to the filing of the tax lien.<sup>25</sup> The Pennsylvania law of judgment liens is settled. A lien against realty arising from an adverse judgment is given priority from the time the judgment is rendered; if the lien arises from an amicable judgment, the priority extends from the time the instrument on which the judgment is entered is left for entry.<sup>26</sup> The docketing and indexing of a judgment are sufficient to render the judgment operative as a lien, and to give notice thereof.<sup>27</sup>

The effective date of a judgment lien arising out of a security interest in personal property or fixtures is governed by section 9-501(b) of the Uniform Commercial Code:

When a secured party has reduced his claim to a judgment the lien of any levy which may be made upon his collateral by virtue of any execution based upon the judgment shall relate back to the date of the perfection of the security interest in such collateral.<sup>28</sup>

The relation back of the judgment lien provides a symmetrical correlation with the "security interest" provision of section 6323(a). Whether the federal tax lien is filed after the security interest is perfected or after the perfected security interest is reduced to judgment, the secured party or lien creditor will have priority from the date of perfection. This result is in agreement with the system of priorities established under section 9-312(5) of the Uniform Commercial Code, which grants priority to the interest which is perfected first.<sup>29</sup>

---

25. Federal Tax Lien Act of 1966, § 6323(a).

26. PA. STAT. ANN. tit. 68, § 602 (1965); PA. STAT. ANN. tit. 12, § 877 (1953).

27. *Coral Gables v. Karl*, 334 Pa. 441, 447, 6 A.2d 275, 278 (1939); see *Philadelphia Nat. Bank v. Taylor*, 205 Pa. Super. 535, 211 A.2d 1, *aff'd*, 421 Pa. 35, 218 A.2d 246 (1965); *Farmers Nat. Bank v. Kern*, 194 Pa. Super. 479, 168 A.2d 620 (1961); *Russek v. Shapiro*, 170 Pa. Super. 89, 84 A.2d 514 (1951); *Jaczyszyn v. Paslawski*, 147 Pa. Super. 97, 24 A.2d 116 (1942).

28. PA. STAT. ANN. tit. 12A, § 9-501(5) (Supp. 1966). The official comments state:

The first sentence of subsection (5) makes clear that any judgment lien which the secured party may acquire against the collateral is, so to say, a continuation of his original interest (if perfected) and not the acquisition of a new interest or a transfer of property to satisfy an antecedent debt. The judgment lien is therefore stated to relate back to the date of perfection of the security interest.

UNIFORM COMMERCIAL CODE § 9-501, Comment 6.

29. PA. STAT. ANN. tit. 12A, § 9-312(5) (1954).

Also relevant under section 6323(a) are the rights of a holder of a purchase money security interest. The Lien Act makes no specific reference to purchase money security, but the committee reports intimate that local law will govern.<sup>30</sup> Section 9-301(2) of the Uniform Commercial Code provides a ten day relation back period which could defeat the federal tax lien. The secured party of a purchase money security interest may file within ten days after the collateral comes into the possession of the debtor and have his filing relate back to the date his security interest attached.<sup>31</sup> The tax lien filed in the interim would be defeated under 6323(a).

The federal tax lien could also be defeated under 6323(a) by a security interest in after-acquired property.<sup>32</sup> The conflict arises when a security interest in after-acquired property is perfected by filing, subsequently a tax lien is filed against the debtor, and at a later time the property in question is shipped to the debtor. Both the tax lien and the security interest in after-acquired property attach to the property. The security interest perfection relates back to the initial filing,<sup>33</sup> however, and thus prevails over the tax lien.

The forty-five day period of limitations of sections 6323(c)(2)(b) and 6323(d) relating to commercial transactions financing and general disbursements financing has its greatest impact in its limitation upon a security interest in after-acquired property.<sup>34</sup> Prior to the Lien Act, security interests in after-acquired collateral were considered inchoate and inferior to the tax lien. Under the Uniform Commercial Code, however, an after-acquired security interest is on equal footing with other security interests. An initial filing will perfect the interest in collateral immediately acquired as well as collateral subsequently acquired, with the date of perfection remaining the date of the initial filing.<sup>35</sup> Sections 6323(c)(2)(b) and 6323(d) represent a compromise between total inchoateness and unlimited perfection. If the security interest in after-acquired

30. H.R. REP. No. 1884, 89th Cong., 2d Sess. 4 (1966); S. REP. No. 1708, 89th Cong., 2d Sess. 4 (1966).

31. PA. STAT. ANN. tit. 12A, § 9-301(2) (1954); see *GMAC v. Wall*, 239 F. Supp. 433 (W.D.N.C. 1965).

32. PA. STAT. ANN. tit. 12A, § 9-204(3) (1954).

33. PA. STAT. ANN. tit. 12A, §§ 9-204(3), 9-312(5) (1954). See *United States v. Strollo*, 67-1 U.S. Tax Cas. 83162 (Fla. Dist. Ct. App. 1966) (note opinion of the chancellor).

34. See Federal Tax Lien Act of 1966, §§ 6323(c)(2)(B), 6323(d); PA. STAT. ANN. tit. 12A, § 9-204(3) (1954).

35. PA. STAT. ANN. tit. 12A, § 9-204(3) (1954). The official comments state:

Subsections (1) and (3) read together make clear that a security interest arising by virtue of an after-acquired property clause has equal status with a security interest in collateral in which the debtor has rights at the time value is given under the security agreement.

UNIFORM COMMERCIAL CODE § 9-204, Comment 2.

collateral is perfected (hence valid against a judgment lien arising at the time of the subsequent filing of a tax lien), then the security interest will be protected against any tax lien which was filed within forty-five days prior to the disbursements under the security agreement.<sup>36</sup> Thus, if a valid security interest in after-acquired property is perfected on day one, and on day eleven a tax lien is filed, any property acquired between day eleven and day fifty-six and covered by the security agreement will be subject to the security interest in after-acquired property. Property acquired after day fifty-six, however, will be subject to the tax lien.

The effect of the limitation period is to place the burden on the secured party to search the records every forty-five days to make certain that no tax liens have been filed. If he finds a filed tax lien, any new advancements of money or property will not be protected.<sup>37</sup> He will retain his priority under the Uniform Commercial Code, but notice of the tax lien will preclude him from achieving priority for any new advances.

#### RIGHTS OF MECHANIC'S LIENORS

The area of mechanic's liens presents special problems under the Lien Act because of the four different sections of the Act which may be relevant in determining the priority rights of one who holds a mechanic's lien under Pennsylvania law. In short: section 6323(a) provides that a mechanic's lien existing prior to the filing of the tax lien will take priority over the tax lien;<sup>38</sup> section 6323(h) (5) gives a super priority to one having a possessory lien in personal property;<sup>39</sup> section 6323(h) (7) gives a super priority to one holding a mechanic's lien for the repair and improvement of residential property;<sup>40</sup> and an attorney's lien is given super priority under section 6323(b) (8).<sup>41</sup>

In each section the requirement of the Lien Act is that the mechanic's lien "exist" under local law.<sup>42</sup> For the lien to "exist" within the contemplation of the Lien Act, however, it must be valid under local law against "subsequent purchasers without notice."<sup>43</sup> Thus, just as the purchaser without notice was used as a test to determine if one qualified as a "purchaser" under section 6323(a), so does the purchaser without notice assume considerable importance as a test of the existence of a mechanic's lien under sections 6323(a), (b) (5), (b) (7) and (b) (8).

---

36. See Federal Tax Lien Act of 1966, §§ 6323(c) (2) (B), 6323(d); PA. STAT. ANN. tit. 12A, § 9-204(3) (1954).

37. Federal Tax Lien Act of 1966, § 6323(d).

38. Federal Tax Lien Act of 1966, § 6323(a).

39. Federal Tax Lien Act of 1966, § 6323(b) (5).

40. Federal Tax Lien Act of 1966, § 6323(b) (7).

41. Federal Tax Lien Act of 1966, § 6323(b) (8).

42. Federal Tax Lien Act of 1966, § 6323(h) (2).

43. Federal Tax Lien Act of 1966, § 6323(h) (2).

The questions which must be answered in order to apply the mechanic's lien sections of the Lien Act are: (1) Who has a mechanic's lien under Pennsylvania law? and (2) When is the lien valid against subsequent purchasers without notice?

Pennsylvania's law of mechanic's liens is comprehensively compiled in the Mechanics' Lien Law of 1963.<sup>44</sup> Section 1301 of the Act provides for a mechanic's lien to arise against an owner of property in favor of a contractor or subcontractor who has expended labor or materials in the alteration, repair, erection, or construction of an improvement on that property.<sup>45</sup> To determine when and in whom a mechanic's lien exists, section 1201 of the Mechanics' Lien Law must be consulted for definitions of the terms used in section 1301. The "improvement" to which the lien attaches is defined as any building, structure, or fixture constructed on land.<sup>46</sup> At least one case has extended the lien to property adjoining the improvement when it was shown that the adjoining land was intended to be used and was actually used to benefit the improvement.<sup>47</sup>

The mechanic's lien on the improvement will arise only in favor of a contractor or subcontractor.<sup>48</sup> Section 1201(4) defines a "contractor" as one who erects, constructs, alters or repairs an improvement; or furnishes labor, skill or superintendence thereto; or supplies or hauls materials, fixtures, machinery, or equipment.<sup>49</sup> A contractor may be a builder, materialman, or superintendent,<sup>50</sup> as well as an architect or engineer who superintends the construction work and prepares plans, drawings and designs incidental to

44. PA. STAT. ANN. tit. 49, §§ 1101-1902 (1965).

45. PA. STAT. ANN. tit. 49, § 1301 (1965):

Every improvement and the estate or title of the owner in the property shall be subject to a lien, to be perfected as herein provided, for the payment of all debts due by the owner to the contractor or by the contractor to any of his subcontractors for labor or materials furnished in the erection or construction, or the alteration or repair of the improvement, provided that the amount of the claim, other than amounts determined by apportionment under section 306(h) of this act, shall exceed five hundred dollars (\$500).

See PA. STAT. ANN. tit. 49, § 1303(a) (1965) (specifically denying a lien to anyone other than a contractor or subcontractor).

46. PA. STAT. ANN. tit. 49, § 1201(1) (1965). See *Wheeler v. Pierce*, 167 Pa. 416, 31 A. 649 (1895); *Short v. Ames*, 121 Pa. 530, 15 A. 607 (1888); *Meehan v. Morris Movocho, Inc.*, 28 Pa. D. & C.2d 143 (C.P. Montg. Co. 1963); *W.H. Kneas Lumber Co. v. Ciccarone*, 20 Pa. D. & C.2d 407 (C.P. Montg. Co. 1961); *C.S. Garber & Sons v. Draper*, 89 Pa. D. & C. 235 (C.P. Lehigh Co. 1955).

47. *Kenepp v. Orner*, 22 Pa. D. & C. 391 (C.P. Luz. Co. 1934). See *Sicardi v. Keystone Oil Co.*, 149 Pa. 139, 24 A. 161 (1892); *Seibert v. Hosiery Co.*, 14 Berks 173, 16 Del. 165 (C.P. Pa. 1922); cf. PA. STAT. ANN. tit. 49, § 1304 (1965); PA. R. CIV. P. 23126 (allowing interested parties to object to the mechanic's lien being extended to "excessive curtilage").

48. PA. STAT. ANN. tit. 49, § 1303(a) (1965).

49. PA. STAT. ANN. tit. 49, § 1201(4) (1965).

50. PA. STAT. ANN. tit. 49, § 1201(4) (1965).

such supervision.<sup>51</sup> A "subcontractor" is one who performs his work or delivers his materials by contracting with the prime contractor.<sup>52</sup> Neither one who performs his work by contract with another subcontractor nor an architect or engineer may be considered a subcontractor.<sup>53</sup> To prevail over the federal tax lien under 6323(a), the private party must be a "contractor" or "subcontractor" within the definitions given in the Pennsylvania Mechanics' Lien Law; this is the only way the mechanic's lien will "exist" for purposes of the Lien Act.

The "owner," against whom the lien must be filed, may be the owner in fee, or a tenant for life or for years, or anyone having some other estate in or title to the property.<sup>54</sup> As between a vendor and a vendee, the vendee is considered the owner for purposes of the Mechanics' Lien Law.<sup>55</sup>

Section 1301 establishes a \$500 minimum on the amount of the claim for a mechanic's lien.<sup>56</sup> This minimum, which applies to both repairs and new construction,<sup>57</sup> has special significance when compared with section 6323(b)(7) of the Lien Act. That section provides for a super priority to be given to mechanic's liens arising from repairs or improvements to residential property.<sup>58</sup> Section 6323(b)(7), however, places a \$1000 maximum on the "contract price on the contract with the owner."<sup>59</sup> Reading the two provisions together, under Pennsylvania law one could not have a mechanic's lien for repairs or improvements on residential property if his claim were under \$500. Hence he could not qualify as a mechanic's lienor under the Lien Act definition,<sup>60</sup> and he would not be entitled to the super priority available under section 6323(b)(7). On the other hand, there is no maximum imposed by section 1301 of the Mechanics' Lien Law; thus one could have a claim for \$1500, valid under Pennsylvania law, but since the contract price was

51. *Alan Parter Lee, Inc. v. Du-Rite Products Co.*, 366 Pa. 548, 79 A.2d 218 (1951); *Bennett v. Frederick R. Gerry Co.*, 273 Pa. 585, 117 A. 345 (1922); *Shollenberger v. Rickman*, 78 Pa. D. & C. 459 (C.P. Lycoming Co. 1952); cf. *Cotter v. McArdle*, 423 Pa. 632, 223 A.2d 718 (1966).

52. PA. STAT. ANN. tit. 49, § 1201(5) (1965).

53. PA. STAT. ANN. tit. 49, § 1201(5) (1965). See *Hamilton v. Means*, 155 Pa. Super. 245, 38 A.2d 528 (1944); *Favo v. Merlot*, 94 Pa. Super 90 (1928).

54. PA. STAT. ANN. tit. 49, § 1201(3) (1965).

55. *McClure v. Fairfield*, 153 Pa. 411, 26 A. 446 (1893); *Ditton v. Fallo*, 4 Del. 458 (C.P. Pa. 1891); cf. *In re Wilkinson's Assigned Estate*, 16 York 129 (C.P. Pa. 1903); *Stauffer v. Bowers*, 11 Lanc. Bar 3, 8 Luz. 209 (C.P. Pa. 1879).

56. PA. STAT. ANN. tit. 49, § 1301 (1965). See *Shaffer v. Green*, 9 W.N.C. 144 (C.P. Pa. 1880); *Seffy v. Frost*, 12 Phila. 445, 3 W.N.C. 409 (C.P. Pa. 1877).

57. PA. STAT. ANN. tit. 49, § 1301 (1965) (comment, *Jt. State Gov't Com. Rep't*).

58. Federal Tax Lien Act of 1966, § 6323(b)(7).

59. Federal Tax Lien Act of 1966, § 6323(b)(7).

60. Federal Tax Lien Act of 1966, § 6323(h)(2).

more than \$1000, the super priority accorded by section 6323(b) (7) would not be available.<sup>61</sup> In the latter example, the mechanic's lienor might prevail under the ordinary priority rules of section 6323 (a) if his lien existed before the tax lien was filed.

The contractor or subcontractor should be informed of section 6323 (b) (7). By keeping his contract price between \$500 and \$1000 for repairs or improvements of residential property, his mechanic's lien will be given a super priority—he will prevail over the tax lien even if the tax lien is filed first.

In addition to the requirement that the mechanic's lien exist under local law, section 6323(h) (2) provides that for Lien Act purposes, one "has a lien on the earliest date such lien becomes valid under local law against subsequent purchasers without notice, but not before he begins to furnish the services, labor, or materials."<sup>62</sup> The Pennsylvania Mechanics' Lien Law provides for the mechanic's lien on new construction to take effect and have priority from the date there is a visible commencement of work upon the ground.<sup>63</sup> For repairs, the mechanic's lien commences from the date the lienor files his claim.<sup>64</sup> In either instance, no mechanic's lien will commence in Pennsylvania before services are performed or materials furnished. Since the earliest effective date established by the Lien Act is not offended by Pennsylvania law, the issue of when a mechanic's lien will arise for purposes of the Lien Act becomes solely a question of when the mechanic's lien is valid under Pennsylvania law against subsequent purchasers without notice. It is on this date that the mechanic's lienor will acquire his lien for purposes of section 6323(a), and it is prior to this date that the federal tax lien must be filed if the government is to prevail over the mechanic's lienor.<sup>65</sup>

The general rule in most jurisdictions is that a mechanic's lien will take priority over all conveyances to purchasers for value and without notice subsequent to the time when the lien arises.<sup>66</sup> Applying this rule to the Lien Act test, it would appear that once the

---

61. Federal Tax Lien Act of 1966, § 6323(b) (7). From the committee reports it appears that when the contract price is over \$1000, the first \$1000 would not be given super priority.

62. Federal Tax Lien Act of 1966, § 6323(h) (2).

63. PA. STAT. ANN. tit. 49, § 1508 (1965).

64. PA. STAT. ANN. tit. 49, § 1508 (1965). See *Zussman v. Yeagle*, 58 Montg. 262 (C.P. Pa. 1942) to distinguish between new construction and repairs: "Where a structure of a building is so completely changed that in common parlance it may be called a new building, or a rebuilding, it is a construction, as distinguished from an alteration or repair. . . ." *Id.* at 265.

65. Federal Tax Lien Act of 1966, § 6323(a).

66. 36 AM. JUR. *Mechanic's Liens* § 190 (1943), citing *H.C. Behrens Lumber Co. v. Loger*, 26 S.D. 160, 167, 128 N.W. 698, 702 (1910): "Obviously, a conveyance which is made after the lien is recorded or proceedings instituted for its enforcement is subordinate."; *Hill v. Alliance Building Co.*, 6 S.D. 160, 163, 60 N.W. 752, 754 (1894): "If the property is purchased subject to a mechanic's lien, obviously the lien has priority." See *Conlee*

mechanic's lien comes into existence in Pennsylvania, its mere life would cause it to prevail over subsequent purchasers. Because of the wording of the Pennsylvania Mechanics' Lien Act, however, this conclusion must be tempered. Although the mechanic's lien, arising upon the commencement of work<sup>67</sup> or the filing of the claim,<sup>68</sup> is valid from its inception, it is subject to being stricken if certain filing requirements are not met.<sup>69</sup> The more cautious view, then, is that when the lien is viable, its priority would protect it against subsequent purchasers without notice. If the mechanic's lienor subsequently fails to meet one of the statutory perfection requirements, however, his lien will be stricken and the subsequent purchaser will prevail.<sup>70</sup>

---

v. Clark, 14 Ind. App. 205, 42 N.E. 762 (1896); Glass v. Freeburg, 50 Minn. 386, 52 N.W. 900 (1892); Rural Plumbing & Heating, Inc. v. Hope Dale Realty, Inc., 263 N.C. 641, 140 S.E.2d 330 (1965); Pipe & Foundry Co. v. Howland, 111 N.C. 615, 16 S.E. 857 (1892); Burr v. Maulsby, 99 N.C. 263, 6 S.E. 108 (1888); Citizens Bank v. Lesko, 277 Pa. 174, 120 A. 808 (1923).

67. PA. STAT. ANN. tit. 49, § 1508 (1965).

68. PA. STAT. ANN. tit. 49, § 1508 (1965).

69. PA. STAT. ANN. tit. 49, § 1502(2) (1965); see Day & Zimmerman, Inc. v. Blocked Ice Corp. of America, 394 Pa. 386, 14 A.2d 332 (1959); McVey v. Kaufman, 223 Pa. 125, 72 A. 503 (1909); Kneely v. Harworth, 208 Pa. 487, 57 A. 957 (1904); Wharton v. Rest Estate Inv. Co., 180 Pa. 168, 36 A. 725 (1897); Giansante v. Pascuzzo, 205 Pa. Super. 28, 206 A.2d 340 (1965); Associated Lumber & Mfg. Co. v. Mastroianni, 173 Pa. Super. 319, 98 A.2d 52 (1953); Samango v. Hobbs, 167 Pa. Super. 399, 75 A.2d 17 (1950); Thompson v. Radall, 42 Pa. Super. 105 (1910); Winegar v. Bente, 39 Pa. D. & C.2d 558 (C.P. West. Co. 1966); Green Hills Lumber Co. v. Williams, 32 Pa. D. & C.2d 759 (C.P. Alleg. Co.), *aff'd*, 203 Pa. Super. 3, 198 A.2d 635 (1964); Shoemaker v. Zerby, 10 Pa. D. & C.2d 227 (C.P. West. Co. 1958); South Hills Co. v. Kelly, 85 Pa. D. & C. 495 (C.P. Alleg. Co. 1954); Pancoast v. Lovan, 8 Chest. 172 (C.P. Pa. 1958); Pressel & Son v. Plotts, 55 York 61 (C.P. Pa. 1941); Morgan v. Bonitoti, 8 West. 62 (C.P. Pa. 1918).

70. See Rural Plumbing & Heating, Inc. v. Hope Dale Realty, Inc., 263 N.C. 641, 140 S.E.2d 330 (1965):

In North Carolina and in other jurisdictions, a laborers' and materialmen's lien on property takes priority over all property conveyances to purchasers for value and without notice subsequent to the time when labor and materials are furnished, provided notice of lien is filed for record within the statutory time and action to enforce the lien is instituted within the statutory time.

*Id.* at 655, 140 S.E.2d 339. The court recognized that when the mechanic's lien was properly filed and action brought within the statutory period, "the lien relates back to the time when the lien claimant began the performance of the work and furnishing of materials and takes precedence by reason of such relationship back over an intervening deed of trust. . . ." *Id.* Although there are no cases under the Pennsylvania Mechanics' Lien Law of 1963 on this point, the relation back theory has been recognized; see Bender v. Mancino, 5 Pa. D. & C.2d 532 (C.P. Lawrence Co. 1954); as well as the priority of the mechanic's lien over a subsequent purchaser; see Citizens Bank v. Lesko, 277 Pa. 174, 120 A. 808 (1923). It is not essential for Pennsylvania courts to adopt the "relation back" theory. A "vested subject to being stricken" approach, which is intimated by the wording of section 1502, would produce the same result of granting priority to the mechanic's lien from the date of its statutory validity (section 1508).

A subcontractor making alterations or repairs must give preliminary notice of his intent to claim a lien.<sup>71</sup> This notice must be given to the owner on or before the date of completion of work.<sup>72</sup> The subcontractor must also give the owner formal written notice of his intention to file a claim at least thirty days before he files his claim with the prothonotary.<sup>73</sup> Section 1501 of the Mechanics' Lien Law clarifies and continues the practice "which required two separate notices by a subcontractor in claims for alterations and repairs and only one notice in claims for new construction."<sup>74</sup>

A final claim must be filed by the subcontractor with the prothonotary within four months after completion of his work.<sup>75</sup> This requirement is the same whether there has been new construction or merely repairs.<sup>76</sup> The prime contractor must also file his claim with the prothonotary within four months after he completes his work.<sup>77</sup> Both must then notify the owner that the claim has been filed within one month after filing with the prothonotary, and then file an affidavit of service of notice within twenty days after notifying the owner.<sup>78</sup>

It appears from the wording of section 1508 of the Mechanics' Lien Law that a mechanic's lien arising from a claim subsequently filed is effective and has priority from the date of the ground-breaking in the case of new construction and from the date of filing the claim in the case of alterations and repairs.<sup>79</sup> Possibly the claim for alterations and repairs will not be filed for a period up to four months after the completion of the work.<sup>80</sup> During the period of work and thereafter until the claim is formally filed with the prothonotary there is no mechanic's lien in existence. A subsequent purchaser without notice could purchase the property being repaired and would take free of any later filed lien.<sup>81</sup> Under these facts, if the tax lien were filed prior to the filing of the me-

71. PA. STAT. ANN. tit. 49, § 1501 (1965); see *Tilo Roofing Co. v. Abeloff*, 75 Pa. D. & C. 535 (C.P. Montg. Co. 1951).

72. PA. STAT. ANN. tit. 49, § 1501 (1965); see PA. STAT. ANN. tit. 49, § 1201(8) (1965); *Boettiger v. Weber*, 57 Pa. Super. 464 (1914); *Schaefer v. Preston*, 18 North. 23 (C.P. Pa. 1921).

73. PA. STAT. ANN. tit. 49, § 1501(b) (1965). *But see* PA. STAT. ANN. tit. 49, § 1506 (1965) (procedure whereby owner may compel the subcontractor to either file his claim within thirty days or be barred). If the owner should use this procedure, no formal notice is required.

74. PA. STAT. ANN. tit. 49, § 1501 (1965) (comment, Jt. State Gov't Com. Rep't). See also PA. STAT. ANN. tit. 49, §§ 23, 101 (1965).

75. PA. STAT. ANN. tit. 49, § 1502(1) (1965).

76. PA. STAT. ANN. tit. 49, § 1501 (1965) (comment, Jt. State Gov't Com. Rep't).

77. PA. STAT. ANN. tit. 49, § 1502(1) (1965).

78. PA. STAT. ANN. tit. 49, § 1502(2) (1965).

79. PA. STAT. ANN. tit. 49, § 1508 (1965).

80. PA. STAT. ANN. tit. 49, § 1502(1) (1965).

81. See PA. STAT. ANN. tit. 49, § 1303(c) (1965): "If the property be conveyed in good faith and for a valuable consideration prior to the filing of a claim for alteration and repairs, the lien shall be wholly lost."

chanic's claim, the tax lien would prevail—both because it is filed first<sup>82</sup> and because the mechanic's lien does not yet exist.<sup>83</sup>

The situation is quite different where new construction is being performed. The lien arises upon the commencement of work,<sup>84</sup> but is subject to being stricken<sup>85</sup> or rendered invalid<sup>86</sup> by a subsequent failure to meet one of the statutory filing requirements. In this instance, however, the lien exists; the filing requirements are necessary to perfect it.<sup>87</sup> A subsequent purchaser without notice would take subject to the mechanic's lien, hence the lien "exists" for purposes of the Lien Act, and the mechanic's lienor will prevail over the government if the government does not file its tax lien prior to the creation of the mechanic's lien.

#### OTHER SUPER PRIORITIES DEPENDENT UPON LOCAL LAW

The Lien Act also gives super priority to an attorney's lien valid under local law.<sup>88</sup> Although Pennsylvania courts have held unconstitutional a 1915 statute granting attorneys of record a lien on any verdict, judgment, or settlement in favor of this client,<sup>89</sup> the weight of judicial authority is to grant both retaining and charging liens in the proper circumstances. A charging lien will be granted upon equitable principles when there is an agreement with the client that the attorney is to be paid from the fund collected, and when the services of the attorney were a substantial factor in creating the fund.<sup>90</sup> When granted, the charging lien will be limited to fees for services rendered in the particular case from which the judgment was secured.<sup>91</sup> "An attorney's ordinary common

82. Federal Tax Lien Act of 1966, § 6323(a).

83. Federal Tax Lien Act of 1966, § 6323(h)(2).

84. PA. STAT. ANN. tit. 49, § 1508 (1965).

85. PA. STAT. ANN. tit. 49, § 1502(2) (1965).

86. PA. STAT. ANN. tit. 49, § 1501(h) (1965).

87. *In re Hempfield Homes, Inc.*, 174 F. Supp. 395 (E.D. Pa. 1959); see *McClosky v. Dowingtown Woolen Mills, Inc.*, 20 F.2d 190 (E.D. Pa. 1927); *Wagner v. Burnham*, 224 Pa. 586, 73 A. 990 (1909); *Hastings v. Thompson*, 47 Pa. Super. 424 (1911).

88. Federal Tax Lien Act of 1966, § 6323(b)(8). This section will not apply, however, where the attorney's lien arises from a judgment against the United States "to the extent that the United States offsets such judgment or amount against any liability of the taxpayer to the United States."

89. *Leplocca v. Philadelphia Rapid Transit Co.*, 265 Pa. 304, 108 A. 612 (1919) (holding unconstitutional Act of May 6, 1915, P.L. 261). See also *Ruzyg v. Brown*, 327 Pa. 61, 192 A. 876 (1937); *Force v. Scranton*, 86 P.L.J. 484, 39 Lack. Jur. 137 (C.P. Pa. 1937) (both expressing doubt as to the existence of any attorney's lien in Pennsylvania).

90. *Smyth v. Fidelity & Deposit Co.*, 326 Pa. 391, 192 A. 640 (1937); *Appeal of Harris*, 323 Pa. 124, 186 A. 92 (1936); *Turtle Creek Bank & Trust Co. v. Murdock*, 150 Pa. Super. 277, 28 A.2d 320 (1942); *Petition of Herbert*, 18 Pa. D. & C.2d 476 (C.P. Luz. Co. 1959); *Willow Brook Packing Co. v. Commonwealth*, 11 Chest. 234 (C.P. Pa. 1963); *Commonwealth v. Central Trust Co.*, 67 P.L.J. 153, 32 York 205 (C.P. Pa. 1919).

91. *Packard v. Pittsburgh Ry.*, 87 P.L.J. 219 (C.P. Pa. 1939). See also

law or retaining lien for compensation for services rendered depends on his possession of property subject thereto, and binds only money, papers, or other property in his hands."<sup>92</sup> The retaining lien, however, has been extended "not only to costs and fees in the particular cause in which the property came into his hands but also to costs and fees due the attorney from the client in other professional business."<sup>93</sup>

For purposes of the Lien Act, the attorney's super priority will be extended "to the extent of his reasonable compensation for obtaining such judgment or procuring such settlement."<sup>94</sup> Whether this will cover a retaining lien encompassing amounts owed for other services is questionable. Although section 6323 (h) (8) appears to be extending super priority to any attorney's lien granted by local law, the insertion of the "reasonable compensation" clause seems to limit the amount of the lien to what is considered reasonable compensation under the Lien Act.

The final priority section of the Lien Act which is dependent upon local law for its application is 6323(b) (6), "Real Property Tax and Special Assessment Liens."<sup>95</sup> The lien of the local taxing authority will be granted a super priority over the federal tax lien if local law gives the real property taxes priority over prior in time security interests.<sup>96</sup> In Pennsylvania real property taxes constitute a first lien on the property and have priority over all other claimants.<sup>97</sup> "Taxes assessed on real property are made a first lien thereon and are required to 'be fully paid and satisfied out of the proceeds of any judicial sale of said property, before any other obligation, judgment, claim, lien or estate . . . save only the costs of the sale of the writ upon which it is made.'<sup>98</sup> In answering the Lien Act test of whether Pennsylvania law gives the real property taxes priority over security interests, it appears that the first lien granted by the statute is sufficient to grant this priority.<sup>99</sup> Thus a lien for

---

Greek Catholic Union of Russian Bhds. v. Russin, 340 Pa. 295, 17 A.2d 402 (1941).

92. Appeal of Harris, 323 Pa. 124, 128, 186 A. 92, 95 (1936).

93. Greek Catholic Union of Russian Bhds. v. Russin, 340 Pa. 295, 296, 17 A.2d 402, 403 (1941).

94. Federal Tax Lien Act of 1966, § 6323 (b) (8).

95. Federal Tax Lien Act of 1966, § 6323 (b) (6).

96. Federal Tax Lien Act of 1966, § 6323 (b) (6).

97. PA. STAT. ANN. tit. 72, § 5860.301 (1950).

98. Petition of Swartzlander, 39 Pa. D. & C.2d 425, 426 (C.P. Northumb. Co. 1965), citing PA. STAT. ANN. tit. 53, § 7103 (1957). See also Girard Trust Co. v. French, 4 Pa. D. & C.2d 427 (C.P. Phila. Co. 1956).

99. "Security interest" under the Lien Act encompasses both the security interest under the Uniform Commercial Code and mortgages on real property. The 6323(b) (6) test contemplates priority over prior in time mortgages ("security interests in such property. . ." referring back to real property). See Odabashian v. Baker, 14 Pa. D. & C.2d 489, 496 (C.P. Del. Co. 1958): "local taxes have priority over a preexisting real estate mortgage. . . ." See also Linker v. Bell, 37 Pa. D. & C.2d 210 (C.P.

real property taxes imposed by any Pennsylvania taxing authority will have priority over the federal tax lien, regardless of when the federal lien was filed.<sup>100</sup>

#### CONCLUSION

Because the Lien Act tests require the application of state law developed without regard to federal taxation, the correlation of local law must in some areas be tenuous. The final decisions, of course, must be left to the courts. In these uncertain areas, their conclusions should be guided by the purpose of the Lien Act: to enhance the competitive position of the private claimant against the federal tax lien.

GERALD K. MORRISON

---

Phila. Co. 1965); *First Nat. Bank v. R.&H. Construction Co.*, 34 Pa. D. & C. 2d 100 (C.P. York Co. 1963).

100. Plumb, *The New Federal Tax Lien Law*, 53 A.B.A.J. 66, 68 (1967): "The law has now eliminated a troublesome 'circular priority' problem by granting priority over a federal tax lien to subsequent liens for real property taxes, special assessments and certain public service charges, if such liens are superior under local law to earlier mortgages."