When Worlds Collide: Resolving Priority Disputes Between the IRS and the Article Nine Secured Creditor

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WHEN WORLDS COLLIDE: RESOLVING PRIORITY DISPUTES BETWEEN THE IRS AND THE ARTICLE NINE SECURED CREDITOR

TIMOTHY R. ZINNECKER*

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I. INTRODUCTION

In my young career as a law professor, I have taught both secured transactions¹ and payment systems.² Each course deals primarily with

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¹ Or, as one student so fondly referred to it on one of my faculty evaluation forms, "sadistic transactions." My favorite comment on a faculty evaluation form was, "Professor Zinnecker does not follow Gilbert's very well."

² When I attended law school at Brigham Young University, the payment systems course was taught under the moniker of "commercial paper." As one professor has noted, "No one knows why this term arose. It could be an attempt to avoid confusion because zoning lawyers helped draft Article 3 and they were looking to distinguish commercial paper from residential and industrial paper." Marianne M. Jennings, I Want to Know What Bearer
relevant articles of the Uniform Commercial Code (U.C.C.)\(^3\) and therefore is statutory in nature. For that reason, and armed with horror stories from their predecessors, most students reluctantly enroll in U.C.C. courses, especially secured transactions, and then only after convincing themselves that enduring forty-plus hours of instruction is necessary to pass the twenty-to thirty-minute essay question that might appear on the bar exam.\(^4\)

I confess that wandering through the interstices of often incoherent statutes\(^5\) does not invoke the passion and fervor traditionally associated with courses such as constitutional law and feminist jurisprudence.\(^6\) Nor does a "Code"\(^7\) class reward the student with those life-long practical skills necessary for a successful legal career, unlike current popular course

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Citing to an article published by the BYU Law Review not only brings recognition to my alma mater but also eases the remorse and guilt that haunt me daily for failing to contribute millions of dollars toward new library wings or endowed chairs.

3. On one of my early exams I asked students to complete the statement, "U.C.C. is an abbreviation for ______." Some of the more popular answers included "Uniform Commercial Crap," "Uniform Confusion Code," and "Unintelligible Commercial Code."

4. During my first-day remarks, I strongly encourage students to drop the class if their sole reason for enrolling is concern that the subject matter frequently appears on the bar exam. Most students will learn (or at least be exposed to) enough law in their bar review course to pass the substantive areas tested. Nevertheless, few students heed my advice. Most prefer to believe that my statements are motivated not by student interest but from a selfish desire to reduce the number of exams that I have to grade over the Christmas and Memorial Day holidays.

5. One author explains:

   Statutes are not designed to be entertaining, or emotionally powerful, or beautiful, or profound. Some writers, primarily adherents of the plain language school, have claimed that statutes' primary virtue is the same as that of a good deal of expository prose: clarity. But common sense demands rejection of that position. Because statutes are written to effect policy decisions, their main virtue is accuracy in the sense of precisely effecting the desired policy. If a statute is difficult to comprehend but accomplishes its purpose it is a success. If its meaning can be discerned instantaneously but its effect is the opposite of the one intended, it is a failure.


6. Because many members of my tenure review committee are female, discretion and self-preservation prompt me not to interject any humor at this point in the Article. However, a transcript of my thoughts on the subject is available by sending $10.00 (no personal checks, please) to Professor Tim Zinnecker, South Texas College of Law, 1303 San Jacinto, Houston, TX 77002. I will leave my forwarding address with the postmaster.

7. When using "Code" as a shorthand reference to the U.C.C., it is proper to capitalize the term as the U.C.C. is the product of educators, lawyers, and other highly trained professionals. Whereas, the lower-case form should be used when making shorthand references to other codes, especially those enacted by publicly elected officials (e.g., members of Congress and other rank amateurs), such as the Bankruptcy Code and the Internal Revenue Code.
offerings such as “Overcoming Bad Facts at Trial Through Pretense and Ostentation,” “How To Operate a Fax Machine,” and “Converting a Five-Minute Telephone Conversation into Thirty Minutes of Billable Time.”

Nevertheless, for the record, I truly enjoy teaching U.C.C. courses, especially secured transactions. For me, the most enjoyable part of the course is covering the materials that resolve priority disputes between the secured party and other creditors, purchasers of the collateral, and the bankruptcy trustee. Perhaps the most challenging priority dispute arises when the contestants are the secured party, claiming an Article 9 security interest in the debtor’s collateral that secures repayment of an obligation, and the Internal Revenue Service (IRS), claiming a statutory lien on the same collateral after the debtor becomes delinquent in paying its taxes. The reason that most students, and, I dare say, practitioners and even a few law professors, find such a priority dispute so intimidating is that in order to resolve the dispute one must be knowledgeable in not one, but two bodies of statutory law. And if the idea of wandering through Article 9 fails to induce mind-numbing trauma in students, the thought of taking a side trip through the Internal Revenue Code may convince students that enduring long, slow, root canal work is not the worst tribulation that life has to offer.

Take courage. Do not abandon all hope. As this Article hopefully illustrates, the challenge is not as daunting as it may first appear.

8. I make this public admission for two reasons. First, I find it therapeutic. And second, I hope that it serves as my ticket into the lurid (yet oh-so-riveting) world of talk show entertainment. Think of the ratings success that Geraldo might enjoy with a show entitled, “Law Professors Who Enjoy Teaching UCC Courses.” Not to be outdone, Oprah could devote an hour to “Federal Judges Who Write Their Own Opinions.” And Sally Jessy might consider “Lawyers Who Draft and Negotiate Guaranties (and the Clients Who Love Them).” Believe it or not, that was the title of an article I recently wrote. See Timothy R. Zinnecker, Lawyers Who Draft and Negotiate Guaranties (and the Clients Who Love Them), 35 S. Tex. L. Rev. 387 (1994). Hey, if you can’t cite yourself, who can you cite?

9. Also known as “The Prince of Darkness.”

10. It’s been at least two full sentences since my last footnote, so I thought I’d drop one here. Some folks in academic circles will judge the quality of this piece solely on the number of footnotes. I therefore feel obligated to “pad” that number with this and similar footnotes throughout this Article. Oh, sure, I could do so with a bunch of supras, infras, and ids., but that’s been done before (and quite successfully, I might add).

11. Students, and others who confront the task of resolving priority disputes between an Article 9 secured creditor and the IRS, may take solace in the fact that even members of the judiciary occasionally quake in their robes when confronted with these priority disputes. See, e.g., Texas Oil & Gas Corp. v. United States, 466 F.2d 1040, 1043 (5th Cir. 1972), cert. denied sub nom. Pecos County State Bank v. United States, 410 U.S. 929 (1973) (“We enter with some trepidation the tortured meanderings of federal tax lien law, intersected now by the somewhat smoother byway of the Uniform Commercial Code.”). But see Valley Bank v. City of Henderson, 528 F. Supp. 907, 910 (D. Nev. 1981) (“While some have character-
a brief discussion of certain technical aspects of federal tax liens, this Article, through a series of hypotheticals, presents and resolves numerous priority disputes between the IRS and various Article 9 secured creditors. Hypotheticals #1 through #6 analyze the basic rule that awards priority to secured creditors relying solely on collateral acquired by the taxpayer before the IRS files its tax lien notice to secure repayment of credit extended solely before such filing. Hypotheticals #7, #8, and #9 examine the statutory framework that offers protection to a secured party who is relying on pre-notice collateral to secure repayment of some post-notice credit. Provisions that allow a secured party to enjoy priority in post-notice collateral are explored in Hypotheticals #10 through #15. And Hypotheticals #16, #17, and #18 address three situations not expressly addressed by statute: (i) a dispute between the IRS and the holder of a post-notice purchase money security interest, (ii) an attempt by a secured party to expand the size of the collateral package in which it enjoys priority by invoking a "proceeds" argument, and (iii) a circular priority dispute between the IRS and two Article 9 creditors.

II. THE TAX LIEN

A. Creation

A tax lien does not arise in favor of the IRS until the tax is assessed, the IRS demands payment, and the taxpayer fails or refuses to make payment. If a taxpayer acknowledges its liability for unpaid taxes on its tax return, assessment occurs as soon as the liability is noted on a list in the office of the district director of the IRS. Absent acknowledgement, assessment does not occur until (i) the deficiency is discovered through a tax audit, (ii) the taxpayer is notified of the deficiency, and (iii) the taxpayer admits liability or exhausts its opportunities for administrative review. 

12. I.R.C. § 6321 ("If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount ... shall be a lien ... ."); I.R.C. § 6322 ("[t]he lien imposed by section 6321 shall arise at the time the assessment is made. . . ."); see also DAVID G. EPSTEIN & STEVE H. NICKLES, DEBT: BANKRUPTCY, ARTICLE 9 AND RELATED LAWS 518 (1994); RICHARD E. SPEIDEL ET AL., SALES AND SECURED TRANSACTIONS 416-17 (5th ed. 1993). Unless otherwise indicated, all cites to the I.R.C. refer to the 1986 version of that statute, as subsequently amended.


14. EPSTEIN & NICKLES, supra note 12, at 518.
As soon as practicable after assessment, the IRS must send the taxpayer a deficiency notice demanding payment. If the taxpayer then fails or refuses to pay the deficiency, the lien becomes enforceable against the taxpayer, with an effective date that relates back to the date of assessment. The lien is in the amount equal to the unpaid tax plus any additional taxes and related interest charges, penalties, and costs. It encumbers all real and personal property belonging to the taxpayer, including property acquired by the taxpayer after assessment.

**B. The Tax Lien Notice**

1. Where to File

Because the lien is enforceable against the taxpayer without the necessity of any filing, its existence may not be known by the taxpayer or third parties, including creditors. Reacting to this "secret lien," Congress added a provision to the tax laws in 1928 that protected certain parties from the adverse effects of the tax lien if the IRS had not filed a notice of its lien in a designated place. That provision was the forerunner to what is now...
I.R.C. § 6323(a), which states: "The lien imposed by section 6321 shall not be valid as against any purchaser, holder of a security interest, mechanic's lienor, or judgment lien creditor until notice thereof . . . has been filed by the Secretary." If the lien encumbers real estate, the IRS must file its notice in the one office designated by the laws of the state where the real estate is located. For personal property, the place for filing is the one office designated by the laws of the state of the taxpayer's residence. If a state has not designated a single recording office for tax lien filings, then the IRS must file its notice with the federal district court for the judicial district where the property is located. If the taxpayer's property is located in Washington, D.C., the notice is filed with the Recorder of Deeds for the District of Columbia.

2. Refiling Requirement

A tax lien notice, which is filed in the appropriate place, is effective for a period of ten years and thirty days which commences on the assessment date rather than the filing date. The IRS may extend the effectiveness by refiling the notice during the last year of that period. For example, if the IRS assessed a tax liability against a taxpayer on March 1, 1995, and filed its notice in the proper place on July 1, 1995, the notice remains effective through March 30, 2005. The IRS will extend the effectiveness to March 30, 2015, if it refiles the notice during the one-year period that begins on April 1, 2004.

secret lien.")]; Dean L. Overman, Federal Tax Liens: A Guide to the Priority System of Section 6323 of the Internal Revenue Code, 16 B. C. INDUS. & COM. L. REV. 729 (1975) ("The federal tax lien is a secret lien arising at the time the tax is assessed.").

23. I.R.C. § 6323(a). The IRS annually files approximately 1,500,000 tax lien notices. LOPUCKI & WARREN, supra note 12, at 759.


25. Id. § 6323(f)(1)(A)(ii), (2)(B). A corporate or partnership taxpayer resides in the state where its principal executive office is located. Id. § 6323(f)(2)(B). A taxpayer that does not reside in the United States is deemed to have a residence in Washington, D.C. Id.

26. Id. § 6323(f)(1)(B).

27. Id. § 6323(f)(1)(C).

28. For a state-by-state listing of appropriate filing offices, see STAND. FED. TAX REP. (CCH) ¶ 39.060.205, at 65,494-501.

29. I.R.C. § 6323(g)(1), (3); cf. U.C.C. § 9-403(2) (stating the general rule that "a filed financing statement is effective for a period of five years from the date of filing"). Unless otherwise stated, all cites to the U.C.C. refer to the version of that statute as amended through 1994.

30. I.R.C. § 6323(g)(3)(A); cf. U.C.C. § 9-403(3) (requiring a secured party to file a continuation statement within the six-month period before the end of the original five-year period of effectiveness of a financing statement in order to extend the period of effectiveness).
If the taxpayer moves its residence to a new filing jurisdiction and the IRS receives proper written notice of the relocation at least ninety days before it refiles its notice in the original jurisdiction, then, in order to continue the effectiveness of its original filing, the IRS must refile (during the effective refiling period) a notice in the original jurisdiction and the new jurisdiction. For example, assume that the IRS filed its original notice in the state of Texas because the taxpayer resided in Houston. If the taxpayer moved to Florida in 1997 and the IRS received proper and timely written notice of the relocation, then, in order to continue the effectiveness of its original notice, the IRS must timely refile its notice in both Texas and Florida. If the same taxpayer then moved to New York in 1998 and gave proper and timely notice of the relocation to the IRS, the IRS must refile its notice in Texas and New York. If, however, the taxpayer notified the IRS of its move to Florida but not its move to New York, then the IRS is required to refile its notice in Texas and Florida.

Failure to timely refile the notice does not invalidate the lien, but it does adversely affect its priority. For instance, a holder of a security interest

31. 26 C.F.R. § 301.6323(g)-1(b)(1). The taxpayer's new residence is located in the District of Columbia if the taxpayer does not relocate to one of the fifty states. Id.

The written notice is effective "if it (A) is received . . . by the district director or the service center director having jurisdiction where the original notice of lien was filed, (B) relates to an unpaid tax liability of the taxpayer, and (C) states the taxpayer's name and the address of his new residence." Id. § 301.6323(g)-1(b)(2). Additionally, if the tax assessment occurred after 1966, a written notice is effective if it is contained in a return or amended return covering the same type of delinquent tax and the return or amended return indicates on its face the change in the taxpayer's address, as well as the taxpayer's correct name, new address, and identification number. Id. § 301.6323(g)-1(b)(2). No other communication, "whether oral or written, is effective, whether or not the Service has actual notice or knowledge of the taxpayer's new residence." Id. § 301.6323(g)-1(b)(3).

32. See id. § 301.6323(g)-1(b)(3) example 2.

33. Id. example 3. See also id. § 301.6323(g)-1(b)(1) ("If on or before the 90th day . . . more than one written notice is received concerning a change in the taxpayer's residence, a notice of lien is required . . . to be filed only with respect to the residence shown on the written notice received on the most recent date.").

34. Id. § 301.6323(g)-1(b)(3) example 4. If the taxpayer gave notice of its relocation from Florida to New York but the IRS did not receive the notice within the prescribed period, then the IRS would refile its notices in Texas and Florida. Id. example 5.

35. See id. § 301.6323(g)-1(a)(3) ("Failure to refile a notice of lien does not affect the existence of the lien."); see also United States v. Stonehill, 702 F.2d 1288, 1300 (9th Cir. 1983); Title Guar. Co. v. IRS, 667 F. Supp. 767, 769-71 (D. Wyo. 1987); S. REP. No. 1708, 89th Cong., 2d Sess. 10 (Sen. Fin. Comm.), reprinted in 1966 U.S.C.C.A.N. 3722, 3733 ("The failure to refile the tax lien at the appropriate time is not to affect the validity of the lien itself."); cf. U.C.C. § 9-403(2) ("The effectiveness of a filed financing statement lapses on the expiration of the five year period unless a continuation statement is filed prior to the lapse. . . . Upon lapse the security interest becomes unperfected . . . [and] is deemed to have been unperfected as against a person who became a purchaser or lien creditor before lapse.");
that arises in 1997 will not have priority over the IRS lien in the previous example if the dispute is resolved on or before March 30, 2005 (the last day of the period of effectiveness for the tax lien filing). If the IRS refiles its notice on July 1, 2004 (a date within the one-year refiling period of April 1, 2004, through March 30, 2005), the IRS lien continues to enjoy priority over the competing security interest for an additional ten years. However, if the IRS does not refile its notice until May 1, 2005 (a date outside the one-year refiling period), the security interest enjoys priority unless the common collateral is (i) the subject of, and the IRS is a party to, a lawsuit commenced before the required refiling period expired or (ii) levied upon by the IRS before the refiling period expired.\(^3\)

3. Effect of Mistake by the IRS in Identifying the Taxpayer

For the tax lien to be valid against a holder of a security interest, the IRS must file its notice in accordance with the requirements of I.R.C. § 6323(f).\(^3\) Subsection (f) states, in relevant part: “The form and

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\(^3\) See S. Rep. No. 1708, at 101, reprinted in 1966 U.S.C.C.A.N. at 3733 (“[I]n the case of a late refiling, any security interest arising after the prior filing of the tax lien, but before the refiling, obtains a priority to the same extent and under the same conditions as if no tax lien had been filed prior to the time of the late refiling.”); see also Title Guar. Co., 667 F. Supp. at 767, 769-70 (holding that the failure to timely refile a notice of tax lien nullified the effect of a prior filing and caused the lien to lose priority as against an intervening mortgagee). Neither the statutes, the regulations, nor the caselaw appear to address the situation in which the IRS refiles before the beginning of the refiling period. If U.C.C. caselaw is invoked by analogy, then jumping the gun and refiling even one day early should prevent the refiling from being effective, and the original filing should be deemed to lapse at the conclusion of the original period of effectiveness. See Jersey State Bank v. Isringhausen (In re Isringhausen), 151 B.R. 203, 206-07 (Bankr. S.D. Ill. 1993) (holding ineffective a continuation statement filed four days before commencement of the six-month refiling period); Banque Worms v. Davis Constr. Co., 831 S.W.2d 921, 923 (Ky. Ct. App. 1992) (same—two days); NBD Bank, N.A. v. Timberjack, Inc., 527 N.W.2d 50, 53 (Mich. Ct. App. 1994) (same—five days).

\(^3\) 26 C.F.R. § 301.6323(g)-1(a)(3). However, if the suit is dismissed or the levy is released when the collateral is subject to the tax lien, the notice no longer remains effective after the dismissal or release unless the notice is refiled during the required refiling period. Id.

\(^3\) I.R.C. § 6323(a); see also United States v. Trigg, 465 F.2d 1264, 1269 (8th Cir. 1972), cert. denied sub nom. First State Bank of Crossett v. United States, 410 U.S. 909 (1973) (“Under 26 U.S.C. § 6323(a), a federal tax lien is not valid against the holder of a security interest until the tax lien is filed.”); Davis v. United States, 705 F. Supp. 446, 449 (C.D. Ill. 1989) (“[T]he IRS lien does not take priority over the delinquent taxpayer’s other lienors until its notice of tax lien is filed in the proper form and with the proper authority.”);
content of the notice referred to in [I.R.C. § 6323(a)] shall be prescribed by the Secretary. Such notice shall be valid notwithstanding any other provision of law regarding the form or content of a notice of lien.\footnote{9} The IRS files its notice on Form 668, entitled “Notice of Federal Tax Lien Under Internal Revenue Laws,” which “must identify the taxpayer, the tax liability giving rise to the lien, and the date the assessment arose...”\footnote{40}

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Pine Builders, Inc. v. United States, 413 F. Supp. 77, 80 (E.D. Va. 1976) (“[A federal tax lien] is not valid as against a holder of a ‘security interest’ until notice thereof has been filed in accordance with 26 U.S.C. § 6323(a), (f).”).

\footnote{39}{I.R.C. § 6323(f)(3).}


42. The same issue under the U.C.C. has been a frequent visitor to the courtroom. Under the U.C.C., the filing officer indexes financing statements "according to the name of the debtor." U.C.C. § 9-403(4). "A financing statement sufficiently shows the name of the debtor if it gives the individual, partnership or corporate name of the debtor[.]" U.C.C. § 9-402(7). Whether an incorrect name prevents the financing statement from being effective depends on whether the error is "seriously misleading." Id. § 9-402(8). Like the name of the demoniac from Gadarenes, see Mark 5:1-20, the number of cases that have addressed the issue of whether an error in a debtor's name is seriously misleading is " legion." See, e.g., Brushwood v. Citizens Bank of Perry (In re Glasco, Inc.), 642 F.2d 793, 796 (5th Cir. 1981) (holding that a financing statement listing the debtor as "Elite Boats, Division of Glasco, Inc." rather than by the legal name of "Glasco, Inc." was not seriously misleading); In re Excel Stores, Inc., 341 F.2d 961, 962 (2d Cir. 1965) (holding that a financing statement listing the debtor as "Excel Department Stores" rather than by the legal name of "Excel Stores, Inc." was not seriously misleading); Citizens Nat'l Bank & Trust Co. v. Star Automotive Warehouse, Inc. (In re Thriftway Auto Supply, Inc.), 159 B.R. 948, 953 (W. D. Okla. 1993) (holding that a financing statement listing the debtor as "Thriftway Auto Stores" rather than by the legal name of "Thriftway Auto Supply, Inc." was not seriously misleading); Hinson v. Centura Bank (In re Seventeen South Garment Co.), 145 B.R. 511, 512, 515 (E.D.N.C. 1992) (holding that a financing statement listing the debtor as "17 South Garment Co., Inc." rather than by the legal name of "Seventeen South Garment Co., Inc." was seriously misleading); Chemical Bank v. Title Serv., Inc., 708 F. Supp. 245, 247-49 (D. Minn. 1989) (holding that a financing statement listing the debtor as "Bois Clair Corporation" rather than by the legal name of "Boisclair Corporation" was seriously misleading); U. S. Cylinders, Inc. v. Vital Breathing Prods., Inc. (In re Vital Breathing Prods., Inc.), 98 B.R. 97, 102 (Bankr. N.D. Ga. 1988) (holding that a financing statement listing the debtor as "Universal Medical Supplies" rather than by the legal name of "Vital Breathing Products, Inc." was seriously misleading); Sencore, Inc. v. Pongetti (In re Columbus Typewriter Co.),
example, a bankruptcy trustee was permitted to avoid a tax lien otherwise enforceable against the bankrupt debtor because the tax lien notice identified the taxpayer as "Gary A. Reid, Jr." rather than "Cary A. Reid, Jr." And because the court held that a notice filed in the name of "W. B. Clark, Sr." rather than "W. R. Clark, Sr." was insufficient, the IRS was found guilty of wrongfully seizing and selling the taxpayer's automobile that was subject to a chattel mortgage. A court held that an IRS lien was invalid against judgment creditors of "S. Ruby Luggage Corporation" because the tax lien notice omitted the "S." from the taxpayer's name. And a notice filed against the partnership of "LaForce-Walker Construction Co." was held insufficient to validate a tax lien against partner R. K. Walker even though

75 B.R. 834, 838 (Bankr. N.D. Miss. 1987) (holding that a financing statement listing the debtor as "Columbus Business Machines" rather than by the legal name of "Columbus Typewriter Company, Inc." was seriously misleading); Cain v. L.B. Smith, Inc. (In re Stebow Constr. Co.), 73 B.R. 459, 467 (Bankr. D.N.J. 1987) (holding that a financing statement listing the debtor as "Stebow Excavating Co., Inc." rather than by the legal name of "Stebow Construction Co., Inc." was seriously misleading); In re Amsco, Inc., 26 B. R. 358 (Bankr. D. Conn. 1982) (holding that a financing statement listing the debtor as "American Supply Company" rather than by the legal name of "Amsco, Inc." was seriously misleading); In re Southern Supply Co., 405 F. Supp. 20, 22 (E.D.N.C. 1975) (holding that a financing statement listing the debtor as "Southern Supply Co." rather than by the legal name of "Southern Supply Company of Greenville, N.C., Inc." was not seriously misleading); District of Columbia v. Thomas Funding Corp., 593 A.2d 1030, 1036 (D.C. App. 1991) (holding that a financing statement listing the debtor as "Silvermine Building Maintenance Co." rather than "Silverline Building Maintenance Co." was seriously misleading); Borg Warner Acceptance Corp. v. Secretary of State of Kansas, 731 P.2d 301, 305 (Kan. 1987) (holding that a financing statement listing the debtor as "Empira Manufacturing Company" rather than by the legal name of "Empire Manufacturing Company" was not seriously misleading); Corporate Financers, Inc. v. Voyageur Trading Co., 519 N.W.2d 238, 243 (Minn. Ct. App. 1994) (holding that a financing statement listing the debtor as "Voyager Trading Co." rather than by the legal name of "Voyageur Trading Co." was not seriously misleading); John Deere Co. v. William C. Pahl Constr. Co., 310 N.Y.S.2d 945, 948 (N.Y. App. Div. 1970) (holding that a financing statement listing the debtor as "Ranelli Construction, Inc." rather than by the legal name of "Ranalli Construction, Inc." was not seriously misleading).


44. Continental Inv. v. United States, 142 F. Supp. 542, 544 (W.D. Tenn. 1953); see also Fritschler, Pellino, Schrank & Rosen, S.C. v. United States, 716 F. Supp. 1157, 1160-61 (E.D. Wis. 1988) (concluding that a tax lien notice erroneously listing the taxpayer as "Alan G. Casey" rather than "Alan J. Casey" was ineffective) (emphasis added).

his name appeared on the notice. Occasionally, however, a court will uphold the validity of a tax notice despite a mistake in identifying the taxpayer. For example, the IRS continued to enjoy priority over subsequent purchasers of real estate sold by taxpayer “Hyde, Tarragon & Co.” even though the IRS dropped the second “r” from “Tarragon” when it prepared and filed the tax lien notice. Although a “bright line” test has been adopted by a few courts, the majority of courts that have confronted the issue have adopted the following constructive notice approach:

The mere fact that a full name is not given or that there is an addition, omission or substitution of letters in a name, or even errors, does not, in and of itself, invalidate the notice. The essential purpose of the filing of the lien is to give constructive notice of its existence. The test is not absolute perfection in compliance with the statutory requirement for filing

46. Robby’s Pancake House of Florida, Inc. v. Walker (In re Robby’s Pancake House of Florida, Inc.), 24 B.R. 989, 996 (Bankr. E.D. Tenn. 1982); see also F. P. Baugh, Inc., 297 F.2d at 695 (holding that a notice indexed against partnership “Little Lake Lumber Co.” and partner “Chas. E. McCulloch et al” did not validate a lien against the holder of a chattel mortgage and deed of trust against the interests of unnamed partners H.W. Ryan and M.L. Kramer in the partnership property); cf. Hudgins v. IRS (In re Hudgins), 967 F.2d 973, 974-77 (4th Cir. 1992) (holding that a notice naming the taxpayer as “Hudgins Masonry, Inc.”—a corporation whose existence had been terminated for failure to pay certain fees—gave effective notice against the business assets of Michael Hudgins, who continued to do business and file federal tax returns under the business name, but not his personal assets); Tony Thornton Auction Serv., Inc., 791 F.2d at 638-39 (holding that notices filed in the name of the husband “Joe W. Davis” and the restaurant (named as either “Davis’s Restaurant” or “Daviss Restaurant”) operated by Joe and his wife (Mary Ann Davis) perfected tax liens against the wife’s interest in proceeds from sale of the restaurant despite the failure to list wife on tax lien notices). But see American Sur. Co. v. Sundberg, 363 P.2d 99, 103 (Wash. 1961), cert. denied, 368 U.S. 989 (1962) (“A notice of the United States liens, using the name of the partnership (Oscar Sundberg and Sons) was notice not only to anyone dealing with Oscar Sundberg, but also to those dealing with [partners and sons] Carl and Thor Sundberg or their property . . . .”).

47. For just a fleeting moment, I thought about working some variation of the phrase “incompetence of the IRS” into the sentence. Not wishing to become the victim of a full-blown tax audit, however, I declined to do so.

48. Feinstein, 717 F. Supp. at 1557; see also Richter’s Loan Co., 235 F.2d at 755 (holding that notice filed against “Joseph & Sally Freidlander” instead of “Joseph & Sally Friedlander” was effective) (emphasis added); Brightwell, 805 F. Supp. at 1471 (concluding that a tax lien notice filed in the name of “William S. Van Horn” was effective against “William B. VanHorn”) (emphasis added); United States v. Jane B. Corp., 167 F. Supp. 352, 355 (D. Mass. 1958) (concluding that the omission of “Inc.” from a taxpayer’s name on tax lien notice was “only a minor error which would not render the filing of notice of the lien ineffective” because “[c]learly any prudent person searching the record would have discovered the actual notice filed and would have been put on notice of the lien . . . .”).

49. See Hudgins, 967 F.2d at 976 (discussing cases that have adopted a “bright line” approach).
the tax lien, but whether there is substantial compliance sufficient to give constructive notice and to alert one of the government’s claim.  

4. Effect of Post-Notice Name Changes

A slightly different issue arises if, after the IRS has filed a proper notice, the taxpayer changes its name as a result of marriage, merger, or otherwise. For example, in Davis v. United States, the IRS filed a tax lien notice against taxpayers “John & Gillian Renslow” in February 1982 for a 1978 tax liability. The Renslows lived on property that Gillian and her mother had originally purchased in 1978 as joint tenants. Gillian and her mother placed the property in an Illinois land trust (under which the disclosed trustee, BancMidwest, held legal and equitable title and the undisclosed beneficiaries, Gillian and her mother, retained full right to control, possess, and manage the property) sometime during the Renslow marriage. The Renslows divorced in April 1981, and Gillian married Richard Rongey in February 1982. During the Rongey marriage, the land trust conveyed title to the property to Gillian Rongey. Later that year she and her husband sold the property to Steve and Judith Davis.

50. United States v. Sirico, 247 F. Supp. 421, 422 (S.D.N.Y. 1965) (footnotes omitted); see also Hudgins, 967 F.2d at 976 (citing Sirico, 247 F. Supp. at 421); Tony Thornton Auction Serv., Inc., 791 F.2d at 639 (same); Reid, 182 B.R. at 446 (“Just how far the name under which the lien is recorded can vary from the taxpayer’s true name before the notice of lien is ineffective depends on all the circumstances, but it is clear than [sic] even fairly significant misspellings may nevertheless be close enough ‘to alert one of the government’s claim.’”) (quoting Hudgins, 967 F.2d at 976); Brightwell, 805 F. Supp. at 1471 (also citing Sirico).

51. My favorite real-life story concerning marital name changes occurred when my family gathered at a local Denny’s Restaurant for Thanksgiving dinner in 1994. We had planned to eat at my parent’s house, but Mom forgot to check the oven before she preheated it for the turkey. Apparently, Dad had bought an early Christmas gift in July and had hidden it where he thought Mom would never look. Everyone simply forgot about it until smoke began pouring out of the kitchen and set off the smoke alarm (which scared everyone except Uncle Merle, who had turned his hearing aid off). Well, anyway, back to the restaurant. Little Billy, my youngest brother, told Aunt Ella that if she would marry Darth Vader her new name would be “Ella Vader” (elevator). My other little brother, Calvin, laughed so hard that he sported Fresca right out of his nose. Two ladies at the next table gave us a dirty look. Accountants, no doubt.
The Davises filed a lawsuit to quiet title after the IRS sought to foreclose on the property under a tax lien notice filed against the Renslows.58 The court first observed that the Davises would not discover the tax lien by reviewing the real estate records because (i) the IRS had not refiled its notice against Gillian “Rongey” and (ii) the IRS had filed its earlier notice against Gillian “Renslow” several years after she and her mother had transferred title to the property to the trustee of the land trust.59 Nevertheless, the IRS argued that it was under no statutory obligation to refile its notice against Gillian after she remarried.60 The court rejected this argument after noting that the history of I.R.C. § 6323 indicated that the IRS was required to file its notice in order to limit the effect of its otherwise “secret lien,” and that the IRS was required to indicate the “identity” of the taxpayer on its notice.61 The court then wrote:

Thus, this Court rejects the IRS’s contention that there is no duty upon it under any circumstances to refile its notice of tax lien. To the contrary, this Court finds that, where the IRS has notice that a delinquent taxpayer has changed his or her name, and where the notice of tax lien was filed under the taxpayer’s original name, the IRS is under an affirmative duty to refile the notice of tax lien to show the taxpayer’s new name. In this way the underlying purposes of the notice provisions of the Internal Revenue Code will be furthered, while at the same time the IRS will not be under any undue administrative burden.62

Other courts have reached a similar result when confronted with the same issue. See Clark, 81-1 U.S. Tax Cas. (CCH) at 87,118 (ruling that a notice filed against “Carolyn Sue Clark” did not give notice to the purchaser of property acquired and sold by the taxpayer after remarrying and changing her name to “Carolyn Sue Harper” and that as between two innocent parties, the IRS would bear the loss since it had knowledge of remarriage and the name change); Fleet Mortgage Corp. v. U. S. Conglomerate, Inc., 519 N.E.2d 949, 954 (III. App. Ct. 1988) (relying on Clark to hold that the IRS notice identifying the taxpayer as “Betty Bradly” did not give constructive notice of an interest in property later acquired by the taxpayer who had remarried and adopted the surname “Brackenridge” and that the IRS had knowledge of the remarriage and the name change).

Under Article 9, if a debtor changes its name after a secured party has filed a proper financing statement with the appropriate recording office, the financing statement continues to perfect the secured party’s interest in collateral owned by the debtor when the name change occurs, as well as all collateral acquired by the debtor during the four-month period

58. Id.
59. Id. at 448.
60. Id. at 453.
61. Id.
62. Id. In response to the inquiry by the IRS regarding how soon after discovering the name change it would be required to refile its notice in order to retain its priority, the court answered: “[T]he standard will be one of reasonableness . . . . Therefore, after the IRS has received reasonable notice of a name change, it will have a reasonable amount of time within which to refile its notice of lien—the factfinder can resolve any disputes as to whether times are reasonable.” Id. at 454.
5. Effect of Post-Notice Asset Sales

Whether an IRS lien retains priority over the interests of third parties who purchase property from the taxpayer after the IRS has filed its notice depends on various factors. For example, a purchaser of a security who has no actual notice or knowledge of the lien at the time of purchase acquires the security free of the tax lien. Additionally, the tax lien is invalid against a party who purchases a motor vehicle from the taxpayer if (i) the purchaser does not have actual notice or knowledge of the lien at the time of purchase and (ii) before it has actual notice or knowledge of the lien, the following the name change. The original financing statement continues to perfect a security interest in collateral acquired by the debtor after the four-month period unless the name change is deemed seriously misleading. If the name change is seriously misleading, the secured party must file a new financing statement reflecting the name change in order to perfect its security interest in collateral acquired by the debtor more than four months after the name change. See U.C.C. § 9-402(7); see also Burnett v. H.O.U. Corp. (In re Kalamazoo Steel Process, Inc.), 503 F.2d 1218, 1220 (6th Cir. 1974) (ruling that debtor’s name change from “Roman Industrial Corporation” to “Kalamazoo Steel Process” rendered a financing statement seriously misleading); Paramount Int’l, Inc. v. First Midwest Bank (In re Paramount Int’l, Inc.), 154 B.R. 712, 717 (Bankr. N.D. Ill. 1993) (holding that a financing statement did not become seriously misleading when the debtor changed its name from “Paramount Attractions, Inc.” to “Paramount International, Inc.”); Rentclub, Inc. v. Transamerica Rental Fin. Corp. (In re Rentclub, Inc.), 149 B.R. 699, 701 (Bankr. M.D. Fla. 1993) (concluding that the filing against “Tampa Rentclub, Inc.” became seriously misleading when the debtor changed its name to “Rentclub, Inc.”); Heckathorn Constr. Co. v. Bass Mechanical Contractors, Inc. (In re Bass Mechanical Contractors, Inc.), 84 B.R. 1009, 1021 (Bankr. W.D. Ark. 1988) (ruling that the debtor’s name change from “Bass Plumbing, Heating and Cooling, Inc.” to “Bass Mechanical Contractors, Inc.” did not render an earlier filing seriously misleading); In re Falk Interiors, 61 B.R. 720, 721-22 (Bankr. W.D. Wis. 1986) (concluding that a financing statement filed against “Sharbill, Inc.” became seriously misleading when the debtor changed its name to “Falk Interiors, Inc.”); Huntington Nat’l Bank v. Tri-State Molded Plastics, Inc. (In re Tyler), 23 B.R. 806, 808-09 (Bankr. S.D. Fla. 1982) (holding that a filing against “Tri-State Molded Plastics, Inc.” became seriously misleading when the debtor changed its name to “Tri-State Molded Plastics, Inc.”).


If Purchaser #1 acquires the security free and clear of the tax lien and then sells the security to Purchaser #2 at a time when Purchaser #2 has actual notice or knowledge of the tax lien, the lien remains invalid against the security purchased by Purchaser #2 because Purchaser #2 acquires the same rights as Purchaser #1. See 26 C.F.R. § 301.6323(b)-1(a)(1)(iiii), (2) example 2. If Purchaser #1 has actual notice or knowledge of the lien when it acquires the security, the lien becomes invalid against Purchaser #2 if Purchaser #2 has no actual notice or knowledge of the lien when it acquires the security from Purchaser #1. Id. example 5. However, Purchaser #1 cannot reacquire the security from Purchaser #2 free of the lien because “no person can improve his position with respect to the lien by reacquiring the interest from an intervening purchaser... against whom the lien is invalid.” Id. § 301.6323(b).
purchaser acquires possession of the motor vehicle and does not thereafter surrender possession to the seller or its agent. The tax lien also becomes invalid against tangible personal property sold at retail to a "purchaser in the ordinary course of the seller's trade or business, unless at the time of such purchase such purchaser intends such purchase to (or knows such purchase will) hinder, evade, or defeat the collection of any tax . . . ." And finally, a purchaser may acquire certain tangible personal property free of a tax lien if the purchaser acquires the goods at a casual sale for less than $250, does not acquire the goods for resale, does not have actual notice or knowledge of the lien, and does not have actual notice or knowledge that the sale is one of a series of sales by the seller.

If none of the above statutory exemptions is available, may a now bankrupt purchaser invalidate the tax lien if the IRS knew of the purchase but failed to refile a notice against the purchaser? A federal appellate court recently addressed this issue in In re LMS Holding Co. In this case, the IRS filed a tax lien notice against taxpayer MAKO, Inc., who later sought relief under Chapter 11 of the Bankruptcy Code. Under MAKO's plan

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64. I.R.C. § 6323(b)(2). A "motor vehicle" is a "self-propelled vehicle which is registered for highway use under the laws of any State or foreign country." Id. § 6323(h)(3).

65. Id. § 6323(b)(3). Observe that a purchaser with actual notice or knowledge of the lien at the time of the retail purchase is not automatically precluded from seeking the protection of I.R.C. § 6323(b)(3). See 26 C.F.R. § 301.6323(b)-1(c) example; cf. I.R.C. § 6323(b)(1), (2).

"Retail sale" is defined as:

a sale, made in the ordinary course of the seller's trade or business, of tangible personal property of which the seller is the owner. Such term includes a sale in customary retail quantities by a seller who is going out of business, but does not include a bulk sale or an auction sale in which goods are offered in quantities substantially greater than are customary in the ordinary course of the seller's trade or business or an auction sale of goods the owner of which is not in the business of selling such goods.

26 C.F.R. § 301.6323(b)-1(c)(2); cf. U.C.C. § 1-201(9) (defining "buyer in ordinary course of business"); U.C.C. § 9-307(1) (permitting certain buyers in the ordinary course of business to acquire goods free of security interests held by the seller's creditors).

66. I.R.C. § 6323(b)(4). A "casual sale" is "a sale not made in the ordinary course of the seller's trade or business." 26 C.F.R. § 301.6323(b)-1(d)(1). "[A] sale is one of a series of sales if the seller plans to dispose of, in separate transactions, substantially all of his household goods, personal effects, and other tangible personal property described in § 301.6334-1." Id. § 301.6323(b)-1(d)(2). "[T]he provision does not cover a purchase where the purchaser knows that it is one of a series of sales since, in such cases, the series of sales itself may be an indication that the seller is having credit problems." S. REP. No. 1708, at 5, reprinted in 1966 U.S.C.C.A.N. at 3726. But see William T. Plumb, Jr., The New Federal Tax Lien Law, 22 BUS. LAW. 271, 288 (1967) ("More likely it means no more than that someone has died, retired from his trade, been transferred overseas, or remodeled his kitchen.").

67. 50 F.3d 1526 (10th Cir. 1995).

68. Id. at 1527.
of reorganization, Retail Marketing Company (RMC) acquired all of MAKO's assets and assumed all of MAKO's secured liabilities. The IRS consented to the plan but never filed a new notice against RMC. After later filing for bankruptcy protection itself, RMC sought to avoid the federal tax lien on the assets that it had acquired from MAKO. The court held that the IRS had no duty to refile in order to continue its lien. Relying on I.R.C. § 6323(f)(4), the court ruled that the lien continued against any real estate sold by MAKO because any purchaser would discover the notice during a reasonable inspection of the real estate records. The court reached a similar conclusion concerning personalty sold by MAKO by relying on U.C.C. § 9-402(7), which states that a secured party need not refile a new financing statement against a transferee to continue perfection of a security interest in the transferred assets.

69. Id.
70. Id.
71. Id.
72. Id. at 1529. I.R.C. § 6323(f)(4) provides:

In the case of real property, if —

(A) under the laws of the State in which the real property is located, a deed is not valid as against a purchaser of the property who (at the time of purchase) does not have actual notice or knowledge of the existence of such deed unless the fact of filing of such deed has been entered and recorded in a public index at the place of filing in such a manner that a reasonable inspection of the index will reveal the existence of the deed, and

(B) there is maintained (at the applicable office under I.R.C. § 6323(f)(1)) an adequate system for the public indexing of Federal tax liens,

then the notice of lien referred to in subsection (a) shall not be treated as meeting the filing requirements under I.R.C. § 6323(f)(1) unless the fact of filing is entered and recorded in the index referred to in subparagraph (B) in such a manner that a reasonable inspection of the index will reveal the existence of the lien.


73. LMS Holding Co., 50 F.3d at 1530.
74. This section presupposes, however, that the secured party retains a security interest in the transferred assets. If the secured party permits the debtor to sell the assets free and clear of the security interest, then the secured party no longer retains a security interest in the transferred assets and perfection becomes a moot point. See U.C.C. § 9-306(2); id. cmt. 3; PEB Commentary No. 3 (analyzing the interplay between U.C.C. § 9-306(2) and U.C.C. § 9-402(7)). Also, a secured party that retains a perfected security interest in the transferred assets may find that a subsequent purchaser has acquired the assets free of the interest. See, e.g., U.C.C. §§ 9-307 (protecting certain purchasers of goods), 9-308 (protecting certain purchasers of chattel paper and instruments), 9-309 (protecting certain holders and purchasers of negotiable instruments, negotiable documents of title, and securities); see also U.C.C. § 9-301(1)(c), (d) (indicating when transferees take free of unperfected security interests).
6. Effect of Errors by the Filing Clerk

The IRS does not bear the risk of loss resulting solely from errors and mistakes of the filing clerk. For example, in Adams v. United States,75 the filing clerk failed to record four notices submitted by the IRS against certain real property.76 The IRS was not aware of the error because it had received copies of the filings bearing the filing clerk’s stamp of receipt.77 Nor were subsequent purchasers of the real property aware of the mistake at the time of purchase.78 In resolving the priority dispute between two innocent parties in favor of the IRS, the court wrote:

In this case, after delivery of the Notices to the County Clerk and receipt of the copies bearing the Clerk’s ‘received’ stamp, there was nothing further the United States could reasonably be expected to have done. Accordingly, the United States complied with the requirements of § 6323(f) and thus is entitled to priority over subsequent purchasers such as plaintiffs.79

III. RULES FOR RESOLVING PRIORITY DISPUTES

A. The General Rule
(No Post-Notice Property; No Post-Notice Advances)

The general rule for resolving priority disputes between an Article 9 secured party and the IRS is found in I.R.C. § 6323(a), which provides, in

76. Id. at 29.
77. Id.
78. Id.
79. Id. at 30. Courts have addressed similar problems and reached similar results under the U.C.C. when the filing clerk erroneously filed a financing statement tendered by a secured party. See, e.g., In re Royal Electrotype Corp., 485 F.2d 394, 395, 398 (3d Cir. 1973) (holding that the secured party did not bear the risk of loss resulting from a clerk’s erroneous switch of the debtor’s and secured party’s names when indexing the financing statement, even though the secured party received a receipt at the time of filing that reflected the error); Borg Warner Acceptance Corp. v. ITT Diversified Credit Corp., 344 N.W.2d 841, 842 (Minn. 1984) (holding that an earlier perfected security interest in inventory retained priority over a conflicting and subsequently perfected purchase money interest after the purchase money lender failed to achieve superpriority status when it failed to notify the earlier secured party after the clerk erroneously omitted the earlier filing from its search report prepared at the purchase money lender’s request); see also U.C.C. § 9-407 cmt. 1:

Note, however, that under Section 9-403(1) the secured party does not bear the risk that the filing officer will not properly perform his duties: under that section the secured party has complied with the filing requirements when he presents his financing statement for filing and the filing fee has been tendered or the statement accepted by the filing officer.
relevant part that "[t]he lien imposed by section 6321 shall not be valid as against any . . . holder of a security interest . . . until notice thereof which meets the requirements of subsection (f) has been filed by the Secretary." 80 The following six hypotheticals illustrate the mechanics of this general rule. 81

Hypothetical #1

AmeriBank loaned $10,000 to the Metropolitan Medical Clinic (the Clinic) on June 1. To secure repayment of the loan, the Clinic executed a security agreement on June 1 that created an enforceable security interest in specific medical equipment (the collateral) previously acquired by the Clinic. AmeriBank filed a proper financing statement 82 with the appropriate filing officer 83 on June 3. Unknown to AmeriBank, the IRS had assessed a tax lien against the property of the Clinic on March 1 for unpaid withholding taxes and social security contributions of $25,000. 84 The IRS filed a

80. I.R.C. § 6323(a).
81. I.R.C. § 6323(a) has been described as a "blueprint" for a secured creditor who seeks priority over the competing lien of the IRS. See Valley Bank, 528 F. Supp. at 911. Read literally, I.R.C. § 6323(a) permits the IRS to enjoy priority over a secured creditor as soon as the IRS files its tax lien notice, for upon the filing (but no earlier) the tax lien becomes valid. However, as Professors LoPucki and Warren explain, that interpretation is incorrect. To get the right answer from I.R.C. § 6323(a) one must read into it something it does not say: Tax liens and third party interests rank in the order in which they became "valid" within the meaning of the Federal Tax Lien Act. The idea of "first in time, first in right" is so basic that the drafters of I.R.C. § 6323 did not even consider it necessary to mention. LOPUCKI & WARREN, supra note 12, at 766; see also JOHN O. HONNOLD ET AL., SECURITY INTERESTS IN PERSONAL PROPERTY 201 (Teacher's Manual) (2d ed. 1992) ("Although the phrase, 'not valid . . . until notice . . . has been filed,' is infelicitous, to say the least, it is not read to subordinate retroactively security interests that existed prior to the filing of a notice.").
82. To be proper, the financing statement filed by AmeriBank must be signed by the Clinic, describe the medical equipment, and give the name and address of AmeriBank and the Clinic. See U.C.C. § 9-402(1).
83. If the medical equipment is located in a state that has adopted either of the first two alternative versions of U.C.C. § 9-401(1), then AmeriBank should file its financing statement with the office of the Secretary of State. See U.C.C. § 9-401(1)(b) (first and second alternatives). If the medical equipment is located in a state that has adopted the third alternative version of U.C.C. § 9-401(1), then AmeriBank should file a financing statement with the office of the Secretary of State and, if the Clinic does business in only one county in the state where the collateral is located, a second financing statement with the office of the county clerk of that county. Id. (third alternative).
84. "By far the most common source of federal tax liens is payroll taxes in the form of federal withholding taxes and social security contributions owed by employers to the U. S. Government." LOPUCKI & WARREN, supra note 12, at 757; see also SPEIDEL, supra note
proper notice of its tax lien with the appropriate filing officer on August 1. AmeriBank discovered the tax lien notice in September after ordering a routine lien search report on the Clinic.

On October 1, AmeriBank and the IRS each seeks a declaratory judgment stating that its interest in the collateral is superior to the interest of the other. Whose interest enjoys priority?

The initial issue that confronts AmeriBank is whether it is a holder of a “security interest,” a term defined by the I.R.C. as follows:

The term “security interest” means any interest in property acquired by contract for the purpose of securing payment or performance of an obligation or indemnifying against loss or liability. A security interest exists at any time (A) if, at such time, the property is in existence and the interest has become protected under local law against a subsequent judgment lien arising out of an unsecured obligation, and (B) to the extent that, at such time, the holder has parted with money or money’s worth.\(^5\)

Under the first sentence of the definition, AmeriBank’s interest in the medical equipment must (i) arise contractually and (ii) secure payment or performance of an obligation or indemnify AmeriBank against a loss or liability. Both requirements are satisfied as AmeriBank’s interest in the equipment arises from the security agreement, a contract,\(^8\) and the property interest secures the Clinic’s obligation to repay the $10,000 loan.

Under the second sentence, (i) the medical equipment must exist, or, to borrow a U.C.C. phrase, the taxpayer must have “rights in the collateral,”\(^7\)

12, at 417 (stating that “[t]he tax lien that a creditors’ rights lawyer is most likely to see is not one that arose out of nonpayment of income taxes on the revenue of the debtor, but rather it is a lien arising because of the debtor’s failure to withhold and pay over taxes on the salaries of employees.”).

85. I.R.C. § 6323(h)(1); see also S. REP. No. 1708, at 11, reprinted in 1966 U.S.C.C.A.N. at 3734 (stating that “[f]or Federal tax purposes, a security interest is not considered as existing until the conditions set forth [in I.R.C. § 6323(h)(1)] 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”).

86. Because the property interest must be acquired by contract, statutory property interests (e.g., mechanic’s liens) and judicial property interests (e.g., judgment liens) fall outside the I.R.C. definition of “security interest.” Cf. U.C.C. § 9-102(2) (“This Article applies to security interests created by contract . . . .”) (emphasis added); id. cmt. (“The main purpose of this Section is to bring all consensual security interests in personal property and fixtures under this Article . . . .”) (emphasis added).

87. See U.C.C. § 9-203(1)(c). “Under [present U.C.C. § 9-203], there can be no U.C.C. security interest in property if the debtor at the time of its purported creation has no rights therein. It would seem that subsection 6323(h)(1) is trying to say the same thing in
at a particular time, (ii) at that time AmeriBank's interest must be protected under local law against a subsequent judgment lien arising out of an unsecured obligation, and (iii) at such time AmeriBank must have parted with money or money's worth. When the second sentence of the definition is read together with I.R.C. § 6321(a), the important point in time when these three requirements must be present is the date when the IRS filed its tax lien notice.

Under the facts, the IRS filed its notice on August 1. As of this date, the Clinic had acquired the medical equipment. Also as of this date, AmeriBank's interest was protected under local law against a subsequent judgment lien arising out of an unsecured obligation. The applicable local law is the U.C.C.,88 particularly section 9-301(1)(b) of the U.C.C.,89

the words 'property is in existence.'" Peter F. Coogan, The Effect of the Federal Tax Lien Act of 1966 Upon Security Interests Created Under the Uniform Commercial Code, 81 HARV. L. REV. 1369, 1383 (1968); see also MICHAEL I. SALZMAN, IRS PRACTICE AND PROCEDURE § 16.03[2], at 16-11 (1981) ("The difference in terminology ('existence' versus 'rights in collateral') probably is not significant . . . ."); National Bank of Commerce v. Alabama Football, Inc., 20 U.C.C. REP. SERV. (Callaghan) 751, 756 (N.D. Ala. 1976) ("Section 6323(h)(1) provides that a 'security interest exists at any time if at such time the property is in existence . . . .'] Consequently, where the taxpayer has no rights in the collateral at the time the notice is filed, § 6323(a) affords no priority since there is no holder of a security interest."); Gold Coast Leasing Co. v. California Carrots, Inc., 155 Cal. Rptr. 511, 515 (Cal. Ct. App. 1979) ("When an agreement creates a security interest in after acquired property, that security does not 'exist' for purposes of section 6323(a) until the collateral is acquired by the debtor or until the debtor has rights in the collateral.").

Why did the I.R.C. drafters create a new phrase "property in existence" rather than use the U.C.C. phrase "rights in the collateral"? And why not borrow the U.C.C. concept of "value," see U.C.C. § 9-203(1)(b), rather than require the creditor to part with "money or money's worth"? "We are unable to discern the purpose for which the drafters of the Federal Tax Lien Act redefined and reconceptualized the Article 9 security interest. Maybe it was a slow day in the drafting department." See LOPUCKI & WARREN, supra note 12, at 777.

88. See Slodov v. United States, 436 U.S. 238, 257 n.22 (1978) ("The local law applicable is . . . the Uniform Commercial Code . . . ."); In re National Fin. Alternatives, Inc., 96 B.R. at 850 ("The applicable local law in this case [involving a priority dispute between a secured creditor and, as a holder of a tax lien, the federal government] is the Illinois Uniform Commercial Code . . . .")

The federal tax lien statutes were significantly amended as part of the Federal Tax Lien Act of 1966. The legislative history indicates that the amendments were "in part an attempt to conform the lien provisions of the internal revenue laws to the concepts developed in [the] Uniform Commercial Code." S. REP. NO. 1708, at 1, reprinted in 1966 U.S.C.C.A.N. at 3722; see also Slodov, 436 U.S. at 257 n.22 (citing legislative history); Griswold v. United States, 59 F.3d 1571, 1576 (11th Cir. 1995) (same); Rice Inv. Co., 625 F.2d at 569 (same); Manalis Fin. Co. v. United States, 611 F.2d 1270, 1273 (9th Cir. 1980) (same); In re National Fin. Alternatives, Inc., 96 B.R. at 850 (same); Valley Bank, 528 F. Supp. at 911 n.2 (same); Pine Builders, Inc., 413 F. Supp. at 80, 81 (same); Doan Resources Corp. v. United States, 81-2 U.S. Tax Cas. (CCH) ¶ 9523, at 87,726, 87,731 (May 27, 1981) (same);
which resolves a priority dispute between a secured creditor and a lien creditor in favor of the former if its interest is perfected no later than the moment that the interest of the lien creditor arises. AmeriBank's security interest was perfected on June 3, before August 1. AmeriBank's security interest became perfected on June 3 because on that date it filed a proper financing statement with the appropriate filing officer—one of the “applicable steps required for perfection”—and the security interest had previously attached or become enforceable. The security interest had attached 

Continental Fin., Inc. v. Cambridge Lee Metal Co., 70-2 U.S. Tax Cas. (CCH) ¶ 9592, at 84,466, 84,468 (June 1, 1970) (same); Overman, supra note 22, at 738 (“The main purpose of the [Federal Tax Lien] Act was to conform the relevant provisions of the Internal Revenue Code to the concepts promulgated in the U.C.C.”).

89. See Dragstrem v. Obermeyer, 549 F.2d 20, 23 (7th Cir. 1977) (“The relevant local law [under I.R.C. § 6323(h)(1)] is Section 9-301(1)(b) of the Uniform Commercial Code . . . .”); see also National Bank of Commerce, 20 U.C.C. REP. SERV. at 758; City of Houston v. United States, 86-1 U.S. Tax Cas. (CCH) ¶ 9101, at 83,005, 83,007 (Oct. 28, 1985); LOPUCKI & WARREN, supra note 12, at 777 (stating that “I.R.C. § 6323(h)(1) provides that a security interest comes into existence when it is protected by local law against a subsequent judgment lien . . . . [This portion of the statute] is a reference to U.C.C. § 9-301, the section that governs priority between a security interest and a judgment lien. In essence, a security interest is protected against a subsequent judgment lien under U.C.C. § 9-301 when it is perfected.”); cf. Manalis Fin. Co., 611 F.2d at 1274 (“The phrase ‘actions required under local law to establish the priority of a security interest’ generally describes the process of perfection.”); George W. Ulch Lumber Co. v. Hall Plastering, Inc., 477 F. Supp. 1060, 1070 (W.D. Mo. 1979) (“The better view is that a protected ‘security interest’ under § 6323(h)(1) means a perfected-security interest under Article 9.”).

90. “Although the two phrases are not the same, we can assume that, for purposes of subsection (a), subsection 6323(h)(1)’s ‘protected against’ the holder of a ‘subsequent judgment lien’ means substantially the same as ‘protected against’ section 9-301(3)’s ‘lien creditor.’” Coogan, supra note 87, at 1382-83; see also Dragstrem, 549 F.2d at 25 (“[C]ourts and commentators have universally concluded that ‘protected against a subsequent judgment lien’ is equivalent to being protected against the ‘lien creditor’ described in Section 9-301(3) of the U.C.C.”); Nevada Rock and Sand Co. v. United States, 376 F. Supp. 161, 169 (D. Nev. 1974) (“Protection against a ‘subsequent judgment lien’ holder is substantially the same as protection against the U.C.C. § 9-301(3) ‘lien creditor.’”); EPSTEIN & NICKLES, supra note 12, at 521 n.56 (concluding that “[t]he use of the term ‘judgment lien’ was unfortunate”); cf. Texas Oil & Gas Corp., 466 F.2d at 1047 (“The phrase ‘protected against a judgment lien’ is not a term of art easily adaptable to the sometimes equally unartful language of the Uniform Commercial Code.”).

Several cases have expressly held that the United States, as a holder of a tax lien, qualifies as a lien creditor as defined by U.C.C. § 9-301(3). See, e.g., Trigg, 465 F.2d at 1268; Nevada Rock and Sand Co., 376 F. Supp. at 165.


92. In distinguishing between the concepts of attachment and perfection, one court wrote:
earlier on June 1, because on that date the Clinic had signed a security agreement that created or provided for a security interest and described the medical equipment, AmeriBank had given value of $10,000, and the Clinic had rights in the medical equipment. Therefore, as of June 3, when perfection occurred, AmeriBank's interest in the medical equipment became protected under the local law of section 9-301(1)(b) of the U.C.C. against a judgment lien arising thereafter on August 1. Finally, by making the $10,000 loan to the Clinic on June 1, AmeriBank satisfied the statutory requirement that it part with "money or money's worth" before the IRS filed its notice on August 1.

93. Under U.C.C. § 9-303(1), "[a] security interest is perfected when it has attached and when all of the applicable steps required for perfection have been taken." Filing a financing statement is one of the "applicable steps" permitted for perfecting a security interest in equipment. U.C.C. § 9-303(1) (citing to the act of filing a financing statement under U.C.C. § 9-302). In fact, unless AmeriBank physically possesses the equipment it is required to file a financing statement in order to perfect its security interest.

94. See id. § 9-203(1) (describing elements of attachment); id. § 9-105(1)(l) (defining "security agreement"). If AmeriBank had filed its financing statement before the attachment date of June 1, then perfection would have occurred on June 1. See id. § 9-303 cmt. 1 ("If the steps for perfection have been taken in advance (as when [AmeriBank] files a financing statement before giving value [of $10,000 on June 1] or before the [Clinic] acquires rights in the collateral), then [AmeriBank's security] interest is perfected automatically when it attaches."). This concept of "pre-filing" is permitted by the U.C.C. See id. § 9-402(1) ("A financing statement may be filed before a security agreement is made or a security interest otherwise attaches.").

95. Under I.R.C. § 6323(h)(1), [t]he term "money or money’s worth" includes money, a security (as defined in paragraph (d) of this section), tangible or intangible property, services, and other consideration reducible to a money value. Money or money’s worth also includes any consideration which otherwise would constitute money or money’s worth under the preceding sentence which was parted with before the security interest would otherwise exist if, under local law, past consideration is sufficient to support an agreement giving rise to a security interest. A relinquishing or promised relinquishment of dower, curtesy, or of a statutory estate created in lieu of dower or curtesy, or of other marital rights is not a consideration in money or money’s worth. Nor is love and affection, promise of marriage, or any other consideration not reducible to a money value a consideration in money or money’s worth.

26 C.F.R. § 301.6323(h)-1(a)(3).
Because AmeriBank became a holder of a security interest before the IRS filed its notice, AmeriBank's interest in the medical equipment is superior to the interest of the IRS under the general rule of I.R.C. § 6323(a). Therefore, the court should enter a declaratory judgment in favor of AmeriBank.

Hypothetical #2
(emphasizing timely attachment)

AmeriBank made an unsecured $10,000 loan to the Clinic on June 1. Unknown to AmeriBank, the IRS had assessed a tax lien against the property of the Clinic on March 1 for unpaid withholding taxes and social security contributions of $25,000. The IRS filed a proper notice of its tax lien with the appropriate filing officer on August 1. AmeriBank discovered the tax lien filing in early September after ordering a routine lien search report on the Clinic. At AmeriBank’s insistence, the Clinic then executed a security agreement on September 15 that created an enforceable security interest in certain medical equipment (the collateral) that the Clinic had acquired in February. AmeriBank filed a proper financing statement with the appropriate filing officer on September 18.

On October 1, AmeriBank and the IRS each seeks a declaratory judgment stating that its interest in the collateral is superior to the interest of the other. Whose interest enjoys priority?

Both requirements of the first sentence of the definition of the term “security interest” are satisfied because AmeriBank’s interest in the collateral (i) arises contractually through the security agreement and (ii) secures the Clinic’s obligation to repay the $10,000 loan.96

Under the second sentence of the definition of “security interest,” (i) the medical equipment must exist, (ii) AmeriBank’s interest must be protected under local law against a subsequent judgment lien arising out of an unsecured obligation, and (iii) AmeriBank must have parted with money or money’s worth.97 AmeriBank must satisfy each requirement as of August 1, the filing date of the IRS notice.98 AmeriBank satisfies the first and the third requirements because the Clinic acquired the collateral in February and AmeriBank made the $10,000 loan in June. However, AmeriBank’s interest in the collateral is not protected under the applicable local law against the rights of a judgment lien creditor in the collateral arising on August 1.

AmeriBank’s interest is protected by section 9-301(1)(b) of the U.C.C. against a competing claim of the IRS as a lien creditor only if AmeriBank’s

96. See I.R.C. § 6323(h)(1) (first sentence).
97. Id. (second sentence).
98. Id. § 6323(a), (h)(1).
interest is perfected on August 1. AmeriBank cannot perfect its security interest until its interest has attached.\textsuperscript{99} Because AmeriBank had given value of $10,000 in June and the Clinic had acquired the collateral in February, AmeriBank’s interest attached on September 15 when the Clinic executed the security agreement that created a security interest in the described collateral.\textsuperscript{100} AmeriBank perfected its interest by filing a financing statement three days later.\textsuperscript{101} AmeriBank’s interest is protected under local law against judgment lien creditors with an interest in collateral arising on or after September 18, but not before that date. Therefore, as of August 1, AmeriBank’s interest is subordinate to the interest of the IRS.

Because AmeriBank did not become a holder of a security interest until after the IRS had filed its notice, AmeriBank does not qualify for the protection afforded to secured parties by I.R.C. § 6323(a). Therefore, the court should enter a declaratory judgment in favor of the IRS, whose interest in the medical equipment is superior to AmeriBank’s interest.

Hypothetical #3
( emphasize timely perfection)

AmeriBank loaned $10,000 to the Clinic on June 1. To secure repayment of the loan, the Clinic executed a security agreement on June 1 that created an enforceable security interest in specific equipment (the collateral) previously acquired by the Clinic. Unknown to AmeriBank, the IRS had assessed a $25,000 federal tax lien against the property of the Clinic on March 1 for overdue corporate income taxes. The IRS filed a proper tax lien notice with the appropriate filing officer on August 1. AmeriBank discovered the notice in September after ordering a routine lien search report on the Clinic. The report also reminded AmeriBank that it had never filed a financing statement. AmeriBank then filed a proper financing statement with the proper official on September 15.

On October 1, AmeriBank and the IRS each seeks a declaratory judgment stating that its interest in the collateral is superior to the interest of the other. Whose interest enjoys priority?

As in the prior hypotheticals, AmeriBank satisfies both requirements of the first sentence of the definition of the term “security interest”:

\textsuperscript{99} See U.C.C. § 9-303(1).
\textsuperscript{100} See id. § 9-203(1) ("[a] security interest . . . does not attach unless: (a) . . . ; (b) . . . ; and (c) . . . .") (emphasis added).
\textsuperscript{101} See id. § 9-303(1) (indicating that perfection occurs upon attachment and compliance with one of the referenced statutes, including U.C.C. § 9-302); id. § 9-302(1)(a) (requiring a secured party to file a financing statement to perfect a non-possessory security interest in equipment).
AmeriBank’s interest in the collateral (i) arises contractually through the security agreement and (ii) secures the Clinic’s obligation to repay the $10,000 loan.\textsuperscript{102}

For AmeriBank’s interest in the collateral to enjoy priority under I.R.C. § 6323(a), AmeriBank must also satisfy the following three requirements as of August 1, the filing date of the IRS notice: (i) the medical equipment must exist, (ii) AmeriBank’s interest must be protected under local law against a subsequent judgment lien arising out of an unsecured obligation, and (iii) AmeriBank must have parted with money or money’s worth.\textsuperscript{103} The first and third requirements are present because the Clinic already owned the collateral when AmeriBank made the $10,000 loan on June 1. As in Hypothetical #2, however, AmeriBank’s interest in the collateral is not protected by section 9-301(1)(b) of the U.C.C. against the rights of a judgment lien creditor in the collateral arising on August 1.

Unlike the situation in Hypothetical #2, where both attachment and perfection of AmeriBank’s security interest occurred after the IRS filed its notice, attachment of AmeriBank’s security interest in this hypothetical occurred before August 1. Attachment occurred on June 1, the date on which all three requirements of section 9-203(1) of the U.C.C. were first satisfied: the Clinic had rights in the collateral (sometime before June 1), AmeriBank had given value (June 1), and the Clinic had executed a security agreement that created a security interest in collateral described therein (June 1). However, AmeriBank did not perfect its security interest until it filed its financing statement on September 15.\textsuperscript{104} Because AmeriBank did not have a perfected interest in the collateral when the IRS filed its notice on August 1, AmeriBank’s interest is not protected under section 9-301(1)(b) of the U.C.C. against the rights of a lien creditor arising on that day. Therefore, AmeriBank does not have a security interest on August 1 and cannot qualify for the protection afforded by I.R.C. § 6323(a) to holders of security interests. As a result, the court should enter a declaratory judgment in favor of the IRS because its interest in the medical equipment is superior to the interest of AmeriBank.

\textsuperscript{102} See I.R.C. § 6323(h)(1) (first sentence).

\textsuperscript{103} See id. § 6323(a), (h)(1) (second sentence).

\textsuperscript{104} See supra note 101. In this hypothetical, AmeriBank lacks priority because it filed its financing statement 45 days after the IRS filed its tax lien notice. For a case in which a creditor (a law firm) lacked priority against the IRS because the creditor filed its financing statement two hours after the IRS filed its tax lien notice, see Black, Robertshaw, Frederick, Copple & Wright, P.C. v. United States, 634 P.2d 398, 399, 402-03 (Ariz. Ct. App. 1981).
Hypothetical #4
(illustrating applicability of purchase money exception)

AmeriBank loaned $10,000 to the Clinic on July 15 to permit the Clinic to buy specific equipment from Equipment Dealer who had refused to extend credit to the Clinic. To secure repayment of the loan, the Clinic executed a security agreement on July 15 that created a security interest in the equipment (the collateral) to be purchased. The Clinic used the $10,000 to acquire the equipment from Equipment Dealer on July 25. Equipment Dealer delivered the equipment to the Clinic three days later. AmeriBank did not file a proper financing statement with the appropriate officer until August 3. Unknown to AmeriBank, the IRS had assessed a $25,000 federal tax lien against the property of the Clinic on March 1 for overdue corporate income taxes. The IRS filed a proper notice of its tax lien with the appropriate filing officer on August 1. AmeriBank discovered the notice in September after ordering a routine lien search report on the Clinic.

On October 1, AmeriBank and the IRS each seeks a declaratory judgment indicating that its interest in the collateral is superior to the interest of the other. Whose interest enjoys priority?

Because its interest in the equipment secures the Clinic's obligation to repay the $10,000 loan and arises contractually through the security agreement, AmeriBank satisfies two of the requirements of the definition of the term "security interest." AmeriBank can also prove that as of August 1, when the IRS filed its notice, the collateral existed (the Clinic acquired the equipment on July 25) and AmeriBank had parted with money or money's worth (the $10,000 loan was funded on July 15). And for reasons that follow, AmeriBank's property interest is protected under applicable local law against the rights of a judgment lien creditor arising on August 1, even though AmeriBank filed its financing statement two days later.

In general, the rights of an unperfected secured party are subordinate to the rights of a person who becomes a lien creditor before the secured party perfects its security interest. If the lien creditor status of the IRS is pegged to the filing date of its notice, then the interest of the IRS in the equipment appears to enjoy priority over the security interest held by AmeriBank because AmeriBank did not perfect its interest until August 3.

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106. Id. § 6323(a), (h)(1).
107. See U.C.C. § 9-301(1)(b) (stating that "an unperfected security interest is subordinate to the rights of . . . a person who becomes a lien creditor before the security interest is perfected").
However, the general rule is expressly subject to the following exception:  

If the secured party files with respect to a purchase money security interest before or within ten days after the debtor receives possession of the collateral, he takes priority over the rights of a . . . lien creditor which arise between the time the security interest attaches and the time of filing.

For AmeriBank to avail itself of the protection afforded by this exception, its interest in the equipment must (1) attach before the rights of the lien creditor arise, (2) qualify as a purchase money security interest, and (3) be perfected by a financing statement filed no later than the tenth day following the day on which the Clinic first possessed the collateral.

The status of the IRS, as a lien creditor, arose on August 1 when it filed its tax lien notice. AmeriBank's security interest attached earlier on July 25, when all three requirements of section 9-203(1) of the U.C.C. were first satisfied: the Clinic had rights in the collateral (July 25), AmeriBank had given value (July 15), and the Clinic had executed a security agreement that created a security interest in collateral described therein (July 15). AmeriBank thus satisfies the first requirement of section 9-301(2) of the U.C.C. as its interest attached before the IRS filed its notice.

108. "Except as otherwise provided in subsection (2) . . . ."
109. Id. § 9-301(2).
111. A similar grace period is found in U.C.C. § 9-312(4), which resolves priority disputes in non-inventory collateral between a purchase money creditor and a non-purchase money creditor (rather than a purchase money creditor and a lien creditor). U.C.C. § 9-312(4). One author has stated the following reasons for the statutory grace periods:

*These grace periods accommodate the "transaction filing" systems developed under pre-Code law. Prior to adoption of the Code, conditional sellers and purchase money chattel mortgagees filed executed conditional sales contracts and chattel mortgages to perfect their liens. The drafters adopted the grace periods to conform the Code to these practices. Moreover, the grace periods expedite purchase money financing transactions. A supplier retaining a purchase money security interest need not delay delivery until filing if the supplier can obtain priority by filing within a subsequent grace period. Philip Lacy, Conflicting Security Interests in Inventory and Proceeds Under the Revised Article 9 of the Uniform Commercial Code, 41 S.C. L. REV. 247, 282 (1990) (footnotes omitted); see also In re Moore, 7 U.C.C. REP. SERV. (Callaghan) at 593 ("By affording a ten-day grace period within which an often inexperienced vendor may file a financing statement and yet prevail over an intervening lien creditor, the Code seeks to afford a commercially reasonable period within which the secured party in purchase money transactions can better protect himself.") (footnote omitted).
112. See I.R.C. § 6323(a), (h)(1).
The second requirement of section 9-301(2) of the U.C.C. is also present because AmeriBank's interest qualifies as a purchase money security interest (PMSI). The U.C.C. states that a security interest is a PMSI if it is either "taken or retained by the seller of the collateral to secure all or part of its price"113 or "taken by a person who by making advances or incurring an obligation gives value to enable the debtor to acquire rights in or the use of collateral if such value is in fact so used."114 AmeriBank's security interest qualifies as a PMSI under the second option115 because (i) AmeriBank made a $10,000 loan to the Clinic that enabled the Clinic to acquire rights in the collateral, and (ii) the Clinic actually used the loan proceeds to acquire rights in the collateral.116

AmeriBank must jump through one more hoop: it must have filed its financing statement no later than August 7, the tenth day following July 28 (the date on which the Clinic first possessed the collateral).117 Because

113. U.C.C. § 9-107(a).
114. Id. § 9-107(b).
115. AmeriBank's security interest does not qualify as a PMSI under U.C.C. § 9-107(a) because AmeriBank is not the "seller of the collateral." If Equipment Dealer had sold the equipment to the Clinic on credit and retained a security interest in the equipment to secure repayment of the purchase price, then Equipment Dealer's security interest would qualify as a PMSI under U.C.C. § 9-107(a). If, under the assumed facts of the previous sentence, AmeriBank had financed any required downpayment, then AmeriBank would have a PMSI in the equipment under U.C.C. § 9-107(b) to the extent of its down payment and Equipment Dealer would enjoy a PMSI in the equipment under U.C.C. § 9-107(a) to the extent of the unpaid purchase price.

116. A lender desiring to cloak its security interest with purchase money status should confirm that the debtor-purchaser is not using the loan proceeds to pay off the purchase price for an asset that it already owns. In such a situation, the lender's security interest does not qualify for purchase money status because the loan does not "enable the debtor to acquire rights in or the use of collateral . . . ." See id. § 9-107(1)(b); see also 8 HAWKLAND, supra note 110, § 9-107:03, at 355 ("If the debtor already has rights in collateral that he or she is using as security for an extension of new value or if the debtor already has the use of such collateral, the person injecting new value into the transaction will not obtain a PMSI.") (footnote omitted). Also, the prospective purchase money lender should forward the loan proceeds directly to the seller rather than advance the funds to the debtor-purchaser (or, alternatively, make a check jointly payable to the debtor-purchaser and the seller) to ensure that the loan "is in fact so used" by the debtor-purchaser to acquire rights in or use of the collateral. See U.C.C. § 9-107(b); see also 8 HAWKLAND, supra note 110, § 9-107:04, at 358-59 (stating that "the burden is on the secured party to establish that the value extended was in fact used to acquire rights in or the use of collateral"); WHITE & SUMMERS, supra note 91, § 33-5, at 325 (suggesting that a cancelled check payable directly to the seller or jointly to the seller and the debtor-purchaser "will evidence the purpose for which the loan was intended . . . and the way it was, in fact, used.").

117. The hypothetical facts stipulate that the Clinic first possessed the collateral on July 28 when Equipment Dealer delivered the equipment to the Clinic. Although not an issue here, determining when a debtor first possesses the collateral (which triggers the commence-
AmeriBank filed its financing statement on August 3, its filing was timely. The third and final requirement of section 9-301(2) of the U.C.C. is satisfied.

Having satisfied the three requirements of U.C.C. § 9-301(2), AmeriBank has priority over the rights of a lien creditor arising on August 1, and its interest in the collateral is protected under local law against a competing judgment lien arising on that date. Having previously satisfied the other statutory requirements, AmeriBank is a holder of a security interest on August 1 and qualifies for the protection afforded to such parties by I.R.C. § 6323(a). As a result, the court should enter a declaratory judgment in favor of AmeriBank.

Hypothetical #5
(illustrating limited applicability of purchase money exception)

AmeriBank loaned $10,000 to the Clinic on July 25 to permit the Clinic to buy specific equipment from Equipment Dealer who had refused to extend credit to the Clinic. While both parties contemplated that repayment of the loan would be secured by the equipment, they agreed not to execute a security agreement until the Clinic acquired the equipment. However, the Clinic agreed to execute, and AmeriBank filed, a proper financing statement with the appropriate officer on July 28. The Clinic used the $10,000 to acquire the equipment from Equipment Dealer on July 31. On August 3, the day that Equipment Dealer delivered the equipment to the Clinic, the Clinic executed a security agreement that created a security interest in the equipment. Unknown to AmeriBank, the IRS had assessed a $25,000 federal tax lien against the property of the Clinic on March 1 for overdue corporate income taxes. The IRS filed a proper notice of its tax lien with the appropriate filing officer on August 1. AmeriBank discovered the notice in September after ordering a routine lien search report on the Clinic.

On October 1, AmeriBank and the IRS each seeks a declaratory judgment indicating that its interest in the equipment is superior to the interest of the other. Whose interest enjoys priority?

Once again, AmeriBank satisfies the two requirements of the first sentence of the definition of the term "security interest" because AmeriBank’s interest in the equipment secures the Clinic’s obligation to
repay the $10,000 loan and arises contractually through the security agreement.119 Also, two of the three requirements of the second sentence of the definition are satisfied because the Clinic acquired the collateral (July 31) and AmeriBank made the $10,000 loan (July 25) before the IRS filed its notice (August 1).120

The determinative issue is whether AmeriBank’s interest in the collateral is protected under applicable local law against the rights of a judgment lien creditor arising on August 1. Even though AmeriBank filed its financing statement on July 28, its interest remained unperfected when the IRS filed its notice on August 1. AmeriBank’s interest remained unperfected because the interest had not yet attached, and attachment is a necessary predicate to perfection.121 AmeriBank’s interest did not attach until August 3, the date on which all three requirements of section 9-203(1) of the U.C.C. were first satisfied: the Clinic had rights in the collateral (July 31), AmeriBank had given value (July 25), and the Clinic had executed a security agreement that created a security interest in collateral described therein (August 3). Because AmeriBank filed its financing statement before attachment had occurred,122 the security interest became perfected at the moment of attachment.123 As attachment and perfection did not occur until August 3, AmeriBank’s interest is subordinate to the rights of a person who became a lien creditor on August 1.124 And although AmeriBank’s interest is a PMSI125 and its financing statement was filed before the tenth day after the Clinic first possessed the collateral, AmeriBank cannot claim the protection afforded by section 9-301(2) of the U.C.C. Why? Because AmeriBank’s security interest attached on August 3, two days after the IRS filed its notice.126

119. See id. (first sentence).
120. Id. (second sentence); id. § 6323(a), (h)(1).
121. See U.C.C. § 9-303(1) (“A security interest is perfected when it has attached and when all of the applicable steps [such as filing a financing statement] have been taken.”) (emphasis added); see also id. § 9-303 cmt. 1.
122. A secured party need not wait until attachment has occurred before filing its financing statement. See id. § 9-402(1) (“A financing statement may be filed before a security agreement is made or a security interest otherwise attaches.”).
123. See id. § 9-303 cmt. 1 (“If the steps for perfection have been taken in advance [of attachment] (as when the secured party files a financing statement before giving value or before the debtor acquires rights in the collateral), then the interest is perfected automatically when it attaches.”).
124. See id. § 9-301(1)(b).
125. See supra notes 113-16 and accompanying text.
126. A literal reading of U.C.C. § 9-301(2) suggests that AmeriBank falls within its protection. Because AmeriBank filed its financing statement before the Clinic possessed the equipment for ten days, AmeriBank technically enjoys priority under U.C.C. § 9-301(2) because the interest of the IRS as a lien creditor arose on August 1, a date that falls “between the time the security interest attached (August 3) and the time of filing (July 28).” See
Not being protected under local law against the rights of a lien creditor arising on August 1 prevents AmeriBank from claiming a security interest under I.R.C. § 6323(h)(1). Therefore, AmeriBank cannot qualify for the protection afforded by I.R.C. § 6323(a) to holders of security interests. As a result, the court should enter a declaratory judgment in favor of the IRS.

Hypothetical #6
(emphasizing the "money or money's worth" requirement)

On June 1, AmeriBank entered into a binding commitment to loan an aggregate amount of up to $10,000 to the Clinic in one or more advances. To secure repayment of all of the advances, the Clinic executed a security agreement on June 1 that created an enforceable security interest in specific equipment then owned by the Clinic (the collateral) worth $25,000. AmeriBank filed a proper financing statement with the appropriate filing officer on June 3. It advanced $5,000 on July 15 and $2,000 on August 15. Unknown to AmeriBank, the IRS had assessed a $25,000 federal tax lien against the property of the Clinic on March 1 for overdue corporate income taxes. The IRS filed a proper notice of its tax lien with the appropriate filing officer on August 1. AmeriBank discovered the notice in September after ordering a routine lien search report on the Clinic.

On October 1, AmeriBank and the IRS each seeks a declaratory judgment indicating that its interest in the collateral is superior to the interest of the other. Whose interest enjoys priority?

As in prior hypotheticals, AmeriBank easily satisfies many of the statutory requirements of a security interest under I.R.C. § 6323(h)(1). AmeriBank’s interest secures the Clinic’s obligation to repay all advances. However, the placement of the phrase “the time the security interest attaches” before “the time of filing” suggests that the drafters contemplated the situation in which attachment precedes filing and the interest of the lien creditor arises between the two acts, rather than the situation presented by the hypothetical, where filing precedes attachment, and the interest of the lien creditor arises after filing but before attachment. The policy reasons for the grace period lend further support to the idea that U.C.C. § 9-301(2) applies only if attachment predates the creation of the lien creditor’s interest. See supra note 111; see also 8 HAWKLAND, supra note 110, § 9-301:05, at 908 (concluding that a purchase money lender that timely filed a financing statement “will take priority over the rights of the lien creditor which arose after the secured interest attached and before the filing”) (emphasis added).

127. Article 9 permits collateral to secure repayment of present and future advances if the security agreement so provides. See U.C.C. § 9-204(3); id. cmt. 5. In general, a security interest securing future advances enjoys the same priority as the security interest securing the first advance. See id. § 9-312(7).
and arises contractually through the security agreement. Additionally, the Clinic had acquired the collateral before the IRS filed its notice on August 1.

AmeriBank also satisfies the requirement that its interest in the property be protected against the rights of a lien creditor arising on August 1. Its interest became enforceable on June 1 when the three elements of attachment were first present: the Clinic had rights in the collateral (sometime prior to June 1), AmeriBank had given value (June 1), and the Clinic had executed a security agreement that created a security interest in the collateral (June 1). Because attachment had already occurred, AmeriBank's security interest became perfected when it filed its financing statement on June 3. Therefore, under section 9-301(1)(b) of the U.C.C., AmeriBank's security interest was protected under local law against the rights of a lien creditor subsequently arising on August 1. But to what extent is AmeriBank's security interest protected? Only $5,000—the amount of the advance funded before the IRS filed its notice on August 1? Or $7,000—the amount of both advances, including the $2,000 advance funded after the IRS filed its notice?

The answer is found in another provision of local law, U.C.C. § 9-301(4), which provides:

A person who becomes a lien creditor while a security interest is perfected takes subject to the security interest only to the extent that it secures advances made before he becomes a lien creditor or within 45 days thereafter or made without knowledge of the lien or pursuant to a commitment entered into without knowledge of the lien.

To paraphrase the statute, the interest of a lien creditor is subordinate or junior to a perfected security interest that secures repayment of any advance funded by the secured party (i) before the party became a lien creditor, (ii) within forty-five days after the party became a lien creditor, (iii) without knowledge of the competing interest of the lien creditor (even if the advance is funded more than forty-five days after the interest of the lien creditor first arose), or (iv) under a commitment entered into without knowing of the interest of the lien creditor (even if the secured party subsequently acquires

129. Id. (second sentence); id. § 6323(a), (h)(1).
130. Id. § 6323(h)(1) (second sentence).
131. U.C.C. § 9-203(1)(b) requires the secured party to give “value.” Value includes “a binding commitment to extend credit . . . whether or not drawn upon . . . .” U.C.C. § 1-201(44)(a). Therefore, the date of the commitment (June 1), rather than the date of the first advance (July 15), is the date when AmeriBank first gave value. See WHITE & SUMMERS, supra note 91, § 31-11, at 147 n.4.
132. See supra note 101.
133. U.C.C. § 9-301(4) (emphasis added).
such knowledge and even if the advance is funded more than forty-five days after the interest of the lien creditor first arose). The statute provides the lender with four possible safe havens, and the disjunctive nature of the statutory language means that the advance is protected if it falls within the ambit of any of the havens.134

AmeriBank can invoke the protection afforded by U.C.C. section 9-301(4) because the IRS filed its notice on August 1, after AmeriBank's interest became perfected on June 3. The section protects the $5,000 advance because AmeriBank funded it on July 15, before the interest of the lien creditor arose.135 The section also protects the $2,000 funded on August 15 for any of three alternative reasons: (i) the advance was funded within forty-five days after August 1, (ii) the advance was funded before AmeriBank acquired knowledge136 in September of the tax lien filing, and (iii) the advance was funded pursuant to a commitment137 entered into in June, long before AmeriBank had knowledge of the tax lien filing.138

134. Professors White and Summers explain:
One might argue that a lien creditor should never be subordinated to a secured creditor's interest to the extent that the secured creditor advances more money after the lien creditor's interest attaches. The drafters have essentially rejected that argument. . . . In the first place the lien creditor is theoretically not injured because the debtor's estate has increased by the amount of the subsequent advance. In the second place who cares? The cases in which a secured creditor will willingly make subsequent advances after another creditor has gone through the tedious process leading to a judicial lien on the collateral are likely to be as scarce as hen's teeth. WHITE & SUMMERS, supra note 91, § 33-2, at 314. For one of these situations "as scarce as hen's teeth," see infra note 167.

135. See U.C.C. § 9-301(4) (describing the first safe haven).

136. AmeriBank is not deemed to have knowledge of the tax lien notice as soon as the IRS files its notice in the public records under a theory of constructive knowledge. "A person 'knows' or has 'knowledge' of a fact when he has actual knowledge of it." Id. § 1-201(25) (emphasis added); see also International Harvester Credit Corp. v. Pefley, 458 N.E.2d 257, 265 (Ind. Ct. App. 1983) (concluding that "knowledge" means "actual rather than constructive knowledge"); cf. infra note 144 (discussing actual notice or knowledge).

137. "An advance is made 'pursuant to commitment' if the secured party has bound himself to make it, whether or not a subsequent event of default or other event not within his control has relieved or may relieve him from his obligation . . . ." U.C.C. § 9-105(1)(k). A lender that commits itself to make advances up to a predetermined ceiling usually includes a provision in the loan documents that relieves it of any continued funding obligations if a default (as defined in the loan documents) exists. As indicated by U.C.C. § 9-105(1)(k), advances funded under a contract that includes such an "out" clause are still advanced "pursuant to commitment."

138. Because AmeriBank funded the second advance pursuant to a commitment entered into by the parties before AmeriBank had knowledge of the tax lien notice, the advance would enjoy the protection of the last safe haven of U.C.C. § 9-301(4) even if AmeriBank had funded the advance after the relevant 45-day period or with knowledge of the tax lien notice. See id. § 9-301(4).
Despite being protected under the U.C.C. for the full $7,000, AmeriBank only has a security interest "to the extent that, at [August 1, it] has parted with money or money's worth." AmeriBank has parted with $7,000, but as of August 1 it had parted with only $5,000. Therefore, AmeriBank only has a "security interest" under I.R.C. § 6323(h)(1) to the extent of $5,000, and the protection afforded by I.R.C. § 6323(a) to AmeriBank as a holder of a security interest is limited to that amount.

If the collateral is sold, the court should distribute the first $5,000 to AmeriBank, the next $25,000 to the IRS, the next $2,000 to AmeriBank, and the balance to the Clinic. Because the tax lien encumbers all of the Clinic's property, the IRS can look to additional assets of the Clinic to satisfy the unpaid portion of its lien if the collateral is sold for less than $30,000. AmeriBank is not so fortunate; its consensual lien does not extend to any other assets of the Clinic. However, AmeriBank need not look to other property to satisfy the unpaid advance of $2,000, for the I.R.C. affords protection to AmeriBank in provisions other than just I.R.C. § 6323(a).

Analysis of one such provision follows.

139. See I.R.C. § 6323(h)(1) (defining "security interest"); see also William T. Plumb, Jr., What the Banker Should Know About Federal Tax Liens and Levies—Revisited, 84 Banking L.J. 1, 19 n.69 (1967) ("Although the loan commitment constitutes 'value' under § 1-201(44)(a) of the Uniform Commercial Code, a security interest is protected against federal tax liens only to the extent that the holder 'has parted with money or money's worth' . . . . In context, it is clear that the commitment itself is not money or money's worth."); William F. Young, Jr., Priority of the Federal Tax Lien, 34 U. Chi. L. Rev. 723, 739 (1967) (concluding that the money or money's worth requirement "is evidently designed to exclude security interests so far as they depend upon the [Uniform Commercial] Code's 'binding commitment'"). That Congress had this result in mind is borne out by the protection expressly afforded by I.R.C. §§ 6323(c) and (d), discussed infra parts III.C. and B., respectively, to advances funded after the IRS has filed its tax lien notice. However, at least one scholar, believing the argument to be "far from conclusive," is convinced that a lender's binding commitment satisfies the money or money's worth requirement. See Coogan, supra note 87, at 1391-94; see also Baird & Jackson, supra note 22, at 226 (Teacher's Manual) (arguing that a binding commitment satisfies the money or money's worth requirement "not so much because it satisfies the U.C.C.'s definition of value, but because such a promise is readily convertible into cash"). But see 26 C.F.R. § 301.6323(d)-1(b) example 2 (illustrating that a creditor that makes a loan after a tax lien filing but pursuant to a commitment entered into before the tax lien filing does not have a security interest under I.R.C. § 6323(h)(1) because the creditor has not parted with money or money's worth before the tax lien filing); William T. Plumb, Jr., Federal Liens and Priorities—Agenda for the Next Decade, 77 Yale L.J. 605, 671 n.399 (responding to Coogan's position).

140. See I.R.C. § 6321 (indicating that the tax lien extends to "all property and rights to property, whether real or personal, belonging to [the delinquent taxpayer]").

141. Is it just me, or has anyone else noticed that half of "analysis" is "anal"?
B. Protection for Post-Notice Advances  
(But Not Post-Notice Property)

A lender only holds a security interest under I.R.C. § 6323(h)(1) to the extent that it has parted with money or money's worth as of the date on which the IRS files its notice. In effect, I.R.C. § 6323(a), which protects holders of security interests, excludes from its coverage every advance funded by a lender after the IRS files its notice, and a lender’s interest in collateral that secures repayment of those post-notice advances is junior to the competing claim of the IRS. However, the protection afforded by the I.R.C. to secured lenders is not found solely in I.R.C. § 6323(a). I.R.C. § 6323(d) offers some solace, particularly to lenders who fund post-notice advances.

I.R.C. § 6323(d) states:

Even though notice of a lien imposed by section 6321 has been filed, such lien shall not be valid with respect to a security interest which came into existence after tax lien filing by reason of disbursements made before the forty-sixth day after the date of tax lien filing, or (if earlier) before the person making such disbursements had actual notice or knowledge of tax lien filing, but only if such security interest

(1) is in property (A) subject, at the time of tax lien filing, to the lien imposed by section 6321, and (B) covered by the terms of a written agreement entered into before tax lien filing, and

(2) is protected under local law against a judgment lien arising, as of the time of tax lien filing, out of an unsecured obligation.\textsuperscript{142}

This provision offers future advance protection to a secured party who can satisfy its five statutory requirements. First, the advance must be funded before the forty-sixth day after the date on which the IRS files its notice.\textsuperscript{143} Second, the advance cannot be made after the secured party has actual notice or knowledge\textsuperscript{144} of the tax lien filing, even if the advance is...

\textsuperscript{142} I.R.C. § 6323(d).
\textsuperscript{143} Id.
\textsuperscript{144} The I.R.C. provides:

[A]n organization shall be deemed for purposes of a particular transaction to have actual notice or knowledge of any fact from the time such fact is brought to the attention of the individual conducting such transaction, and in any event from the time such fact would have been brought to such individual's attention if the organization had exercised due diligence. An organization exercises due diligence if it maintains reasonable routines for communicating significant information to the person conducting the transaction and there is reasonable compliance with the routine. Due diligence does not require an individual acting for the organization to communicate information unless such communication is part of his regular duties or unless he has reason to know of the transaction and that the transaction would be materially affected by the information.
funded before the forty-sixth day following the filing date of the notice.\textsuperscript{145} Third, the taxpayer must have rights in the collateral before the IRS files its notice.\textsuperscript{146} Fourth, the creditor’s property interest must arise from a written agreement executed before the tax lien filing.\textsuperscript{147} And fifth, the secured party’s interest in the property must be protected under local law against the interest of a lien creditor arising on the date of the tax lien filing.\textsuperscript{148}

With the exception of the first two requirements, which address whether post-notice advances qualify for protection, I.R.C. § 6323(d) does not require the secured party to prove much more than it must prove under I.R.C. § 6323(a) and the accompanying statutory definition of the term “security interest” at I.R.C. § 6323(h)(1). As indicated above,\textsuperscript{149} clause (d) requires the taxpayer to have rights in the collateral when the IRS files its tax lien notice, and it also mandates that the secured party’s interest in the collateral must be protected against the competing claim of a lien creditor as of the filing date of the tax notice. Clause (a) also has the same two requirements.\textsuperscript{150}

Clause (d) requires the creditor’s property interest to arise from a written agreement executed before the IRS files its notice.\textsuperscript{151} Clause (a) does not require a written agreement, but it does require the secured party to acquire its interest in the property “by contract.”\textsuperscript{152} Although an oral agreement

\textsuperscript{Id.} § 6323(i)(1); cf. U.C.C. § 1-201(27) (using the same substantive language in discussing when “[n]otice, knowledge or a notice of notification received by an organization is effective for a particular transaction”). The I.R.C. does not state when an individual has actual notice or knowledge of a fact; cf. id. § 1-201(25) (indicating when a “person” has “notice” or “knowledge”); id. § 1-201(30) (defining “person” as including “an individual or an organization”).

The IRS has the burden of proving that the secured party had actual notice or knowledge that the IRS had filed its tax lien notice. See S. REP. No. 1708, at 12, reprinted in 1966 U.S.C.C.A.N. at 3735; John J. Creedon, The Federal Tax Lien Act of 1966—An Historic Breakthrough, 4 HARV. J. ON LEGIS. 163, 189 (1967); Plumb, supra note 66, at 273.

\textsuperscript{145} I.R.C. § 6323(d).
\textsuperscript{146} Id. § 6323(d)(1)(A).
\textsuperscript{147} Id. § 6323(d)(1)(B).
\textsuperscript{148} Id. § 6323(d)(2).
\textsuperscript{149} See supra notes 146, 148, and accompanying text.
\textsuperscript{150} See I.R.C. § 6323(a) (giving priority to a holder of a security interest that exists when the IRS files notice of its tax lien); id. § 6323(h)(1) (indicating that a security interest does not exist when the IRS files notice of its tax lien unless “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”).
\textsuperscript{151} See supra note 147 and accompanying text.
\textsuperscript{152} See I.R.C. § 6323(a) (giving priority to a holder of a security interest that exists when the IRS files notice of its tax lien); id. § 6323(h)(1) (defining “security interest” as “any interest in property acquired by contract”) (emphasis added).

Unlike the limitations found in the second sentence of I.R.C. § 6323(f)(1), which expressly fall into place when the IRS files its notice, the contractual requirement described
can create an enforceable security interest under the U.C.C., it does so only if the collateral is either (i) in the possession of the secured party or (ii) "investment property" subject to the secured party's "control." 153 In many situations, however, the secured party either will not possess the collateral (e.g., inventory and equipment that the debtor must control in order to operate its business) or cannot possess the collateral (e.g., accounts, which have no tangible form), or the collateral will not consist of investment property (e.g., stocks, bonds, and mutual fund shares). And in many, if not most, secured transactions the secured party acquires its interest in collateral by a written agreement, thus satisfying both the contract and written agreement requirements of clauses (a) and (d), respectively. Only in the limited situation in which the secured party's interest in collateral arises by oral rather than written agreement will the secured party find refuge in clause (a) but not clause (d). If a written agreement creates the secured party's interest in the collateral, then the secured party need not prove anything more under clause (d) than under clause (a), other than the timeliness of the future advance and lack of notice or knowledge of the tax lien filing on the funding date.

Under the facts of Hypothetical #6, AmeriBank acquired its interest in the property under the terms of a written agreement executed before the IRS filed its tax lien notice. Having previously proved two other requirements of clause (d) as part of its case under I.R.C. § 6323(a) and I.R.C. § 6323(h)(1)—(i) the Clinic had acquired the collateral before the IRS filed its notice and (ii) AmeriBank's interest in the collateral is fully protected under local law for both advances154—AmeriBank need only prove that it funded the $2,000 timely and without knowledge of the tax lien filing in order to claim the protection extended to that advance by clause (d). AmeriBank can do so because it funded the $2,000 advance on August 15, which was (i) within forty-five days after the filing date of the tax notice155 and (ii) before AmeriBank discovered the notice in September.156

in the first sentence arguably need not yet be satisfied as of the filing date. However, if the contract creating the interest in the pre-notice property does not exist when the IRS files its notice, the creditor's interest will not be perfected on the filing date. This prevents the creditor from being protected by U.C.C. § 9-301(1)(b) against a lien creditor on the date that the notice is filed. It is this requirement in the second sentence of I.R.C. § 6323(h)(1), which must be satisfied as of the filing date of the tax lien notice, that effectively requires the creditor's interest to arise from a pre-notice contract.

153. U.C.C. § 9-203(1)(a); see also U.C.C. § 9-115(1)(e) (defining "control"); id. § 9-115(1)(f) (defining "investment property").

154. See supra notes 130-32, 135-38, and accompanying text.

155. The fact that U.C.C. § 9-301(4) has a 45-day grace period similar to that found in I.R.C. § 6323(d) is more than coincidence. See U.C.C. § 9-301 cmt. 7. Note, however, that the 45-day period is absolute under the U.C.C. but not under the I.R.C.

156. See I.R.C. § 6323(d) (protecting property interests which secure repayment of
Because AmeriBank has satisfied all of the requirements of I.R.C. §§ 6323(a) and 6323(d), AmeriBank’s interest in the collateral is superior to the interest of the IRS to the full extent of its advances, $7,000. If the collateral is sold in order to satisfy the claims of AmeriBank and the IRS, the court should distribute the first $7,000 to AmeriBank and the balance (up to $25,000) to the IRS. As the tax lien encumbers all of the Clinic’s property, the IRS can look to additional assets of the Clinic to satisfy the unpaid portion of its lien if the collateral sells for less than $32,000. AmeriBank is not so fortunate; its consensual lien does not extend to any other assets of the Clinic. Therefore, AmeriBank must hope that any sale yields at least $7,000.

Hypothetical #7
(emphasizing timeliness limitation)

On June 1, AmeriBank entered into a binding commitment to loan up to $10,000 to the Clinic in one or more advances. To secure repayment of all advances, the Clinic executed a security agreement on June 1 that created an enforceable security interest in specific equipment (the collateral) worth $25,000 then owned by the Clinic. AmeriBank filed a proper financing statement with the appropriate filing officer on June 3. AmeriBank funded four advances of $2,500 on June 18, July 18, August 18, and September 18. Unknown to AmeriBank, the IRS had assessed a $25,000 federal tax lien against the property of the Clinic on March 1 for unpaid withholding taxes and social security contributions. The IRS filed a proper tax lien notice with the appropriate filing officer on August 1. AmeriBank discovered the notice on October 10 after ordering a routine lien search report on the Clinic.

On November 1, AmeriBank and the IRS each seeks a declaratory judgment indicating that its interest in the collateral is superior to the interest of the other. Whose interest enjoys priority?

AmeriBank cannot rely solely on the protection afforded to secured creditors by I.R.C. § 6323(a) because it funded two of the four advances after the IRS filed its tax lien notice. AmeriBank will invoke the post-notice advance protection of I.R.C. § 6323(d), but as the following analysis illustrates, that protection will cover only one of the two post-notice advances.

"disbursements made before the forty-sixth day after the date of tax lien filing, or (if earlier) before the person making such disbursements had actual notice or knowledge of tax lien filing") (emphasis added).

157. See id. § 6321 (indicating that the tax lien extends to "all property and rights to property, whether real or personal, belonging to [the delinquent taxpayer]").
The two property-related requirements of I.R.C. § 6323(a) (through (h)(1)) and I.R.C. § 6323(d) are satisfied. First, the Clinic acquired the collateral before June 1 and thus had rights in the collateral before the IRS filed its notice on August 1. Second, the property interest was created by a written agreement executed on June 1, long before the IRS filed its notice.

The "protected under local law" requirement is also satisfied. AmeriBank’s interest attached on June 1, the earliest date on which (i) the Clinic had rights in the collateral (sometime before June 1), (ii) the Clinic executed a security agreement that created a security interest in collateral described therein (June 1), and (iii) AmeriBank gave value (June 1). Perfection occurred thereafter on June 3 when AmeriBank filed its financing statement. Because AmeriBank perfected its interest before the interest of the lien creditor arose on August 1, AmeriBank’s interest is protected under local law. As a result of having a security interest perfected before August 1, and because AmeriBank did not discover the tax notice until October, AmeriBank can cloak all four advances with the protection afforded by U.C.C. § 9-301(4).

158. See id. § 6323(a) (giving priority to a holder of a security interest that exists when the IRS files notice of its tax lien); id. § 6323(d)(1) (protecting security interests “in property (A) subject, at the time of tax lien filing, to the lien imposed by section 6321”); id. § 6323(h)(1) (indicating that a security interest does not exist when the IRS files notice of its tax lien unless “at such time, the property is in existence”).

159. See id. § 6323(a) (giving priority to a holder of a “security interest” that exists when the IRS files notice of its tax lien); id. § 6323(d)(1) (protecting security interests “in property . . . (B) covered by the terms of a written agreement entered into before tax lien filing”); id. § 6323(h)(1) (indicating that a “security interest” means “any interest in property acquired by contract”).

160. See id. § 6323(a) (giving priority to a holder of a security interest that exists when the IRS files notice of its tax lien); id. § 6323(d)(2) (protecting security interests that are “protected under local law against a judgment lien arising, as of the time of tax lien filing, out of an unsecured obligation”); id. § 6323(h)(1) (indicating that a “security interest exists at any time (A) if, at such time . . . the interest has become protected under local law against a subsequent judgment lien arising out of an unsecured obligation”).

161. See U.C.C. § 9-203(1) (listing the elements of attachment); see also supra note 131 (discussing when value is first given).

162. See id. § 9-302(1)(a); id. § 9-303(1).

163. See id. § 9-301(1)(b).

164. See id. § 9-301(4) (affording protection to advances “made without knowledge of the lien”). Even if AmeriBank had funded advances after (i) discovering the tax notice or (ii) the 45-day period following August 1, the rights of the lien creditor in the collateral would remain subject to AmeriBank’s interest for all of the advances—not just those made without knowledge of the tax notice or before such forty-fifth day—since the advances were made “pursuant to a commitment entered into [by AmeriBank] without knowledge of the lien.” See id. § 9-301(4).
Although the local law of the U.C.C. affords protection to all four advances, the protection afforded by I.R.C. § 6323(a) is limited to the first two advances made before the IRS filed its tax lien notice. AmeriBank must seek the protection of clause (d) for the two advances made after August 1. However, "subsection 6323(d) does not give the secured party as much protection against a tax lien as subsection 9-301(4) gives him against a lien creditor." Under clause (d), AmeriBank must fund the advance without knowledge of the tax lien filing and before the forty-sixth day following the date of the IRS tax lien filing. The third advance is protected by clause (d) because AmeriBank did not yet know of the tax lien filing on the funding date of August 18 (which is before the forty-sixth day following the filing date). While AmeriBank funded the fourth advance without knowledge of the tax lien filing, the funding date of September 18 is just beyond September 15—the forty-fifth day following August 1. Therefore, the fourth advance is not protected by clause (d).

AmeriBank’s interest in the collateral is superior to the interest of the IRS to the extent of the first two advances under I.R.C. § 6323(a) and the third advance under I.R.C. § 6323(d). If the collateral is sold in order to satisfy the claims of AmeriBank and the IRS, the court should distribute the first $7,500 to AmeriBank, the next $25,000 to the IRS, and up to $2,500 of any remaining proceeds to AmeriBank. As the tax lien encumbers all of the Clinic’s property, the IRS may satisfy the unpaid portion of its lien

165. See I.R.C. § 6323(a) (giving priority to a holder of a “security interest” that exists when the IRS files notice of its tax lien); id. § 6323(h)(1) (indicating that a “security interest” is limited to “the extent that, at such time, the holder has parted with money or money’s worth”).

166. HAWKLAND, supra note 110, § 9-301:08, at 930.

167. Conceivably, a secured party could have actual notice or knowledge of the earlier tax assessment but not the later tax lien filing. Determining whether notice or knowledge of the former imposes a duty of inquiry on the secured party before it can successfully argue that it made advances without actual notice or knowledge of the tax lien filing, however, is not an issue likely to present itself. Why? Because few lenders will advance funds after acquiring notice or knowledge of the tax assessment. One creditor that might continue to fund post-knowledge advances is the inventory financier. By continuing to fund advances, the creditor permits the debtor-taxpayer to complete its manufacturing process and then sell the finished goods at a price that increases the likelihood that the creditor and the IRS will be paid more on their respective claims than if the inventory remains unfinished. A creditor that finds itself in such a situation may attempt to improve its priority position by entering into a subordination agreement with the IRS pursuant to I.R.C. § 6325(d). See generally Coogan, supra note 87, at 1414-15; Plumb, supra note 66, at 276, 279.

168. See I.R.C. § 6323(d) (protecting property that secures repayment of “disbursements made before the forty-sixth day after the date of tax lien filing, or (if earlier) before the person making such disbursements had actual notice or knowledge of tax lien filing”) (emphasis added).

169. See id. § 6321.
out of the Clinic's other assets if the collateral sells for less than $32,500. AmeriBank is not so fortunate; its consensual lien does not extend to any other assets of the Clinic. Therefore, AmeriBank must hope that the fair market value of the collateral is at least $35,000.

Hypothetical #8
(emphasizing "no knowledge or notice" limitation)

On June 1, AmeriBank loaned $5,000 to the Clinic. To secure repayment of the $5,000 loan, as well as any future loans from AmeriBank to the Clinic, the Clinic executed a security agreement on June 1 that created an enforceable security interest in specific equipment (the collateral) worth $25,000 then owned by the Clinic. AmeriBank filed a proper financing statement with the appropriate filing officer on June 3. AmeriBank made three additional loans to the Clinic of $5,000 each on July 1, August 10, and September 1. The Clinic did not disclose that the IRS had assessed a $25,000 federal tax lien against the property of the Clinic on March 1 for overdue corporate income taxes. The IRS filed a proper notice of its tax lien with the appropriate filing officer on August 1. AmeriBank discovered the notice on August 29 after ordering a routine lien search report on the Clinic.

On October 1, AmeriBank and the IRS each seeks a declaratory judgment indicating that its interest in the collateral is superior to the interest of the other. Whose interest enjoys priority?

AmeriBank funded two of the four advances after the IRS filed its notice, so it cannot rely solely on the protection afforded to secured creditors by I.R.C. § 6323(a). AmeriBank will seek to extend the protection of I.R.C. § 6323(d) to the two post-notice advances but will be only partially successful.

The two property-related requirements of I.R.C. § 6323(a) (through (h)(1)) and I.R.C. § 6323(d) are satisfied. First, the Clinic acquired the collateral before June 1 and thus, had rights in the collateral before the IRS filed its notice. Second, AmeriBank is claiming its interest in the collateral through the written security document executed on June 1, long before August 1.

Additionally, AmeriBank's interest is protected under local law to the full extent of all four advances against the competing claim of a judgment lien creditor arising as of August 1. AmeriBank's interest in the collateral attached on June 1, the earliest date on which (i) the Clinic had

170. See supra note 158.
171. See supra note 159.
172. See supra note 160.
rights in the collateral (sometime before June 1), (ii) the Clinic executed a security agreement that created a security interest in collateral described therein (June 1), and (iii) AmeriBank gave value (June 1). AmeriBank perfected its interest in the collateral on June 3 by filing its financing statement. Because AmeriBank perfected its interest before the IRS filed its tax lien notice on August 1, AmeriBank’s interest is protected under local law against the competing property claim of the IRS. This protection covers all four advances—including those funded after August 1—even though AmeriBank funded the last advance three days after it had discovered the tax lien filing. Why? All of the advances were made either before the IRS filed its notice on August 1 “or within 45 days thereafter . . .” Therefore, the priority that AmeriBank enjoys under local law in the collateral extends to all four advances.

Unfortunately for AmeriBank, the mercy afforded by the I.R.C. to advances is not so broad. The protection afforded by I.R.C. § 6323(a) is limited to the two pre-notice advances. The two post-notice advances do satisfy the timeliness requirement of I.R.C. § 6323(d): they were funded before September 16 (the forty-sixth day following the filing date of the tax lien notice). However, unlike the forty-five days of U.C.C. § 9-301(4), the forty-five days of clause (d) are not absolute. Rather, it terminates as soon as the secured party acquires actual notice or knowledge of the tax lien filing. Therefore, AmeriBank’s discovery on August 29 of the tax lien filing terminated the period of protection afforded by clause (d). As a result, the advance funded by AmeriBank on September 1, although made before the forty-sixth day following the filing date of the IRS tax lien notice, is not protected.

AmeriBank’s interest in the collateral enjoys priority over the competing interest of the IRS to the extent of the first two advances under I.R.C. § 6323(a) and the third advance under I.R.C. § 6323(d). If the collateral is sold in order to satisfy the claims of AmeriBank and the IRS, the court should distribute the first $15,000 to AmeriBank, the next $25,000

173. See U.C.C. § 9-203(1) (listing the elements of attachment).
174. See id. § 9-302(1)(a); id. § 9-303(1).
175. See id. § 9-301(1)(b).
176. Id. § 9-301(4); see also id. cmt. 7 (“[T]he priority of the security interest for future advances over a judgment lien is made absolute for 45 days regardless of knowledge of the secured party concerning the judgment lien.”) (emphasis added).
177. See I.R.C. § 6323(a), (h)(1).
178. See id. § 6323(d).
179. Id. (indicating that the future advance must be funded "before the forty-sixth day after the date of tax lien filing, or (if earlier) before the person making such disbursements had actual notice or knowledge of tax lien filing") (emphasis added).
to the IRS, and up to $5,000 of any remaining proceeds to AmeriBank. Because the tax lien encumbers all of the Clinic’s property, the IRS can sell other assets of the Clinic to satisfy the unpaid portion of its lien if the collateral sells for less than $40,000. AmeriBank is not so fortunate; it only has an enforceable property interest in the collateral. Therefore, AmeriBank must hope that the collateral is worth at least $45,000.

Hypothetical #9
(illustrating no protection for post-notice collateral)

On June 1, AmeriBank loaned $100,000 to the Clinic. To secure repayment of this loan, as well as any future loans from AmeriBank to the Clinic, the Clinic executed a security agreement on June 1 that created an enforceable security interest in all of the Clinic’s equipment and accounts receivable, whether then owned or thereafter acquired or created. AmeriBank filed a proper financing statement with the appropriate filing officer on June 3. AmeriBank made three additional $50,000 loans to the Clinic on July 1, August 5, and September 10. The Clinic did not disclose that the IRS had assessed a $150,000 federal tax lien against its property on March 1 for overdue corporate income taxes. The IRS filed a proper notice with the appropriate filing officer on August 1. AmeriBank discovered the notice on September 25 after ordering a routine lien search report on the Clinic.

On October 1, AmeriBank and the IRS each seeks a declaratory judgment stating that its interest in the collateral is superior to the interest of the other. Evidence indicates that (i) some, but not all, of the equipment owned by the Clinic on October 1 was acquired by the Clinic after August 1 and (ii) some, but not all, of the accounts receivable reflected on the Clinic’s books on October 1 were generated by rendering services after August 1. Whose interest enjoys priority? In what collateral?

AmeriBank will enjoy some priority under I.R.C. § 6323(a) and some priority under I.R.C. § 6323(d). However, its priority will extend to only a portion of the equipment and accounts receivable.

AmeriBank satisfies one of the mutual requirements of clauses (a) and (d) by claiming its interest in the collateral through a written security agreement executed before the IRS filed its notice.

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180. See id. § 6321.
181. Article 9 permits a debtor to grant a security interest not only in assets it presently owns but also in assets yet to be acquired or created, if the security agreement so provides. See U.C.C. § 9-204(1).
182. See supra note 159.
Also, each of the loans was timely funded as required by either clause (a) or clause (d). The former protects the two pre-notice loans funded on June 1 and July 1. The latter protects the two post-notice loans funded on August 5 and September 10 because AmeriBank funded each of those loans before (i) September 25, when it acquired actual notice or knowledge of the tax lien filing, and (ii) September 16, the forty-sixth day following the filing date of the tax notice.

Additionally, local law protects AmeriBank’s property interest in all of the collateral to the full extent of all advances even though some advances were funded and some collateral was acquired or created after the IRS filed its tax lien notice. Because the Clinic executed a security agreement on June 1 that created a security interest in collateral described therein, and because AmeriBank gave value on June 1, AmeriBank’s interest in each piece of equipment and each account receivable becomes perfected on the later of (i) June 3, the filing date of AmeriBank’s financing statement and (ii) the date when the Clinic acquired the equipment or rendered the service that generated the account receivable. AmeriBank’s interest in equipment and accounts receivable existing when the IRS filed its tax lien notice on August 1 clearly enjoys priority under U.C.C. § 9-301(1)(b). But what about equipment purchased and accounts receivable generated by the Clinic after the IRS filed its notice?

The answer is found in the language of U.C.C. § 9-301(1)(b), which awards priority to a lien creditor only if its interest arises before the interest of the secured party is perfected. Because a lien creditor’s interest in property of the Clinic cannot arise before the Clinic acquires or generates the property, and because AmeriBank’s interest in that property becomes perfected at the very moment of acquisition or generation, the lien creditor’s interest in the collateral arises simultaneously with—and not before—the moment of perfection. Therefore, AmeriBank continues to be protected

183. See I.R.C. § 6323(a), (h)(1).
184. See id. § 6323(d).
185. This later date is the date when the Clinic has rights in the collateral—the third and final element necessary for the interest of AmeriBank to attach under U.C.C. § 9-203(1). Having previously filed its financing statement, AmeriBank’s interest is perfected at the moment of attachment. See U.C.C. § 9-402(1) (“A financing statement may be filed before a security agreement is made or a security interest otherwise attaches.”); id. § 9-303 cmt. 1 (“If the steps for perfection have been taken in advance (as when the secured party files a financing statement before giving value or before the debtor acquires rights in the collateral), then the interest is perfected automatically when it attaches.”).
186. See Texas Oil & Gas Corp., 466 F.2d at 1048. The court states:

[A] perfected security interest “is protected by local law” against a person who does not become “a lien creditor . . . before it [the security interest] is perfected . . . .” Tex. Bus. & Comm. Code Ann. § 9.301(a)(2). Because a judgment creditor, like a secured creditor, cannot attach his lien to the debtor’s after-acquired accounts receivable until the accounts receivable come into existence regardless of whether he has taken all the
under local law, even with respect to collateral acquired or generated by the Clinic after the IRS files its notice. And since the property interest of the IRS does not arise before the property interest of AmeriBank is perfected, AmeriBank can cloak all of its advances with the protection afforded by U.C.C. § 9-301(4) for either of two reasons: AmeriBank funded each advance (i) before the forty-sixth day following the filing date of the tax notice and (ii) without knowledge of the tax notice. 187

Unfortunately for AmeriBank, 188 the scope of protection under I.R.C. § 6323(a) and I.R.C. § 6323(d) is narrower than that of the U.C.C. Each of the two clauses restricts its protection to collateral that exists when the IRS files its notice. 189 Unlike the U.C.C., neither clause (a) nor clause necessary actions for perfection under state law, the judgment lien could not possibly become perfected before the security holder’s interest becomes perfected. At the most, the judgment lien could become perfected at the same time that the security interest becomes perfected, but that circumstance does not alter the security holder’s priority under the Uniform Commercial Code.

Id. at 1048 (footnotes omitted); see also id. at 1053 (“And, like the state-created lien, a federal tax lien would be subject to execution only when the collateral came into existence, for only then would there be something on which to levy.”); Sperry Corp. v. Farm Implement, Inc., 760 F.2d 196, 198 (8th Cir. 1985) (holding that a lender with a security interest in a debtor’s after-acquired receivables enjoyed priority under U.C.C. § 9-301(1)(b) over the competing interest of a judgment lien creditor in receivables that the debtor generated after the judgment lien arose); Donald v. Madison Indus., Inc., 483 F.2d 837, 844 (10th Cir. 1973) (“[I]t is pertinent to note that because a judgment lienor, like a secured creditor, could not attach his lien to after-acquired property until said property is, in fact, ‘acquired,’ the judgment lien could not possibly be perfected prior to the security holder’s interest being perfected.”); Chrysler Credit Corp., 73-1 U.S. Tax Cas. (CCH) ¶ 9263, at 80,519 (“The government admits that its lien could not attach until the right to receive the proceeds came into existence . . . .”); Continental Fin., Inc., 70-2 U.S. Tax Cas. (CCH) ¶ 9592, at 84,467 (“When the accounts receivable did actually materialize they became property of [the taxpayer] to which the prior recorded federal lien immediately attached.”); Creedon, supra note 144, at 175 (“[P]resumably, once the property is in existence, that is, once the taxpayer acquires it, the security interest attaches; and the date is also the earliest one on which the federal tax lien can attach to the property. The problem, therefore, seems to be one of simultaneous attachment of liens . . . .”)(emphasis added); cf. Southern Rock, Inc. v. B & B Auto Supply, 711 F.2d 683 (5th Cir. 1983) (awarding ratable priority to competing claims held by the IRS and a secured creditor in pre-existing collateral when the IRS filed its tax lien notice at the very moment that the secured creditor filed its financing statement).

187. The language of U.C.C. § 9-301(4) is phrased disjunctively, so AmeriBank need not satisfy both the timeliness requirement and the “no knowledge” requirement. Satisfaction of either test is sufficient. If the facts had indicated that AmeriBank had contractually agreed on June 1 to fund multiple advances, then the last clause of U.C.C. § 9-301(4) would protect each advance regardless of timing and knowledge.

188. You didn’t think that I would express sympathy for the IRS, did you?

189. See supra note 158.
(d) offers any solace to creditors claiming a property interest in post-notice collateral. AmeriBank has a property interest that enjoys priority under clause (a) (for the two advances funded on June 1 and July 1) and clause (d) (for the two advances funded on August 5 and September 10) in all equipment and accounts receivable that are the subject of the dispute on October 1 and that existed on August 1. However, neither clause affords AmeriBank any priority in the equipment and accounts receivable existing on October 1 that were acquired or generated by the Clinic after the IRS filed its notice.

Should AmeriBank be concerned? That depends largely on the value of the pre-notice collateral and, to a lesser extent, the value of the post-notice collateral. If the pre-notice collateral has a value greater than AmeriBank’s total credit exposure of $250,000, then AmeriBank is not harmed by its inability to claim priority under I.R.C. § 6323(a) or I.R.C. § 6323(d) in the post-notice collateral. To the extent that the value of pre-notice collateral is less than $250,000, AmeriBank does not have priority in its dispute with the IRS and must hope that one of two situations exists. First, it must hope that the value of the post-notice collateral (in which AmeriBank continues to hold an enforceable Article 9 security interest) exceeds the amount of the tax lien; this excess can then be applied to reduce AmeriBank’s credit exposure. Barring that situation, AmeriBank must hope that, somewhere in its provisions, the I.R.C. expressly offers some protection to creditors seeking priority in post-notice collateral. The I.R.C. does so, and analysis of the relevant provision follows.

C. Protection for Post-Notice Advances and Post-Notice Property

I.R.C. § 6323(c) offers some, but not complete, protection to a secured creditor who is relying on post-notice collateral to secure repayment of advances. The opening language of clause (c) provides as follows:

(1) In general. To the extent provided in this subsection, even though notice of a lien imposed by section 6321 has been filed, such lien shall not be valid with respect to a security interest which came into existence after tax lien filing but which—

(A) is in qualified property covered by the terms of a written agreement entered into before tax lien filing and constituting—

(i) a commercial transactions financing agreement,

(ii) a real property construction or improvement financing agreement, or

(iii) an obligatory disbursement agreement, and
(B) is protected under local law against a judgment lien arising, as of the time of tax lien filing, out of an unsecured obliga-
tion. 190

To enjoy the limited protection afforded by clause (c), the secured creditor must satisfy four statutory requirements. 191 First, just as I.R.C. § 6323(d) requires, 192 the creditor's interest in collateral must arise from a written contract executed before the IRS files its tax lien notice. 193 Second, unlike clause (d), the written contract must constitute one of three prescribed types of agreements: (i) a "commercial transactions financing agreement," (ii) a "real property construction or improvement financing agreement," or an "obligatory disbursement agreement." 194 Third, the collateral must be "qualified property." 195 And fourth, as required by both clauses (a) and (d), 196 the secured party's interest must be protected under local law against the rights of a lien creditor arising on the day of the tax lien filing. 197

The following five hypotheticals explore the statutory requirements of clause (c). The materials are organized by the three types of written contracts, beginning with the commercial transactions financing agreement.

1. Commercial Transactions Financing Agreement

Hypothetical #10
(secured party makes loans)

On June 1, AmeriBank loaned $1,000,000 to Texas Furniture Corporation (TFC), an entity that sells and leases furniture at its three Houston stores. To secure repayment of the $1,000,000 loan, as well as any future loans from AmeriBank to TFC, TFC executed a security agreement on June 1 that created an enforceable security interest in all of its accounts receivable and inventory, in each case whether then owned or thereafter acquired or created. AmeriBank filed a proper financing statement with the appropriate filing officer on June 3. AmeriBank made three additional loans to TFC of $500,000 each on July 1, August 15, and September 1. TFC did

190. I.R.C. § 6323(c)(1).
191. The secured party has the burden of proving that it enjoys priority under clause (c). See Rice Inv. Co., 625 F.2d at 571; City of Houston, 86-1 U.S. Tax Cas. (CCH) ¶ 9101, at 83,006.
193. Id. § 6323(c)(1)(A); cf. I.R.C. § 6323(h)(1) (defining "security interest" as a property interest acquired "by contract"). See supra notes 151-53 and accompanying text.
195. Id. § 6323(c)(1)(A).
196. See supra note 160.
197. I.R.C. § 6323(c)(1)(B).
not disclose that the IRS had assessed a $600,000 federal tax lien against the
property of TFC on March 1 for unpaid withholding taxes and social
security contributions. The IRS filed a proper tax lien notice with the
appropriate filing officer on August 1. AmeriBank discovered the notice on
September 5 after ordering a routine lien search report on TFC.

On October 1, AmeriBank and the IRS each seeks a declaratory
judgment stating that its interest in TFC’s inventory and receivables is
superior to the interest of the other. Evidence indicates that the inventory
and receivables existing on October 1 were acquired or created as follows:
(i) 25% was acquired or created before the IRS filed its notice on August
1, (ii) 25% was acquired or created after the IRS filed its notice on August
1 but before AmeriBank discovered the notice on September 5, (iii) 25%
was acquired or created after AmeriBank discovered the notice but before
September 16, the forty-sixth day following the filing date of the notice, and
(iv) 25% was acquired or created on or after September 16. Whose interest
enjoys priority? In what collateral?

AmeriBank funded two post-notice advances, and its security includes
some post-notice collateral. Therefore, AmeriBank should attempt to
supplement any protection afforded by I.R.C. § 6323(a) with the protection
of I.R.C. § 6323(c). AmeriBank satisfies one of the requirements of clause
(a) and clause (c) as its interest in the collateral arises from a written
contract that was executed before August 1. Clause (c) imposes the
additional requirement that the written contract be a “commercial transac-
tions financing agreement,” which is:

198. *See id.* § 6323(a) (giving priority to a holder of a security interest that exists
when the IRS files notice of its tax lien); *id.* § 6323(c)(1)(A) (protecting security interests
“in qualified property covered by the terms of a written agreement entered into before tax
lien filing”); *id.* § 6323(h)(1) (indicating that a “security interest” means “any interest in
property acquired by contract”).

199. *Id.* § 6323(c)(1)(A)(i). Actually, the security agreement need not be a commercial
transactions financing agreement if it is either a “real property construction or improvement
financing agreement,” *id.* § 6323(c)(1)(A)(ii), or “an obligatory disbursement agreement,”
*id.* § 6323(c)(1)(A)(iii). The facts do not suggest that the contractual relationship between
AmeriBank and TFC involves real estate construction, real estate improvements, or farm
crops or livestock. Therefore, the security agreement is not a “real property construction or
improvement financing agreement.” *Id.* § 6323(c)(3)(A) (defining “real property construction
or improvement financing agreement”). Nor do the facts suggest that anyone other than TFC
enjoys the right to demand advances under the loan agreement. Thus, the security agreement
cannot be an obligatory disbursement agreement. *Id.* § 6323(c)(4)(A) (defining “obligatory
disbursement agreement”).
an agreement (entered into by a person in the course of his trade or business)

(i) to make loans to the taxpayer to be secured by commercial financing security acquired by the taxpayer in the ordinary course of his trade or business, or

(ii) to purchase commercial financing security (other than inventory) acquired by the taxpayer in the ordinary course of his trade or business;

but such an agreement shall be treated as coming within the term only to the extent that such loan or purchase is made before the forty-sixth day after the date of tax lien filing or (if earlier) before the lender or purchaser had actual notice or knowledge of such tax lien filing.

Six requirements can be extracted from this definition. First, the contract must be entered into by the secured party in the course of its trade or business. Second, the secured party must contractually agree either to make loans to the taxpayer or to purchase “commercial financing security” (excluding inventory) from the taxpayer. Third, repayment of such loans must be secured by commercial financing security. Fourth, the commercial financing security must be acquired by the taxpayer in the ordinary course of its business. Fifth, the secured party must make its loan or purchase without actual notice or knowledge that the IRS has filed its tax lien notice. And sixth, the secured party must make its loan or purchase before the 46th day following the date of the tax lien filing.

AmeriBank satisfies the first requirement because, as a financial institution, it is in the business of making secured loans and executing agreements evidencing those loans. AmeriBank meets the second requirement because it has agreed to make loans to TFC. Whether the third and fourth requirements are satisfied is determined by the term “commercial financing security,” which the I.R.C. defines as “(i) paper of a kind ordinarily arising in commercial transactions, (ii) accounts receivable, (iii) mortgages on real property, and (iv) inventory.” TFC’s accounts receivable and inventory, both of which are commercial financing

200. Id. § 6323(c)(2)(A).

201. For a case in which the court held that a security agreement did not qualify as a commercial transactions financing agreement because the creditor did not execute the agreement in the course of his trade or business, see Sgro, 609 F.2d at 1259.


203. “An account receivable is any right to payment for goods sold or leased or for services rendered which is not evidenced by an instrument or chattel paper.” 26 C.F.R. § 301.6323(c)-1(c)(2)(ii); cf. U.C.C. § 9-106 (defining “account” as “any right to payment for goods sold or leased or for services rendered which is not evidenced by an instrument or chattel paper, whether or not it has been earned by performance”) (emphasis added). The U.C.C. does not distinguish between the terms “account” and “account receivable.” See id. § 9-106 cmt. (“‘Account’ is defined as a right to payment for goods sold
security, secure repayment of AmeriBank’s loan. Thus, the third requirement is satisfied. AmeriBank seems to satisfy the fourth requirement, as TFC is in the business of selling and leasing its inventory of furniture, and presumably its accounts receivable are generated from the credit sales of that furniture. AmeriBank satisfies the final two requirements because it funded the four loans before September 16 (the forty-sixth day after the IRS filed its tax lien notice on August 1), and it did not discover the tax lien filing until September 5, after funding the four loans.

AmeriBank’s interest also must be protected under local law against the rights of a lien creditor arising on August 1, the day of the tax lien filing. Section 9-301(1)(b) of the applicable local law, the U.C.C., fully protects AmeriBank’s interest in all of the collateral—even the furniture acquired and the receivables generated by TFC after the IRS filed its notice on August 1. As of June 1, TFC had executed a security agreement that created a security interest in collateral described therein and AmeriBank had given value. Therefore, AmeriBank’s interest in each piece of inventory and each account receivable attached on the later of (i) June 1 and (ii) the date on which TFC acquired or generated the individual item of collateral. Further, AmeriBank’s interest in each item of collateral became perfected on the later of (i) June 3, the filing date of AmeriBank’s financing

or leased or services rendered: the ordinary commercial account receivable.”).

The omission of the emphasized language in the U.C.C. definition from the IRS definition permits the IRS to argue that a U.C.C. account is not “in existence” for purposes of I.R.C. § 6323 until it has been earned by performance. See 26 C.F.R. § 301.6323(c)-I (d) (“An account receivable (as defined in paragraph (c)(2)(ii) of this section) is acquired by a taxpayer at the time, and to the extent, a right to payment is earned by performance.”).

204. “Inventory” includes “raw materials and goods in process as well as property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business.” 26 C.F.R. § 301.6323(c)-I (c)(1); cf. U.C.C. § 9-109(4) (defining “inventory” as goods “held by a person who holds them for sale or lease or to be furnished under contracts of service or if he has so furnished them, or if they are raw materials, work in process or materials used or consumed in a business”).

205. See I.R.C. § 6323(c)(2)(C)(ii), (iv). I am not using real property mortgages, one of the other types of commercial financing security, see id. § 6323(c)(2)(C)(iii), in any of my hypotheticals for two reasons. First, Article 9 excludes from its coverage most interests in real estate. See U.C.C. § 9-104(j). Second, I received my lowest law school grade on my property exam, so I have an inferiority complex when it comes to discussing real property. I once raised this matter with my therapist who offered these comforting words: “You are inferior. Get rid of the complex.”

206. See I.R.C. § 6323(a) (giving priority to a holder of a security interest that exists when the IRS files notice of its tax lien); id. § 6323(c)(1)(B) (protecting security interests that are “protected under local law against a judgment lien arising, as of the time of tax lien filing, out of an unsecured obligation”); id. § 6323(h)(1) (indicating that a security interest exists “at any time (A) if, at such time . . . the interest has become protected under local law against a subsequent judgment lien arising out of an unsecured obligation”).

207. See U.C.C. § 9-203(1) (listing the elements of attachment).
statement, and (ii) the date on which TFC acquired the piece of furniture or generated the receivable.\textsuperscript{208} AmeriBank’s interest in the pre-notice collateral is protected by U.C.C. § 9-301(1)(b) against the claim of the lien creditor arising on August 1 because the property interest of the lien creditor in that collateral does not arise before AmeriBank’s interest is perfected. Although AmeriBank’s interest in some items of collateral will not be perfected until after August 1, AmeriBank’s interest in those items also is protected by U.C.C. § 9-301(1)(b). The interest of the lien creditor cannot arise in property of TFC until TFC enjoys rights in the property. Because AmeriBank’s interest in the post-notice collateral becomes perfected upon acquisition or creation, the interest of the lien creditor arises at the same time that AmeriBank’s interest becomes perfected, rather than before perfection, as required by U.C.C. § 9-301(1)(b).\textsuperscript{209} Therefore, the local law protects AmeriBank’s interest against the claim of a lien creditor arising on August 1 not only in the pre-notice collateral, but also in the post-notice collateral.\textsuperscript{210}

Because the property interest of the IRS does not arise before AmeriBank’s property interest is perfected, AmeriBank can invoke the protection afforded to multiple advances under U.C.C. § 9-301(4). All four advances enjoy priority under that provision for either of two alternative reasons: AmeriBank funded each advance (i) before September 16 (the forty-sixth day following the date of the tax lien filing)\textsuperscript{211} and (ii) before it discovered the tax lien filing on September 5.\textsuperscript{212}

\textsuperscript{208} See id. § 9-302(1)(a) (permitting a filed financing statement to perfect security interests in collateral not possessed by the secured party); id. § 9-303(1) (requiring attachment as a predicate to perfection).

\textsuperscript{209} See supra note 186 and accompanying text.

\textsuperscript{210} AmeriBank’s discovery on September 5 of the tax notice is irrelevant in applying U.C.C. § 9-301(1)(b). Only occasionally does a party’s knowledge adversely impact an otherwise favorable resolution of a priority dispute under the U.C.C. See U.C.C. § 9-115(5) (knowledge is irrelevant); id. § 9-301(1)(c) (knowledge is relevant); id. § 9-301(1)(d) (knowledge is relevant); id. § 9-301(2) (knowledge is irrelevant); id. § 9-301(4) (knowledge may or may not be relevant); id. § 9-307(1) (certain knowledge may prevent party from qualifying as a buyer in the ordinary course of business); id. § 9-307(2) (knowledge is relevant); id. § 9-307(3) (knowledge may or may not be relevant); id. § 9-308 (knowledge may or may not be relevant); id. § 9-309 (knowledge may prevent party from qualifying as a holder in due course); id. § 9-312(3) (knowledge is irrelevant); id. § 9-312(4) (knowledge is irrelevant); id. § 9-312(5) (knowledge is irrelevant).

\textsuperscript{211} See id. § 9-301(4) (subordinating the interest of a lien creditor to advances made by a perfected secured creditor “within 45 days [after the person becomes a lien creditor]”). The similarity between the U.C.C. § 9-301(4) 45-day grace period and that in I.R.C. § 6323(c) is more than coincidence. See U.C.C. § 9-301 cmt. 7. Note, however, that the 45-day period is absolute under the U.C.C. but not under the I.R.C.

\textsuperscript{212} See id. § 9-301(4) (subordinating the interest of a lien creditor to advances made by a perfected secured creditor “without knowledge of the lien”); see also supra note 187.
Although AmeriBank's property interest is completely protected by the U.C.C. against the competing claim of the IRS, I.R.C. § 6323(a) limits its protection to pre-notice collateral. While I.R.C. § 6323(c) has no such limitation, it does require the collateral to be "qualified property." To be qualified property, the collateral must be commercial financing security. AmeriBank's collateral is commercial financing security because the collateral consists of inventory and receivables—two of the expressly enumerated types of commercial financing security. However, to be qualified property, the commercial financing security must be acquired by TFC "before the 46th day after the date of tax lien filing." The facts indicate that TFC acquired or generated the collateral on various dates both before and after September 16, the forty-sixth day after the date of the tax lien filing. As only collateral acquired or generated before that date is qualified property, AmeriBank's priority under clause (c) is limited to that collateral. The IRS enjoys priority in all receivables and inventory generated and acquired by TFC on or after September 16.

213. See I.R.C. § 6323(a) (giving priority to a holder of a security interest that exists when the IRS files notice of its tax lien); id. § 6323(h)(1) (indicating that a security interest does not exist when the IRS files notice of its tax lien unless "at such time, the property is in existence").

214. See id. § 6323(c)(1)(A).

215. See id. § 6323(c)(2)(B).

216. See id. § 6323(c)(2)(C)(ii), (iv).

217. Id. § 6323(e)(2)(B).

218. Observe that while AmeriBank's discovery of the tax lien filing shortens the period during which its post-notice advances are protected, see I.R.C. § 6323(c)(2)(A), the same discovery does not shorten the period during which post-notice collateral becomes qualified property, see I.R.C. § 6323(c)(2)(B); see also Rice Inv. Co., 625 F.2d at 570 n.18 (quoting 26 C.F.R. § 301.6323(c)-1(d)(1979)); 26C.F.R. § 301.6323(c)-1(d) ("Commercial financing security acquired before [the forty-sixth day after the date of tax lien filing] may be qualified property even though it is acquired by the taxpayer after the lender received actual notice or knowledge of the filing of the tax lien.") (emphasis added); Coogan, supra note 87, at 1408 ("Subsection (e)(2) will be helpful to the financer of commercial financing security in that collateral added within 45 days of filing will benefit him regardless of notice or knowledge."); Overman, supra note 22, at 745 ("Although the receipt of actual knowledge of the filing of the tax lien notice terminates the period within which protected disbursements may be made to the borrower, the creditor's priority extends to commercial financing security acquired by the borrower after the creditor's receipt of such knowledge and before such 46th day."); Plumb, supra note 66, at 275 ("This latter 45-day period is not cut short by earlier knowledge of the lien."). Why does AmeriBank's knowledge adversely impact the scope of its debt protection but not the size of its protected collateral package? The reason is that AmeriBank can refuse to fund advances after it discovers the tax lien filing, but it cannot control when TFC acquires collateral. But see Coogan, supra note 87, at 1408. Coogan states:

His legal right to suspend advances affords little actual protection if the half-finished collateral is worthless without future advances to complete it. His only real protection
In summary, AmeriBank's interest in the collateral enjoys some priority under I.R.C. § 6323(a) and I.R.C. § 6323(c) over the competing interest of the IRS. Although the priority extends to all money advanced ($2,500,000), the collateral to which the priority extends is limited to inventory acquired and receivables generated by TFC prior to September 16. To avoid a shortfall, AmeriBank must hope that either (i) the value of the qualified property is at least $2,500,000 or (ii) the value of the collateral in which the IRS enjoys priority exceeds the amount of the tax lien by an amount that will revert to AmeriBank through its enforceable, but subordinate, Article 9 security interest.

Hypothetical #11
(secured party purchases assets)

TFC sells many pieces of furniture on credit. TFC requires many credit customers to execute an installment sales contract that evidences the customer's repayment obligations. Under each contract, TFC retains a security interest in the purchased items to secure repayment of the unpaid purchase price.

depends on his success in convincing the local director of Internal Revenue that the ultimate collection of the tax will be furthered by the director's exercising his discretionary power under section 6325(d) to subordinate the tax lien to the necessary future advances.

Id.

219. Clause (a) protects AmeriBank's security interests that arose before the IRS filed its notice. Such interests are limited to property interests in pre-notice collateral, but only to the extent that such property interests secure repayment of pre-notice advances. Clause (c) protects AmeriBank's security interests that arise thereafter. Such interests include (i) property interests in pre-notice collateral, to the extent such property interests secure repayment of post-notice advances, (ii) property interests in post-notice collateral, to the extent such property interests secure repayment of pre-notice advances, and (iii) property interests in post-notice collateral, to the extent such property interests secure repayment of post-notice advances.

220. AmeriBank may enjoy priority for collateral acquired or generated by TFC on or after September 16 under a "proceeds" theory. See infra part IV.B.

221. For example, assume that the value of all inventory acquired and receivables generated by TFC prior to September 16 is $2,000,000. Because AmeriBank has extended credit of $2,500,000, it will have a priority shortfall of $500,000. If the value of the receivables and inventory in which the IRS enjoys priority (e.g., that collateral acquired or generated by TFC on or after September 16) is $500,000 and the amount of the tax lien is $600,000, then no surplus proceeds are available to cover AmeriBank's shortfall. However, if the value of the receivables and inventory in which the IRS enjoys priority is $750,000 and the amount of the tax lien is $600,000, then the surplus of $150,000 would revert to AmeriBank under Article 9 principles to reduce its priority shortfall from $500,000 to $350,000.

222. TFC's security interest would qualify as a purchase money security interest under
TFC also leases many pieces of furniture to various businesses. TFC requires each lessee to execute TFC's master lease agreement, which includes among its various terms a description of the furniture being leased and the periodic lease payment.

On June 1, Furniture Finance Company (an entity that specializes in buying receivables and commercial paper from furniture retailers) and TFC executed a master purchase agreement. Under this agreement, Furniture Finance agreed to finance TFC's credit and lease transactions by purchasing at a discounted price all of TFC's receivables, installment sales contracts, and lease documents. Furniture Finance filed an original counterpart of the purchase agreement with the appropriate filing officer on June 3. (The purchase agreement included the name and address of, and was executed by, both TFC and Furniture Finance; it also described the receivables, contracts, and leases being purchased.) Furniture Finance made three separate purchases of then-existing receivables, contracts, and leases on June 15, July 15, and August 15 by paying $1,000,000 to TFC on each date. Some, but not all, of the receivables, contracts, and leases purchased by Furniture Finance on August 15 had been generated by TFC after August 1. TFC never disclosed to Furniture Finance that the IRS had assessed a $1,000,000 federal tax lien against the property of TFC on March 1 for overdue corporate income taxes. The IRS filed a proper notice of its tax lien with the appropriate filing officer on August 1. Furniture Finance discovered the notice on September 1 after ordering a routine lien search report on TFC.

On October 1, Furniture Finance and the IRS each seeks a declaratory judgment stating that its interest in the receivables, installment sales contracts, and lease documents is superior to the interest of the other. Whose interest enjoys priority?

Although Furniture Finance is buying assets from TFC rather than lending money or providing other consideration to TFC, Furniture Finance's interest in the assets may qualify as a security interest under the I.R.C.\textsuperscript{223} Because TFC generated some of the purchased assets after August 1 and Furniture Finance purchased some of the assets after August 1, Furniture Finance can maximize its priority by invoking both I.R.C. § 6323(a) and I.R.C. § 6323(c).

To do so, Furniture Finance's interest in the receivables, installment sales contracts, and lease documents must arise from a written contract that pre-dates the filing date of the tax notice.\textsuperscript{224} This requirement is met because the interest arises from the master purchase agreement executed by both parties on June 1, two months before the IRS filed its notice.

\textsuperscript{223} See I.R.C. § 6323(c)(2)(D).
\textsuperscript{224} See supra note 198.
The purchase agreement also qualifies as a commercial transactions financing agreement, one of the three forms of agreement required by clause (c).\textsuperscript{225} The contractual relationship between Furniture Finance and TFC is typical of other contractual relationships that Furniture Finance enjoys as part of its ordinary course of business.\textsuperscript{226} Pursuant to the master purchase agreement, Furniture Finance contractually agreed to purchase commercial financing security (other than inventory) from TFC.\textsuperscript{227} Additionally, the receivables, contracts, and leases were generated by TFC in the ordinary course of its business of selling and leasing furniture.\textsuperscript{228} Furthermore, each purchase by Furniture Finance was timely, having occurred before the forty-sixth day following the filing date of the tax lien notice.\textsuperscript{229} Finally,

\textsuperscript{225} See I.R.C. § 6323(c)(1)(A)(i)-(iii). The master purchase agreement would not be a "real property construction or improvement financing agreement" or an "obligatory disbursement agreement." \textit{See supra} note 199.

\textsuperscript{226} See I.R.C. § 6323(c)(2)(A) (defining a "commercial transactions financing agreement" as an agreement entered into by a person in the course of his trade or business"). The language in I.R.C. § 6323(c)(A)(i) and (ii) indicates that the person in the quoted parenthetical is not the taxpayer (who nevertheless may be entering into the contractual relationship in the ordinary course of its trade or business), but instead is the party extending credit under clause (i) or buying the commercial financing security under clause (ii).

\textsuperscript{227} Receivables are expressly mentioned as one of the four types of commercial financing security. \textit{See I.R.C. § 6323(c)(2)(C)(ii). Installment sales contracts and lease documents are not expressly mentioned in the definition of "commercial financing security." However, commercial financing security includes "paper of a kind ordinarily arising in commercial transactions." \textit{Id} § 6323(c)(2)(C)(i). The quoted term is defined as any written document customarily used in commercial transactions. For example, such written documents include paper giving contract rights ..., \textit{chattel paper}, documents of title to personal property, and negotiable instruments or securities. The term "commercial financing security" does not include general intangibles such as patents or copyrights ... [or] a mortgage where the taxpayer is the mortgagor or realty owned by him.

\textsuperscript{228} See I.R.C. § 6323(c)(2)(A)(ii).

\textsuperscript{229} See \textit{id.} § 6323(c)(2)(A).
Furniture Finance made each purchase before it discovered the tax lien filing on September 1. Therefore, the purchase agreement is a commercial transactions financing agreement.

Furniture Finance’s interest in the receivables, contracts, and leases is also fully protected under local law against the rights of a lien creditor arising on August 1. Although Furniture Finance purchased rather than took a traditional security interest in the receivables, contracts, and leases, Article 9 remains the applicable local law. Article 9 applies not only to transactions intended to create security interests, but also to most sales of accounts receivable and chattel paper (which includes the installment sales contracts and the leases).

Section 9-301(1)(b) of the U.C.C. fully protects Furniture Finance’s interest in the purchased assets even though TFC generated some of the assets by selling or leasing furniture after the IRS filed its notice. On June 1, TFC executed the purchase agreement that created a security interest in the assets. Furniture Finance gave value on June 1 when it entered into the purchase agreement. Therefore, Furniture Finance’s interest in each purchased asset attached on the later of (i) June 1 and (ii) the date when TFC sold or leased the item of furniture that created the account receivable, installment sales contract, or lease. The interest of Furniture Finance in each item became perfected on the later of the date when (i) Furniture

230. Id.
231. See supra note 206.
232. See U.C.C. § 9-102(1)(b). But see id. § 9-104(f) (excluding from Article 9 coverage a few transactions involving accounts and chattel paper). The drafters of Article 9 included sales of accounts and chattel paper within its scope because “[c]ommercial 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 . . . .” Id. § 9-102 cmt. 2. See also 8 HAWKLAND, supra note 110, § 9-102.01, at 23 (“The reason for this major departure from the parties’ intent is based in expediency; it will often be impossible to distinguish between a sale of accounts or chattel paper and a transaction in which the accounts or chattel paper are being used merely as security.”) (footnote omitted). The distinction between security transfers and sales is important if the debtor is in default. See U.C.C. §§ 9-502(2), 9-504(2) (indicating that while the debtor is normally entitled to a surplus but obligated to pay a deficiency, such is not the case in a transaction involving the sale of accounts or chattel paper unless the security agreement so provides).

Article 9 treats Furniture Finance, the purchaser, as the secured party, and TFC, the seller, as the debtor. See id. § 9-105(1)(d) (defining “debtor” as including “the seller of accounts or chattel paper”); id. § 9-105(1)(m) (including within the definition of “secured party” any “person in whose favor there is a security interest, including a person to whom accounts or chattel paper have been sold”); see also id. § 1-201(37) (indicating that “any interest of a buyer of accounts or chattel paper which is subject to Article 9” is a security interest).

233. See supra note 227.
234. See U.C.C. § 9-203(1) (listing the elements of attachment).
Finance filed its financing statement (June 3)235 and (ii) TFC sold or leased the furniture that generated the respective receivable, contract, or lease.236 Because Furniture Finance filed its financing statement before August 1, and because the interest of a lien creditor cannot encumber a receivable, contract, or lease until TFC generates it, the lien creditor’s interest cannot exist before TFC’s interest is perfected. Therefore, Furniture Finance’s interest in each receivable, contract, and lease purchased from TFC is fully protected against the competing claim of a lien creditor by U.C.C. § 9-301(1)(b).237

Because the lien creditor’s interest does not arise before the property interest of Furniture Finance is perfected, Furniture Finance can cloak all three $1,000,000 purchases (including the post-notice purchase on August 15) with the protection of U.C.C. § 9-301(4). Each purchase is fully protected against the claims of a lien creditor arising on August 1 for any of the following alternative reasons. First, Furniture Finance made each

235. Actually, the facts indicate that Furniture Finance filed an original counterpart of the purchase agreement rather than a standard financing statement. Nevertheless, because the agreement included a description of the receivables, contracts, and leases, as well as the name, address, and signature of Furniture Finance and TFC, the agreement qualifies as a financing statement. See U.C.C. § 9-402(1); id. cmt. 1 (“A copy of the security agreement may be filed in place of a separate financing statement, if it contains the required information and signature.”). If a party desires to perfect its security interest by filing an earlier agreement rather than a separate financing statement, the party must file an original counterpart of the agreement unless either the agreement states that a carbon, photographic, or other reproduction may be filed as a financing statement or the party has already filed an original counterpart of the agreement in the state. See id. § 9-402(1) (last sentence).

Unless the transaction qualifies under U.C.C. § 9-302(1)(e), Furniture Finance must file a financing statement (or something that qualifies as a financing statement) in order to perfect its security interest in the receivables. See id. § 9-302(1)(a) (requiring a filing for non-possessory collateral); id. § 9-305 cmt. 1 (“A security interest in accounts . . . may under this Article be perfected only by filing . . . .”). Furniture Finance can perfect its security interest in the contracts and leases, both of which are chattel paper, by filing or by possession. See id. § 9-304(1) (“A security interest in chattel paper . . . may be perfected by filing.”); id. § 9-305 (“A security interest in . . . chattel paper may be perfected by the secured party’s taking possession of the collateral.”).

In some instances, a subsequent purchaser of chattel paper who takes possession of the chattel paper enjoys greater rights therein over a competing security interest, even if the security interest is perfected and arose prior to the purchase. See id. § 9-308. A creditor with a perfected security interest in chattel paper (such as Furniture Finance) can prevent a purchaser of chattel paper from successfully invoking U.C.C. § 9-308 by taking possession of the chattel paper and not relying solely on its financing statement. Without possession, the subsequent purchaser cannot rely on the protection afforded by U.C.C. § 9-308. Id. (“A purchaser of chattel paper . . . who gives new value and takes possession of it . . . .”) (emphasis added).

236. See supra note 208.

237. See supra note 186 and accompanying text.
purchase before September 16, the forty-sixth day following August 1, the
date of the tax lien filing. 238 Second, Furniture Finance made each
purchase before September 1, the date on which it discovered the tax lien
filing. 239 Third, Furniture Finance made each purchase pursuant to a
commitment executed by Furniture Finance and TFC on June 1, before
Furniture Finance discovered the tax lien notice. 240

Because I.R.C. § 6323(a) offers no protection to post-notice collateral
or post-notice advances, 241 the scope of the security interest that enjoys
priority under clause (a) is limited to the two purchases on June 15 and July
15, repayment of which is secured solely by receivables, contracts, and
leases resulting from sales or leases of furniture before August 1. Clause
(a) does not permit repayment of the pre-notice debt of $2,000,000 to be
secured by the post-notice collateral; nor does it allow the pre-notice
collateral to secure repayment of the post-notice debt of $1,000,000.
Nevertheless, Furniture Finance can claim the protection afforded by clause
(c) to the post-notice debt of $1,000,000 and the post-notice collateral. The
post-notice purchase price of $1,000,000 is protected because Furniture
Finance made the purchase on August 15, before both the forty-sixth day
following the filing date of the tax notice and the date when Furniture
Finance discovered the tax lien filing. 242 The post-notice collateral is
protected because it satisfies the two-prong definition of "qualified prop-
erty." 243 As mentioned earlier, 244 the receivables, contracts, and leases are
commercial financing security. 245 Also, TFC generated the receivables,
contracts, and leases on or before the last purchase date of August 15, long
before the forty-sixth day after the IRS filed its notice. 246

238. See U.C.C. § 9-301(4) (subordinating the interest of a lien creditor to advances
made by a perfected secured creditor "within 45 days [after the person becomes a lien
creditor]").

239. Id. (subordinating the interest of a lien creditor to advances made by a perfected
secured creditor "without knowledge of the lien").

240. Id. (subordinating the interest of a lien creditor to advances made by a perfected
secured creditor "pursuant to a commitment entered into without knowledge of the lien").

241. See I.R.C. § 6323(a) (giving priority to a holder of a security interest that exists
when the IRS files notice of its tax lien); id. § 6323(h)(1) (indicating that a security interest
does not exist when the IRS files notice of its tax lien unless "at such time, the property is
in existence" and only exists "to the extent that, at such time, the holder has parted with
money or money's worth").

242. See id. § 6323(c)(2)(A).

243. See id. § 6323(c)(1)(A) (requiring collateral to be qualified property).

244. See supra note 227.

245. See I.R.C. § 6323(c)(2)(B) (indicating that qualified property "includes only
commercial financing security . . . ").

246. Id. (limiting qualified property to collateral "acquired by the taxpayer before the
forty-sixth day after the date of tax lien filing").
Having satisfied all of the requirements of I.R.C. § 6323(a) and I.R.C. § 6323(c), Furniture Finance enjoys priority. Therefore, the court should enter a declaratory judgment in its favor.

2. Real Property Construction or Improvement Financing Agreement

A creditor may invoke the protection afforded by I.R.C. § 6323(c) even if its contract with the taxpayer is not a commercial transactions financing agreement if the contract is either a "real property construction or improvement financing agreement" or an "obligatory disbursement agreement." The following two hypotheticals explore the parameters of the protection afforded to a creditor whose interest in collateral arises under the former.

Hypothetical #12
(real estate financing)

On June 1, AmeriBank contractually agreed to loan up to $1,000,000 in one or more advances to Smith Construction Company (SCC), a corporation that constructs, remodels, and demolishes commercial buildings. The contract called for SCC to use the funds to finance the destruction of various buildings under demolition contracts that the City of Houston had recently awarded to SCC. To secure repayment of all of the advances, the contract between AmeriBank and SCC created an enforceable security interest in amounts payable by the City of Houston to SCC under the demolition contracts. AmeriBank filed a proper financing statement with the appropriate filing officer on June 3. AmeriBank made five single advances of $200,000 to SCC on June 10, July 15, August 20, September 10, and September 25. SCC did not disclose that the IRS had assessed a $300,000 federal tax lien against its property on March 1 for overdue corporate income taxes. The IRS filed a proper notice of its tax lien with the appropriate filing officer on August 1. AmeriBank discovered the notice on September 1 after ordering a routine lien search report on SCC.

On October 1, AmeriBank and the IRS each seeks a declaratory judgment stating that its interest in the payment stream under the demolition contracts is superior to the interest of the other. Whose interest enjoys priority?

AmeriBank made three post-notice advances, and presumably the City of Houston did not become obligated to make some of its payments under the demolition contracts until after August 1. Therefore, AmeriBank should supplement the protection afforded by I.R.C. § 6323(a) with the protection available under I.R.C. § 6323(c).

247. See id. § 6323(c)(1)(A)(i)-(iii).
The property interest of AmeriBank satisfies one of the requirements of clauses (a) and (c): it arises from a written contract executed long before the IRS filed its notice.248

The contract is a "real property construction or improvement financing agreement" if it is "an agreement to make cash disbursements to finance (i) the construction or improvement of real property, (ii) a contract to construct or improve real property, or (iii) the raising or harvesting of a farm crop or the raising of livestock or other animals."249 Because SCC is using AmeriBank's funds to finance its obligations under the demolition contracts rather than to raise or harvest farm crops or raise animals, AmeriBank must hope that its contract with SCC qualifies under either clause (i) or (ii).250

The distinction between the two clauses appears blurry at first glance. The examples posed in the applicable regulations suggest that if the taxpayer is

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248. See supra note 198.

249. I.R.C. § 6323(c)(3)(A). AmeriBank will prefer that its contract be a real property construction or improvement financing agreement rather than a commercial transactions financing agreement. The protection afforded by clause (c) to commercial transactions financing agreements is limited to advances "made before the forty-sixth day after the date of tax lien filing or (if earlier) before the lender or purchaser had actual notice or knowledge of such tax lien filing." Id. § 6323(c)(2)(A). This limitation would preclude AmeriBank from enjoying priority for the last two advances made to SCC, both of which AmeriBank funded after discovering the tax lien filing. (Even absent knowledge of the tax lien filing, the final advance would not be protected because it was funded after the forty-fifth day had passed.) No such limitation is applicable to advances funded under a real property construction or improvement financing agreement.

The legislative history offers the following policy underlying the superpriority afforded to property interests arising under real property construction or improvement financing agreements:

Your committee's bill gives priority in the case of security interests arising from disbursements for these purposes even though a notice of a tax lien has been filed because . . . the disbursements generally enhance the value of the property for purposes of the tax lien. Thus, the completion of the construction or the improvement of the property or the completion of the raising of the crop or livestock usually increases the value of the property underlying the security interest for tax lien purposes by more than the amount of the disbursement being accorded the priority.

S. REP. NO. 1708, at 8, reprinted in 1966 U.S.C.C.A.N. at 3730; see also LOPUCKI & WARREN, supra note 12, at 780; Plumb, supra note 66, at 276.

250. Initially, AmeriBank may be concerned that its contract does not qualify under either clause as neither clause refers to "demolition" or "destruction," terms that arguably are not included under the concept of construction or improvement. However, the applicable regulations resolve the argument in favor of AmeriBank by expressly stating that "construction or improvement may include demolition." 26 C.F.R. § 301.6323(c)-(b); see also id. § 301.6323(c)-(b)(1), (2) (including within the definition of "real property construction or improvement financing agreement" a contract that finances (i) "the construction, improvement, or demolition of real property" and (ii) a contract to "construct or improve, or demolish real property") (emphasis added).
constructing or improving its own real estate, then the first clause applies; however, if the taxpayer is constructing or improving real property of a third party, then the second clause applies.251 Because SCC is performing demolition work on property owned by the City of Houston, AmeriBank can claim that its contract with SCC is a real property construction or improvement financing agreement under I.R.C. § 6323(c)(3)(A)(ii).

Whether AmeriBank’s agreement with SCC is a commercial transactions financing agreement, a real property construction or improvement financing agreement, or an obligatory disbursement agreement, AmeriBank’s property interest must be in collateral that is qualified property.252 When the contract is a real property construction or improvement financing agreement, the definition of “qualified property” is dictated by the type of agreement. As AmeriBank is making cash disbursements under a contract to finance SCC’s obligations under its demolition contracts with the City of Houston, “qualified property” means, and is limited to, “the proceeds of the [demolition] contract[s between SCC and the City of Houston].”253 AmeriBank’s property interest falls within the definition because its collateral is the payment stream (proceeds) under the demolition contracts.254

251. See id. § 6323(c)-2(d) examples 1, 2.
253. Id. § 6323(c)(3)(B)(ii). If AmeriBank was financing SCC’s construction or improvement of its own property, then “qualified property” would mean “the real property with respect to which the construction or improvement has been or is to be made . . . .” Id. § 6323(c)(3)(B)(i). Conflicts between an Article 9 secured creditor and the IRS should not arise under this provision, which limits the collateral to the real estate being constructed or improved. With the exception of fixtures, interests in real estate are expressly excluded from Article 9 coverage. See U.C.C. § 9-104(j). For this reason, I have not posed any hypothetical that would be resolved by applying I.R.C. § 6323(c)(3)(A)(i) and its companion definition of “qualified property” set forth in I.R.C. § 6323(c)(3)(B)(i). For such an illustration, see 26 C.F.R. § 6323(c)-2(d) example 1.
254. The payment stream from the demolition contracts should qualify as an account receivable, a form of commercial financing security. See I.R.C. § 6323(c)(2)(C)(ii) (defining “commercial financing security” as including, among other things, “accounts receivable”); 26 C.F.R. § 301.6323(c)-1(c)(2)(ii) (“An account receivable is any right to payment . . . for services rendered which is not evidenced by an instrument or chattel paper.”). Because the payment stream is commercial financing security, AmeriBank might consider pursuing the protection afforded by I.R.C. § 6323(c) to commercial transactions financing agreements. However, unlike collateral that is qualified property associated with commercial transactions financing agreements, collateral may be qualified property under a real property construction or improvement financing agreement even if the taxpayer does not acquire rights in the collateral until more than 45 days have elapsed since the IRS filed its tax lien notice. Compare I.R.C. § 6323(c)(2)(B) (defining “qualified property” in the context of “a commercial transactions financing agreement”) with id. § 6323(c)(3)(B) (defining “qualified property” in the context of a “real property construction or improvement financing agreement”). This distinction has relevance only if SCC did not acquire rights in a specific payment from the City of Houston until after September 15. Nevertheless, another distinction
AmeriBank’s interest in the collateral also must be protected against the competing claim of a lien creditor arising on the date of the tax lien filing—a requirement that exists regardless of the type of agreement under clause (c). Section 9-301(1)(b) of the U.C.C. fully protects AmeriBank’s interest in payments owed by the City of Houston to SCC under the demolition contracts, even if the City of Houston is not obligated to make payment until after the IRS files its notice. On June 1, SCC executed the contract with AmeriBank that created a security interest in the payments and AmeriBank gave value. Therefore, AmeriBank’s interest in each payment attached on the later of (i) June 1 and (ii) the date when the City of Houston became legally obligated to make the payment under the demolition contract. AmeriBank’s interest in each payment became perfected on the later of (i) June 3, the filing date of AmeriBank’s financing statement, and (ii) the date on which the City of Houston became legally obligated to make the payment. Because AmeriBank filed its financing statement before August 1 and the interest of a lien creditor cannot encumber any payment until SCC is entitled to receive it, the lien creditor’s interest in any payment cannot arise before AmeriBank’s interest in that payment is perfected. Therefore, under U.C.C. § 9-301(1)(b), AmeriBank’s interest in each payment by the City of Houston enjoys priority over the competing claim of a lien creditor arising on August 1.

AmeriBank’s interest in the payments is perfected no later than the moment when the interest of the lien creditor encumbers those payments. Thus, AmeriBank can invoke U.C.C. § 9-301(4) and bring within its protection all five advances (including the three advances funded after August 1) because AmeriBank funded each advance “pursuant to a commitment entered into [on June 1 before AmeriBank had] knowledge of the lien [on September 1].”

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noted earlier will prompt AmeriBank to pursue the protection afforded to real property construction or improvement financing agreements rather than commercial transactions financing agreements. See supra note 249.

255. See I.R.C. § 6323(c)(1)(B); see also id. § 6323(a) (giving priority to a holder of a security interest that exists when the IRS files notice of its tax lien); id. § 6323(h)(1) (indicating that a security interest exists “at any time (A) if, at such time . . . the interest has become protected under local law against a subsequent judgment lien arising out of an unsecured obligation”).

256. See supra note 131 (discussing when value is first given).

257. See id. § 9-203(1) (listing the elements of attachment).

258. See supra note 208.

259. See supra note 186 and accompanying text.

260. U.C.C. § 9-301(4). None of the other three alternative safe havens of U.C.C. § 9-301(4) protects all five advances. The first two advances are protected by the first safe haven because they were funded before the interest of the lien creditor arose on August 1. The advances funded on August 20 and September 10 are protected against the lien creditor’s claim by the second safe haven because they were funded within 45 days after
AmeriBank has successfully jumped through all of the hoops necessary to invoke the protection afforded by I.R.C. § 6323(a) and, as applicable to real property construction or improvement financing agreements, I.R.C. § 6323(c). Therefore, the court should enter a declaratory judgment in favor of AmeriBank.

Hypothetical #13
(agricultural financing)

On February 1, AgrilIndustries contractually agreed to finance the farming and livestock operations of Victoria Barkley and her four children, Audra, Jarrod, Nick, and Heath. Throughout the year, AgrilIndustries made numerous cash disbursements to the Barkleys and provided them with various goods and services, such as lumber and seed, on credit. To secure repayment of all cash disbursements and goods and services, the contract between AgrilIndustries and the Barkleys created an enforceable security interest in all crops harvested by the Barkleys during the year, all of their farm equipment, and all of their livestock, whether then owned or thereafter acquired. AgrilIndustries filed a proper financing statement with the appropriate filing officer on February 3. Despite receiving various loans aggregating $500,000 and another $500,000 in goods and services on credit August 1; the last advance was funded on September 25, outside the grace period. The first three advances are protected by the third safe haven because they were funded before AmeriBank discovered the notice on September 1. The two advances funded thereafter on September 10 and 25 are not protected by this safe haven. Nevertheless, because the statute is phrased disjunctively, and because each advance was funded “pursuant to a commitment entered into without knowledge of the lien,” all five advances enjoy the protection afforded by U.C.C. § 9-301(4).

261. Clause (a) protects AmeriBank’s security interests that arise before the IRS filed its tax lien notice. Such interests are limited to property interests in payments that the City of Houston became legally obligated to make before August 1, but only to the extent that such payments secure repayment of the two pre-notice advances. Clause (c) protects AmeriBank’s security interests that arise thereafter. Such interests include property interests in (i) payments that the City of Houston became legally obligated to make before August 1, to the extent such payments secure repayment of the three post-notice advances, and (ii) payments that the City of Houston became legally obligated to make after August 1, regardless whether such payments secure repayment of the two pre-notice advances or the three post-notice advances.

262. These characters, from the television series The Big Valley, were portrayed by Barbara Stanwyck, Linda Evans, Richard Long, Peter Breck, and Lee Majors, respectively. Lee Majors later played The Six Million Dollar Man, a character that became romantically involved with The Bionic Woman, a role made famous by Lindsay Wagner. One of Ms. Wagner’s early film roles was playing the daughter of Professor Charles Kingsfield (a role for which John Houseman won the Oscar for Best Supporting Actor) and the girlfriend of law student James Hart (portrayed by Timothy Bottoms) in The Paper Chase. And you thought this footnote had no jurisprudential value.
throughout the year, the Barkleys never disclosed to AgriIndustries that the IRS had assessed a $250,000 federal tax lien against the Barkleys' farm on May 1 for overdue income taxes. The IRS filed a proper notice of its tax lien with the appropriate filing officer on July 1. AgriIndustries discovered the notice on August 1 after ordering a routine lien search report on the Barkleys.

On October 1, AgriIndustries and the IRS each seeks a declaratory judgment stating that its interest in the current year's crops, as well as all equipment (including a combine acquired on July 15) and all livestock (including thirty horses purchased on August 1), is superior to the interest of the other. Whose interest enjoys priority? In what collateral?

AgriIndustries may have made one or more post-notice advances, and its property interest extends to some post-notice collateral. Therefore, it needs the dual protection of I.R.C. § 6323(a) and I.R.C. § 6323(c).

Regardless of the label attached to the contract between AgriIndustries and the Barkleys, AgriIndustries is not entitled to any protection under clause (a) or clause (c) unless the property interest arose from a contract executed by the parties before the IRS filed its tax lien notice. AgriIndustries satisfies this requirement because the parties executed the contract that created the property interest on February 1; the IRS did not file its notice until July 1.

The contract also qualifies as a real property construction or improvement financing agreement because AgriIndustries agreed to "make cash disbursements to finance . . . (iii) the raising or harvesting of a farm crop

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263. See supra note 198.

264. AgriIndustries prefers that its contract with the Barkleys be construed as a real property construction or improvement financing agreement rather than a commercial transactions financing agreement for several reasons. First, no equipment acquired by the Barkleys after the IRS files its notice will qualify for protection afforded to commercial transactions financing agreements. See I.R.C. § 6323(c)(2)(A) (extending protection to property interests in "commercial financing security"); id. § 6323(c)(2)(C) (defining "commercial financing security" as four discrete forms of collateral, none of which is "equipment"). Second, AgriIndustries would receive no protection for post-notice advances made either with knowledge of the tax lien notice or more than 45 days after the IRS filed its notice. See id. § 6323(c)(2)(A). And third, even if some of the collateral falls within one of the four discrete categories of commercial financing security, only collateral acquired by the Barkleys before the forty-sixth day after the IRS filed its notice would be protected. Id. § 6323(c)(1)(A) (extending protection to property interests in qualified property); id. § 6323(c)(2)(B) (defining "qualified property" in the context of a commercial transactions financing agreement). These three limitations disappear if the contract between AgriIndustries and the Barkleys is a real property construction or improvement financing agreement.
or the raising of livestock or other animals [by the Barkleys]." The fact that AgriIndustries provided goods and services, in addition to cash, under its contract with the Barkleys does not remove the contract from the quoted language. "For purposes of clause (iii), the furnishing of goods and services shall be treated as the disbursement of cash."266

Even if the contract is a real property construction or improvement financing agreement, the property interest of AgriIndustries is protected against the competing claim of the IRS only to the extent that the collateral is qualified property.267 Because AgriIndustries is financing farming and livestock operations, "qualified property" means "property subject to the lien imposed by section 6321 at the time of tax lien filing and the crop or the livestock or other animals [harvested or raised]."268 This definition requires that the collateral satisfy one of two tests: it must exist when the IRS filed its notice, or it must be the crop or the livestock being harvested or raised under the financing contract. Rephrased, all of the taxpayer's crops and livestock are "qualified property" to the extent the harvesting or raising thereof are being financed by the creditor. Other collateral comprised of non-crop and non-livestock assets of the taxpayer, such as equipment, also constitutes qualified property, but only to the extent that the taxpayer acquired rights in that collateral before the IRS filed its notice.

All crops harvested and livestock raised by the Barkleys with the financial assistance of AgriIndustries are qualified property. Although the Barkleys acquired the thirty horses after the IRS filed its notice, the horses are qualified property if AgriIndustries can prove that the Barkleys used some of the financial support to raise the horses. If evidence indicates that the Barkleys never used any of the financial support provided by AgriIndustries to raise the horses, the horses are not qualified property.269 Despite the inclusion of an after-acquired property clause in the contract, only equipment acquired by the Barkleys before the IRS filed its tax lien notice will be qualified property. Because the IRS filed its notice on July 1 and the Barkleys did not acquire the combine until July 15, the combine is not qualified property.

265. Id. § 6323(c)(3)(A).
266. Id. § 6323(c)(3)(A)(iii).
267. See id. § 6323(c)(1)(A).
268. Id. § 6323(c)(3)(B)(iii).
269. Just because evidence may indicate that the Barkleys never used any of the financial support provided by AgriIndustries to raise specific livestock or certain crops does not prevent the non-financed assets from being qualified property. However, such non-financed assets are qualified property only if the Barkleys had rights in them before the IRS filed its notice. See I.R.C. § 6323(c)(3)(B)(iii). The Barkleys did not acquire the thirty horses until one month after the IRS had filed its notice. Therefore, the horses cannot be qualified property unless the Barkleys used some of the financial support provided by AgriIndustries to raise them.
AmeriBank’s interest in the collateral also must be protected under local law against the competing interest of a lien creditor arising as of July 1.\textsuperscript{270} Section 9-301(1)(b) of the U.C.C. fully protects the interest of AgrilIndustries in the crops, livestock, and equipment, including the combine and the thirty horses acquired by the Barkleys after the tax lien filing. AgrilIndustries and the Barkleys executed the contract that created the security interest on February 1, the same day on which AgrilIndustries first gave value.\textsuperscript{271} Therefore, AgrilIndustries’ interest attached to an item of collateral on the earlier of (i) February 1 or (ii) the day on which the Barkleys first acquired rights in that item.\textsuperscript{272} If the Barkleys had rights in an item of collateral before AgrilIndustries filed its financing statement on February 3, then AgrilIndustries’ interest in that item became perfected on February 3; if the Barkleys did not acquire rights in an item of collateral until after AgrilIndustries filed its financing statement, then attachment and perfection of the interest in that item occurred at the moment the Barkleys acquired rights in that item.\textsuperscript{273} Because AgrilIndustries filed its financing statement before July 1, and the interest of the lien creditor cannot encumber any item of collateral until the Barkleys acquire rights in it, the interest of the lien creditor in any item of collateral cannot arise before the interest of AgrilIndustries becomes perfected. Therefore, U.C.C. § 9-301(1)(b) protects the interest of AgrilIndustries in each item of collateral against the competing claim of a lien creditor arising on July 1.\textsuperscript{274}

The interest of the lien creditor in the protected collateral does not arise before the interest of AmeriBank is perfected. Therefore, the entire amount of all unpaid loans, goods, and services provided by AgrilIndustries, including the loans made and goods and services provided after the IRS filed its tax lien notice, is fully protected because AgrilIndustries made each loan and provided all goods and services “pursuant to a commitment entered into [on February 1 before AgrilIndustries had] knowledge of the lien [on August 1].”\textsuperscript{275}

\textsuperscript{270.} See supra note 206.
\textsuperscript{271.} See supra note 131 (discussing when value is first given).
\textsuperscript{272.} See U.C.C. § 9-203(1) (listing the elements of attachment).
\textsuperscript{273.} See supra note 208.
\textsuperscript{274.} See supra note 186 and accompanying text. Nevertheless, for reasons discussed in the previous textual paragraph, AgrilIndustries will not enjoy priority in the combine and may not enjoy priority in other collateral.
\textsuperscript{275.} See U.C.C. § 9-301(4). The extent to which any of the other safe havens of U.C.C. § 9-301(4) protect AgrilIndustries’ loans and credit sales is fact-sensitive. All cash disbursements (including goods and services sold or provided on credit according to I.R.C. § 6323(c)(3)) made by AgrilIndustries before July 1 are protected by the first safe haven. Any cash disbursements made after July 1 but within the 45 days thereafter are protected by the second safe haven. The third safe haven protects all cash disbursements made by AgrilIndustries before it discovered the tax lien filing on August 1. Those cash disbursements made by AgrilIndustries after August 15 would not be protected by any of the
In summary, both AgrilIndustries and the IRS enjoy priority in certain collateral, and the court should issue its declaratory judgment accordingly. The judgment should indicate that the interest of AgrilIndustries enjoys priority over the competing claim of the IRS in (i) all crops and livestock (which may include the thirty horses) being harvested or raised by the Barkleys with the financial assistance of AgrilIndustries and (ii) all farm equipment in which the Barkleys had rights when the IRS filed its notice on July 1. Conversely, the judgment should indicate that the interest of the IRS enjoys priority over the competing claim of AgrilIndustries in (i) all crops and livestock (which may include the thirty horses) not being harvested or raised by the Barkleys with the support of AgrilIndustries and (ii) all farm equipment (including the combine purchased on July 15) in which the Barkleys did not have rights when the IRS filed its notice on July 1.

3. Obligatory Disbursement Agreement

All is not lost under I.R.C. § 6323(c) for a creditor whose property interest arises under a contract that is neither a commercial transactions financing agreement nor a real property construction or improvement financing agreement. A creditor may still claim some of the protection afforded by I.R.C. § 6323(c) if its property interest arises under a contract first three safe havens since they would occur (i) after the lien creditor’s interest arose on July 1, (ii) beyond the forty-fifth day after July 1, and (iii) with knowledge of the tax lien filing. Nevertheless, because the language of U.C.C. § 9-301(4) is phrased disjunctively, every cash disbursement made by AgrilIndustries, regardless of timing or knowledge, enjoys full protection under the fourth safe haven of U.C.C. § 9-301(4) against the competing claim of the IRS as a lien creditor as AgrilIndustries made each cash disbursement “pursuant to a commitment entered into without knowledge of the lien.” Id.

For at least two reasons, the reference to the word “advance” in U.C.C. § 9-301(4) should not prevent AgrilIndustries from invoking the statute to protect not only its cash advances but also the goods sold and services provided on credit by AgrilIndustries to the Barkleys. First, “advance” is not defined in the U.C.C., so expanding its meaning to include not only cash advances but other forms of advances (e.g., credit advances provided in the form of goods and services) does not violate any definitional constraints; cf. id. § 9-204(3) (“Obligations covered by a security agreement may include future advances or other value . . . .”) (emphasis added). Second, in the context of real property construction or improvement financing agreements, the I.R.C. expressly attempts to afford protection to creditors who furnish goods and services in addition to making cash loans. See I.R.C. § 6323(c)(3)(A)(iii) (treating “the furnishing of goods and services” as “cash disbursements”). If U.C.C. § 9-301(4) is construed to apply solely to cash advances, much of the protection expressly afforded to creditors by the I.R.C. would be lost, and the concluding sentence of I.R.C. § 6323(c)(3)(A) is rendered meaningless. Instead, to harmonize the two statutes, the term “advance” in U.C.C. § 9-301(4) should include within its meaning not only cash advances but the furnishing of goods and services—if not generally, then at least in the context of a credit document that qualifies as a real property construction or improvement financing agreement.
that is an "obligatory disbursement agreement." Hypothetical #14 and the accompanying discussion illustrate the hurdles over which the creditor must successfully jump in order to qualify for such protection.

Hypothetical #14

On July 1, Texas Furniture Company (TFC) contractually agreed to purchase a large shipment of bedroom furniture from Bradford Interiors, a Seattle-based manufacturer. Because this was the first contract between the two parties, TFC hesitated to pay for the furniture before it arrived in Texas, and Bradford Interiors refused to deliver the furniture before being paid. The parties agreed that Bradford Interiors would be paid by presenting drafts and various other documents (including a negotiable bill of lading\textsuperscript{277}) described in a letter of credit to be issued by TFC’s financial institution, AmeriBank, to Bradford Interiors.\textsuperscript{278} AmeriBank issued a $1,000,000 irrevocable letter of credit on July 10. Additionally, TFC and AmeriBank executed a reimbursement agreement on July 10 that summarized AmeriBank’s payment obligations and TFC’s reimbursement duties.\textsuperscript{279} Additionally, to secure repayment of all pay-

\textsuperscript{276} See I.R.C. § 6323(c)(1)(A)(iii).

\textsuperscript{277} The U.C.C. defines a “bill of lading” as “a document evidencing the receipt of goods for shipment issued by a person engaged in the business of transporting or forwarding goods, and includes an airbill.” U.C.C. § 1-201(6). An “airbill” is “a document serving for air transportation as a bill of lading does for marine or rail transportation, and includes an air consignment note or air waybill.” Id. A bill of lading is negotiable “(a) if by its terms the goods are to be delivered to bearer or to the order of a named person; or (b) where recognized in overseas trade, if it runs to a named person or assigns.” Id. § 7-104(1).

\textsuperscript{278} Professor Baird explains:

This arrangement benefits all parties to the transaction. [Bradford Interiors] can manufacture goods to [TFC’s] order, confident it will be paid regardless of what befalls [TFC], because it can rely on [AmeriBank’s] commitment. [TFC] is better off than if it had advanced cash to [Bradford Interiors], because it does not become liable for the price until a trustworthy party [AmeriBank] has possession of a negotiable document of title. [AmeriBank], in turn, earns a fee for issuing the letter and exposes itself to only a small risk, because it can readily assess the creditworthiness of [TFC] and, as the holder of a negotiable bill of lading, it has a perfected security interest in the goods involved in the transaction.

Douglas G. Baird, Standby Letters of Credit in Bankruptcy, 49 U. Chi. L. Rev. 130, 134 (1982); see also U.C.C. § 1-201(6) (defining “bill of lading”); id. § 1-201(15) (defining “document of title” as including a “bill of lading”); id. § 7-104(1) (indicating when a bill of lading is “negotiable”); id. § 9-105(1)(f) (defining “document” as including a “document of title”); id. § 9-304(2) & cmt. 2 (indicating that a security interest in goods that are subject to a negotiable document is perfected by perfecting a security interest in the negotiable document itself); id. § 9-305 (“A security interest in . . . negotiable documents . . . may be perfected by the secured party’s taking possession of the collateral.”).

\textsuperscript{279} AmeriBank enjoys a statutory right to prompt repayment by TFC of all funds
ments properly made by AmeriBank to Bradford Interiors under the letter of credit, the reimbursement agreement created a security interest in (i) the furniture being sold by Bradford Interiors to TFC and (ii) three pieces of equipment already owned by TFC. AmeriBank filed a proper financing statement with the appropriate filing officer on July 15.

As contemplated by the purchase contract, Bradford Interiors made a $200,000 furniture shipment on August 10, a $300,000 furniture shipment on September 10, and a $500,000 furniture shipment on October 10. AmeriBank honored Bradford Interiors’ proper demands for payment by paying $200,000 to Bradford Interiors on August 13, $300,000 on September 13, and $500,000 on October 13.

TFC did not disclose to AmeriBank that the IRS had assessed a $1,500,000 federal tax lien against its property on May 1 for overdue corporate income taxes. The IRS filed a proper tax lien notice with the appropriate filing officer on August 1. AmeriBank discovered the notice on September 1 after ordering a routine lien search report on TFC.

On November 1, AmeriBank and the IRS each seeks a declaratory judgment stating that its interest in the furniture purchased by TFC from Bradford Interiors, as well as the three pieces of equipment also serving as collateral, has priority over the interest of the other. Whose interest enjoys priority? In what collateral?

Because AmeriBank advanced the entire $1,000,000 after the IRS filed its notice, it enjoys no protection afforded by I.R.C. § 6323(a) to holders of security interests. If evidence indicates that TFC did not acquire an interest in some of the collateral until after August 1, AmeriBank will prefer to pursue its remedies under I.R.C. § 6323(c) (which offers some protection to post-notice collateral) rather than I.R.C. § 6323(d) (which does not).

AmeriBank satisfies one of the requirements of clause (c) because its interest in the collateral arises from a written agreement executed on July 10, three weeks before the IRS filed its notice on August 1.
For AmeriBank to enjoy the protection afforded by I.R.C. § 6323(c) to post-notice security interests, the reimbursement agreement also must be a real property construction or improvement financing agreement, a commercial transactions financing agreement, or an obligatory disbursement agreement.\textsuperscript{282} The agreement is not a real property construction or improvement financing agreement because AmeriBank is not financing real estate, crop, or livestock activity.\textsuperscript{283} The reimbursement agreement may be a commercial transactions financing agreement, but AmeriBank will not be able to protect the two advances made after it discovered the tax lien filing on September 1.\textsuperscript{284} Furthermore, the protection extends only to furniture sold by Bradford Interiors in which TFC acquired rights before September 16; all furniture in which TFC acquired rights thereafter, plus all equipment—regardless of when TFC acquired rights therein—is excluded from the protection afforded to property interests arising under commercial transactions financing agreements.\textsuperscript{285} To enjoy any protection under clause (c) for the two advances funded after September 1, and to enjoy priority in the furniture, in which TFC acquired rights after September 15, as well as the three pieces of equipment serving as collateral, AmeriBank must hope that its contract with TFC is an obligatory disbursement agreement.

An obligatory disbursement agreement is defined as:

an agreement (entered into by a person in the course of his trade or business) to make disbursements, but such an agreement shall be treated as coming within the term only to the extent of disbursements which are required to be made by reason of the intervention of the rights of a person other than the taxpayer.\textsuperscript{286}

AmeriBank’s agreement with TFC satisfies the two-pronged definition. First, AmeriBank made disbursements under an agreement entered into in

\begin{itemize}
  \item \textsuperscript{282} See id. § 6323(c)(1)(A)(i)-(iii).
  \item \textsuperscript{283} See id. § 6323(c)(3)(A).
  \item \textsuperscript{284} See id. § 6323(c)(2)(A). Even absent knowledge of the tax lien filing, AmeriBank’s payment of $500,000 to Bradford Interiors on October 13 would not be protected as part of a commercial transactions financing agreement because the payment occurred more than 45 days after the IRS filed its notice. \textit{Id.}
  \item \textsuperscript{285} See id. § 6323(c)(1)(A) (limiting protection to qualified property); \textit{id.} § 6323(c)(2)(B) (defining “qualified property” in the context of a commercial transactions financing agreement as “commercial financing security acquired by the taxpayer before the forty-sixth day after the date of tax lien filing”); \textit{id.} § 6323(c)(2)(C) (including inventory, but not equipment, within the definition of “commercial financing security”).
  \item \textsuperscript{286} \textit{Id.} § 6323(c)(4)(A). “Interests arising under an obligatory disbursement agreement are protected because a person is obliged under a preexisting agreement to make disbursements after a tax lien filing and someone other than the taxpayer has relied on this obligation.” \textit{S. REP. NO. 1708, reprinted in 1966 U.S.C.C.A.N. at 3723-24.}
\end{itemize}
the normal course of its business as a financial institution.\textsuperscript{287} And second, AmeriBank was required to make disbursements under the contract upon proper demand by Bradford Interiors,\textsuperscript{288} a person other than taxpayer TFC.\textsuperscript{289}

Additionally, the equipment and furniture must be qualified property.\textsuperscript{290} When used in the context of an obligatory disbursement agreement, "qualified property" means "property subject to the lien imposed by section 6321 at the time of tax lien filing and (to the extent that the acquisition is directly traceable to the disbursements [made under the agreement]) property acquired by the taxpayer after tax lien filing."\textsuperscript{291} The three pieces of equipment are qualified property because TFC owned them before the IRS filed its notice. And all of the furniture acquired by TFC from Bradford Interiors is qualified property because TFC either had rights in the furniture before the IRS filed its notice or acquired rights in the furniture by making disbursements directly traceable to the reimbursement agreement and letter of credit.\textsuperscript{292}

Finally, AmeriBank's interest in the collateral must be protected against the interest of a lien creditor arising on the date of the tax lien filing.\textsuperscript{293} AmeriBank first gave value on July 10 when it issued the letter of credit, and TFC executed an agreement on July 10 that created a security interest in the furniture described therein. Because TFC already owned the three pieces of equipment, AmeriBank's interest in the equipment attached on July 10\textsuperscript{294} and became perfected when AmeriBank filed its financing statement

\textsuperscript{287}. For a case in which the court held that an indemnity agreement was not an obligatory disbursement agreement because the indemnitors did not enter into the agreement as part of their trade or business, see Trigg, 465 F.2d at 1264. One commentator argues that the "trade or business" requirement is "utterly indefensible" and "not merely inequitable but . . . irrational." See Plumb, supra note 66, at 278-79.

\textsuperscript{288}. See U.C.C. § 5-108(a) (1995) ("an issuer shall honor a presentation that . . . appears on its face strictly to comply with the terms and conditions of the letter of credit."); id. § 5-114(1) ("An issuer must honor a draft or demand for payment which complies with the terms of the relevant credit . . . .").

\textsuperscript{289}. Unlike loans or purchases made under a commercial transactions financing agreement, disbursements under an obligatory disbursement agreement may be made with knowledge of, or more than 45 days after, the tax lien filing. Compare I.R.C. § 6323(c)(2)(A) (defining "commercial transactions financing agreement") with id. § 6323(c)(4)(A) (defining "obligatory disbursement agreement").

\textsuperscript{290}. See id. § 6323(c)(1)(A).

\textsuperscript{291}. Id. § 6323(c)(4)(B).

\textsuperscript{292}. AmeriBank should be able to satisfy its tracing burden by matching furniture descriptions in the documents that accompanied the payment requests by Bradford Interiors to the actual furniture that is the subject of the priority dispute.

\textsuperscript{293}. See I.R.C. § 6323(c)(1)(B). If AmeriBank attempted to pursue its remedies under clause (d), it must satisfy the same requirement. See id. § 6323(d)(2).

\textsuperscript{294}. See U.C.C. § 9-203(1)-(2).
PRIORITY DISPUTES

on July 15. AmeriBank’s interest in the equipment was perfected before August 1, the date the IRS became a lien creditor, and therefore is protected against the competing claim of the IRS.

Likewise, AmeriBank’s interest in the furniture attached on the later of (i) July 10 (when AmeriBank gave value and the parties executed the reimbursement agreement) and (ii) the date on which TFC acquired rights in the furniture. The property interest became perfected on the later of (i) July 15 (when AmeriBank filed its financing statement) and (ii) the date on which TFC acquired rights in the furniture. With respect to furniture in which TFC acquired rights before August 1, AmeriBank’s interest enjoys priority over the competing interest of the lien creditor under U.C.C. § 9-301(1)(b). The lien creditor’s interest does not arise before AmeriBank’s interest is perfected. With respect to the furniture in which TFC acquires rights after August 1, the interest of the lien creditor arises at the very moment that AmeriBank’s interest becomes perfected—when TFC acquires rights in the furniture. Because the lien creditor’s interest arises simultaneously with, rather than before, the moment of perfection, U.C.C. § 9-301(1)(b) awards priority in the post-notice furniture to AmeriBank.

Because the lien creditor’s interest in the collateral does not arise before perfection of AmeriBank’s interest, AmeriBank can bring all three advances within the ambit of U.C.C. § 9-301(4). AmeriBank funded each advance pursuant to a commitment entered into on July 10, before it discovered on September 1 that the IRS had already filed its notice.

295. See supra note 208.
296. U.C.C. § 9-301(1)(b).
297. See id. § 9-203(1). At what time a debtor acquires “rights” in collateral is an issue left unresolved by Article 9. See 8 HAWKLAND, supra note 110, § 9-203.12, at 717 (“Article 9 nowhere defines what is meant by the term rights in the collateral . . . .”). See also WHITE & SUMMERS, supra note 91, § 31-11, at 147 n.4 (“[I]n a letter of credit the final event for attachment of the security interest would be the debtor’s acquisition of rights. When a buyer ‘acquires rights’ is unclear, but rights could be and likely would be acquired long before the goods had arrived.”). If the contract involves the sale of goods, selected provisions of Article 2 of the U.C.C. may be helpful. See, e.g., id. § 2-401(1) (“In a letter of credit the final event for attachment of the security interest would be the debtor’s acquisition of rights. When a buyer ‘acquires rights’ is unclear, but rights could be and likely would be acquired long before the goods had arrived.”); id. § 2-501(1) (“The buyer obtains a special property and an insurable interest in goods” upon identification of the goods to the contract).
298. See supra note 208.
299. See also supra note 186 and accompanying text.
300. See U.C.C. § 9-301(4) (protecting advances made “pursuant to a commitment entered into without knowledge of the lien”). The $200,000 payment on August 13 and the $300,000 payment on September 13 also are protected because they were made within 45 days after August 1. Id. (protecting advances made within 45 days after the interest of the lien creditor arises). Furthermore, the $200,000 payment on August 13 is protected because AmeriBank funded it before discovering the tax lien filing. Id. (protecting advances “made without knowledge of the lien”). Because AmeriBank made the $400,000 advance on
AmeriBank has successfully jumped through all of the hoops necessary to invoke the protection afforded by I.R.C. § 6323(c) to property interests arising under an obligatory disbursement agreement. As a result, its interest in the equipment and furniture enjoys priority over the competing claims of the IRS. The court should enter a declaratory judgment in favor of AmeriBank.

D. I.R.C. § 6323(d): Mere Surplusage in Light of the Protection Afforded by I.R.C. § 6323(c)?

The protection afforded to a secured party by I.R.C. § 6323(d) extends to post-notice advances that are funded timely and without notice or knowledge of the tax lien filing. However, the statute offers no solace to the secured party relying on the Article 9 protection afforded by an after-acquired property clause, at least if the after-acquired property is acquired by the taxpayer after the IRS files its tax lien notice. Because I.R.C. § 6323(c) offers similar protection not only for post-notice advances, but also for certain post-notice collateral, why would a secured party ever invoke the protection of I.R.C. § 6323(d)? Can a secured party not receive at least the same—if not more—protection under I.R.C. § 6323(c) than under I.R.C. § 6323(d)? And if so, why not purge the latter from the I.R.C.?

The following hypothetical, based on a common situation, suggests that subsection (d) is not rendered redundant by subsection (c). In fact, depending on the market values of the various types of collateral, it illustrates that a secured party actually may receive a greater benefit by invoking subsection (d) rather than subsection (c).

Hypothetical #15

On June 1, AmeriBank contractually agreed to loan up to $5,000,000 in one or more advances to TFC. To secure repayment of all advances, TFC executed a security agreement on June 1 that created an enforceable security interest in all of its accounts receivable, inventory, and equipment, in each case whether then owned or thereafter acquired or created. AmeriBank filed a proper financing statement with the appropriate filing officer on June 3. AmeriBank made loans to TFC of $1,000,000 on June 5 and July 5 and $1,500,000 on August 5 and September 5. TFC did not disclose that October 13, which is a date after AmeriBank had knowledge of the tax lien notice and beyond the 45-day safe harbor, the advance is protected under U.C.C. § 9-301(4) solely by the “pursuant to commitment” provision.

301. See I.R.C. § 6323(d).
302. See id. § 6323(d)(1)(A) (requiring property to exist when the IRS files its tax lien notice).
IRS had assessed a $3,500,000 federal tax lien against the property of TFC on March 1 for overdue corporate income taxes. The IRS filed a proper notice with the appropriate filing officer on August 1. AmeriBank discovered the notice on September 10 after ordering a routine lien search report on TFC.

On October 1, AmeriBank and the IRS each seeks a declaratory judgment stating that its interest in TFC's equipment, inventory, and receivables is superior to the interest of the other. Evidence indicates that the collateral has the following market value as of October 1:

<table>
<thead>
<tr>
<th>Equipment</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>acquired before 8/1</td>
<td>$ 3,000,000</td>
</tr>
<tr>
<td>acquired on or after 8/1</td>
<td>$ 250,000</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Inventory</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>acquired before 8/1</td>
<td>$ 500,000</td>
</tr>
<tr>
<td>acquired 8/1 - 9/15</td>
<td>$ 500,000</td>
</tr>
<tr>
<td>acquired thereafter</td>
<td>$ 1,000,000</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Receivables</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>acquired before 8/1</td>
<td>$ 500,000</td>
</tr>
<tr>
<td>acquired 8/1 - 9/15</td>
<td>$ 500,000</td>
</tr>
<tr>
<td>acquired thereafter</td>
<td>$ 1,000,000</td>
</tr>
</tbody>
</table>

If the collateral is liquidated at its market value, to whom should the court distribute the proceeds?

Because AmeriBank made two post-notice loans and TFC acquired or generated much of the collateral after the IRS filed its notice, AmeriBank cannot rely solely on the protection afforded by I.R.C. § 6323(a) to holders of security interests. If AmeriBank assumes that I.R.C. § 6323(d) affords no greater (and probably less) protection than I.R.C. § 6323(c), it initially will seek the supplemental protection afforded by I.R.C. § 6323(c).

As required by subsections (a) and (c),

303. See supra note 198.
This security agreement also satisfies the numerous elements of a commercial transactions financing agreement, one of the three required forms of agreement under clause (c).304 First, AmeriBank entered into the agreement in the ordinary course of its business as a financial institution that regularly makes secured loans to corporate customers.305 Second, the agreement requires AmeriBank to make loans to TFC.306 Third, some of the collateral (e.g., the receivables and inventory) that secures repayment of the loans is commercial financing security.307 Fourth, the equipment, inventory, and receivables presumably were acquired, manufactured, or generated by TFC in the ordinary course of its business as a seller and lessor of furniture.308 Fifth, AmeriBank funded the four advances before September 10, the date it discovered the tax lien notice.309 And finally, AmeriBank funded each advance before September 16, the forty-sixth day following the filing date of the notice (August 1).310

Also as required by subsections (a) and (c), AmeriBank’s interest is completely protected under local law against the rights of a lien creditor arising on August 1.311 On June 1, TFC executed a security agreement that created a security interest in the collateral, and AmeriBank first gave value.312 Therefore, AmeriBank’s interest in any item of collateral attached on the earlier of (i) June 1 and (ii) the date when TFC acquired or generated the item of collateral.313 Its interest in any item of collateral became perfected on the later of (i) June 3, the filing date of the financing statement, and (ii) the date when TFC acquired or generated the item of collateral.314 With respect to pre-notice collateral, AmeriBank’s interest became perfected before August 1 and thus enjoys priority under U.C.C. § 9-301(1)(b). Such priority is not limited to the pre-notice collateral. The interest of the lien creditor in the post-notice collateral arises as soon as TFC acquires or creates the property; AmeriBank’s interest in the

304. I.R.C. § 6323(c)(1)(A). The agreement is not a real property construction or improvement financing agreement because the facts do not indicate that AmeriBank is financing “(i) the construction or improvement of real property, (ii) a contract to construct or improve real property, or (iii) the raising or harvesting of a farm crop or the raising of livestock or other animals.” Id. § 6323(c)(3)(A). The agreement is not an obligatory disbursement agreement because the facts do not indicate that AmeriBank is required to fund advances demanded by someone other than TFC. See id. § 6323(c)(4)(A).

305. See id. § 6323(c)(2)(A).
306. See id. § 6323(c)(2)(A)(i).
307. See id. § 6323(c)(2)(A)(i); id. § 6323(c)(2)(C)(ii), (iv).
308. See id. § 6323(c)(2)(A)(i).
309. See id. § 6323(c)(2)(A).
310. Id.
311. See supra note 206.
312. See supra note 131 (discussing when value is first given).
313. U.C.C. § 9-203(1) (discussing the elements of attachment).
314. See supra note 208.
same collateral not only attaches, but becomes perfected, at the very same moment. Because the interest of the lien creditor in the post-notice collateral arises simultaneously with, rather than before, perfection of AmeriBank’s interest, U.C.C. § 9-301(1)(b) awards priority in the post-notice collateral to AmeriBank.\footnote{See supra note 186 and accompanying text.}

The lien creditor’s interest in the collateral does not arise before AmeriBank’s interest is perfected. Thus, all four of AmeriBank’s advances (including the two post-notice advances) enjoy protection under the U.C.C. AmeriBank funded each advance (i) before September 16, the forty-sixth day following the date of the tax lien filing, (ii) before AmeriBank discovered the filing on September 10, and (iii) pursuant to a commitment entered into by AmeriBank without knowledge of the tax lien.\footnote{See U.C.C. § 9-301(4). Because the language of U.C.C. § 9-301(4) is phrased disjunctively, the advances enjoy protection for any one of the three reasons stated.}

Nevertheless, to enjoy the protection afforded by subsection (c) AmeriBank’s interest must be in collateral that is qualified property.\footnote{See I.R.C. § 6323(c)(1)(A).} AmeriBank’s interest contractually extends to receivables, inventory, and equipment. Qualified property includes accounts receivable and inventory—but only to the extent that TFC created or acquired the accounts receivable and inventory before September 16.\footnote{See id. § 6323(c)(2)(C)(i), (iv).} Furthermore, and perhaps most alarming to AmeriBank, equipment—even equipment acquired by TFC before the IRS filed its tax lien notice—is not qualified property.\footnote{See id. § 6323(c)(2)(B).} AmeriBank can claim priority in the pre-notice equipment under I.R.C. § 6323(a), but only to the extent that that property secures repayment of the two pre-notice advances.

Therefore, if the collateral existing on the dispute date of October 1 is liquidated for market value, AmeriBank will suffer a shortfall of $1,000,000 if it relies solely on the protection afforded by clauses (a) and (c). Clause (a) gives AmeriBank priority in the pre-notice collateral of $4,000,000, but only to the extent of the pre-notice advances of $2,000,000. Because clause (c) permits pre-notice collateral to secure repayment of post-notice advances only if the pre-notice collateral is qualified property, AmeriBank will achieve maximum benefit if it applies the proceeds of the pre-notice, non-qualified property (the equipment) against the pre-notice advances. The pre-notice equipment, if liquidated for its fair market value of $3,000,000, will completely satisfy the two pre-notice advances of $1,000,000. AmeriBank will then add the proceeds of the pre-notice inventory ($500,000) and pre-

\footnote{The only types of qualified property other than receivables and inventory are “paper of a kind ordinarily arising in commercial transactions,” id. § 6323(c)(2)(C)(i), and “mortgages on real property,” id. § 6323(c)(2)(C)(iii).}
notice receivables ($500,000) to the post-notice qualified property (inventory of $500,000 and receivables of $500,000) and apply those proceeds ($2,000,000) against the post-notice advances of $3,000,000, leaving a priority shortfall of $1,000,000. The IRS will claim priority in all other equipment ($250,000), inventory ($1,000,000), and receivables ($1,000,000) and apply the proceeds therefrom against its tax lien of $3,500,000. The IRS can cover its shortfall of $1,250,000 by claiming priority in the $1,000,000 proceeds remaining from the sale of the pre-notice equipment that AmeriBank could not apply to its post-notice debt. Then the IRS can satisfy the $250,000 balance by liquidating other collateral of TFC. But where can AmeriBank turn for solace?

The answer is I.R.C. § 6323(d). AmeriBank’s interest in the collateral arises from the security agreement, thus satisfying the pre-notice “written contract” requirement. Also, AmeriBank satisfies the timeliness and “no knowledge or notice” requirements as AmeriBank funded each advance before discovering the notice and before the forty-sixth day following its filing date. And for the same reasons already discussed, AmeriBank can prove, as required by I.R.C. § 6323(d)(2), that its interest is protected under local law against the competing claim of a lien creditor arising on August 1. But so far, none of the foregoing means any greater protection for AmeriBank. The collateral pool in which AmeriBank has priority certainly appears to be deeper under clause (c) than clause (d). Unlike the former, the latter offers no protection to interests in post-notice collateral. And like clause (d), clause (c) permits pre-notice collateral to secure post-notice advances. However, unlike clause (c), clause (d) does not require the pre-notice collateral to be “qualified property.”

Therefore, by supplementing the protection of clauses (a) and (c) with the protection of clause (d), AmeriBank can claim priority in the excess proceeds of $1,000,000 remaining from the sale of the pre-notice equipment, apply it to repayment of the post-notice advances, and completely eliminate its shortfall.

321. See id. § 6321 (extending the tax lien to all property of the taxpayer).
322. See id. § 6323(d)(1)(B).
323. See id. § 6323(d).
324. See supra notes 312-16 and accompanying text.
325. Compare I.R.C. § 6323(c)(1)(A) (protecting security interests in qualified property) and id. § 6323(c)(2)(B) (defining “qualified property” in the context of a commercial transactions financing agreement as including certain types of collateral “acquired by the taxpayer before the 46th day after the date of tax lien filing”) with id. § 6323(d)(1)(A) (protecting security interests in property that is “subject, at the time of tax lien filing” to the tax lien).
326. Compare id. § 6323(c) (permitting pre-notice collateral to secure post-notice advances) with id. § 6323(d) (also permitting pre-notice collateral to secure post-notice advances).
Two related observations about the interplay between clause (c) (as it pertains to commercial transactions financing agreements) and clause (d) are apparent from the foregoing analysis. First, if the value of qualified property equals or exceeds the amount of the aggregate advances protected under the two clauses, then the secured party receives complete protection under clauses (a) and (c) and does not need any additional protection that may exist under clause (d). Second, if the value of qualified property is less than the amount of the aggregate advances so protected, subsection (d) may afford the secured party the additional protection needed to reduce or eliminate any existing priority shortfall if its Article 9 security interest extends to pre-notice collateral that is not qualified property (e.g., equipment).

A creditor that enjoys the protection extended by clause (c) to property interests arising under an obligatory disbursement agreement will never receive any additional protection by invoking clause (d). From a collateral perspective, clause (d) covers (but is limited to) the creditor's interest in all types of pre-notice collateral.\textsuperscript{327} Clause (c) covers not only all types of pre-notice collateral; it also protects post-notice collateral directly traceable to disbursements made under the agreement.\textsuperscript{328} And from a debt perspective, clause (d) protects advances made by the creditor before the forty-sixth day after, and without knowledge of, the tax lien filing.\textsuperscript{329} But an advance funded under an obligatory disbursement agreement is protected by clause (c) regardless of the timing and the creditor's knowledge.\textsuperscript{330} Because the scope of protection afforded by clause (c) to advances made under an obligatory disbursement agreement (and the collateral securing repayment of those advances) is broader than the protection afforded by clause (d) to advances (and related collateral), a creditor cannot supplement the protection afforded by clause (c) with additional protection under clause (d). No such additional protection exists.

A creditor attempting to invoke the protection afforded by clause (c) to a real property construction or improvement financing agreement may receive additional benefits under clause (d). Under clause (d), advances must be funded by a creditor no later than a specific date after, and without knowledge of, the tax lien filing.\textsuperscript{331} Advances funded under a real property construction or improvement financing agreement are not subject to either constraint.\textsuperscript{332} However, advances funded under a real property construction or improvement financing agreement must be made to the

\textsuperscript{327} See id. § 6323(d)(1)(A).
\textsuperscript{328} See id. § 6323(c)(1)(A) (limiting protection to qualified property); id. § 6323(c)(4)(B) (defining "qualified property" in the context of an obligatory disbursement agreement).
\textsuperscript{329} See id. § 6323(d).
\textsuperscript{330} See id. § 6323(c)(4)(A).
\textsuperscript{331} See id. § 6323(d).
\textsuperscript{332} See id. § 6323(c)(3)(A).
taxpayer for one of three specific, and limited, purposes.\textsuperscript{333} A creditor making advances to the taxpayer for both permissible and impermissible purposes (e.g., a bank that agrees to loan $20,000,000 to the taxpayer, of which $10,000,000 is earmarked to finance the construction of the taxpayer’s new office building (permissible) and $10,000,000 is available for general corporate purposes (impermissible)) may find clause (d) helpful in protecting the impermissible advances not protected by clause (c)—at least if the advances are made by the creditor without knowledge of, and before the forty-sixth day following the tax lien filing. Additionally, repayment of advances made under a real property construction or improvement financing agreement can be secured only by very specific collateral.\textsuperscript{334} If advances otherwise qualify for the protection afforded by clause (d), the creditor might prefer the protection of clause (d) to clause (c), as the former does not limit the type of collateral that may secure repayment of protected advances. However, the preference may be short-lived as clause (d) protects interests only in pre-notice property.\textsuperscript{335} Therefore, whether a creditor under a real property construction or improvement financing agreement can expand the size of its protected collateral package under clause (d) depends on the acquisition date of the non-qualified property.

IV. SPECIAL ISSUES

Some common priority issues are not specifically addressed by clauses (a), (c), and (d) of I.R.C. § 6323. These issues concern (i) priority disputes between the IRS and a secured party with a post-notice purchase money security interest, (ii) the ability of a secured party to expand its priority to collateral beyond the confines of I.R.C. § 6323(c) under a “proceeds” theory, and (iii) circular priority disputes that may arise when the competing claimants include two Article 9 creditors and the IRS. These issues are illustrated and analyzed in Hypotheticals #16, #17, and #18, respectively.

A. Protection for Post-Notice Purchase Money Security Interests

Hypothetical #16

On September 1, CopyCorp sold three photocopiers on credit to TFC for everyday use in its three furniture stores. To secure repayment of the unpaid purchase price, CopyCorp retained a security interest in the three

\textsuperscript{333} See id. § 6323(c)(1)(A) (extending protection to interests in qualified property); id. § 6323(c)(3)(B) (defining “qualified property” in the context of real property construction or improvement financing agreements).

\textsuperscript{335} See id. § 6323(d)(1)(A).
photocopiers pursuant to the retail installment contract executed by TFC. CopyCorp delivered and installed the three photocopiers on September 3 and filed a proper financing statement with the appropriate filing officer on September 5. CopyCorp was unaware that the IRS had assessed a $100,000 federal tax lien against the property of TFC on March 1 for overdue corporate income taxes. The IRS had filed a proper notice of its tax lien with the appropriate filing officer on August 1. After CopyCorp discovered the notice in November, CopyCorp sought a declaratory judgment stating that its interest in the three photocopiers is superior to the interest of the IRS. Should the court honor CopyCorp’s request?

I.R.C. § 6323(a) affords no protection because the CopyCorp-TFC transaction occurred after the IRS had filed its notice. I.R.C. § 6323(d) is likewise inapplicable because the retail installment contract had not yet been executed, and TFC had not yet acquired rights in the photocopiers, when the IRS filed its notice on August 1. And although TFC did acquire rights in the photocopiers on September 3, a date before the forty-sixth day following the filing date of the notice, the protection given by I.R.C. § 6323(c) to property interests under commercial transactions financing agreements is not available for at least two reasons. First, the retail installment contract does not predate the filing date of the notice. Second, because TFC intends to use the photocopiers in its business operations, rather than sell or lease them, the photocopiers are equipment, rather than inventory, and thus are not qualified property.

336. See id. § 6323(a) (protecting security interests that pre-date the filing date of the tax notice); id. § 6323(h)(1) (indicating that a security interest does not arise until the property exists (i.e., the taxpayer has rights in it) and the creditor has given money or money’s worth (e.g., an extension of credit)).

337. See id. § 6323(d).

338. Because CopyCorp is financing the sale of photocopiers, rather than real estate, farm crops, or livestock, the retail installment contract is not a real property construction or improvement financing agreement. See id. § 6323(c)(3)(A) (defining “real property construction or improvement financing agreement”). Nor do the facts suggest that anyone other than CopyCorp and TFC enjoys any benefits under the contract. Therefore, it is not an obligatory disbursement agreement. See id. § 6323(c)(4)(A) (defining “obligatory disbursement agreement”).

339. See id. § 6323(c)(1)(A).

340. See U.C.C. § 9-109(2) (defining “equipment” as goods “used or bought for use primarily in business”).

341. See supra note 204.

342. See I.R.C. § 6323(c)(1)(A) (protecting a creditor’s interest in qualified property); id. § 6323(c)(2)(B) (defining “qualified property” as “commercial financing security” timely acquired by the taxpayer); id. § 6323(c)(2)(C) (defining “commercial financing security”).
CopyCorp has a PMSI under U.C.C. § 9-107(a) because CopyCorp is the seller of the photocopiars and is retaining an interest in them to secure repayment of their purchase price. As the holder of a PMSI, CopyCorp may enjoy priority over existing secured creditors under the superpriority provision of U.C.C. § 9-312(4). Unlike the U.C.C., however, I.R.C. § 6323 does not expressly award superpriority to holders of PMSIs.

Nevertheless, CopyCorp may enjoy priority through Revenue Ruling 68-57, in which the IRS has stated that "a purchase money security interest or mortgage valid under local law is protected [from competing claims of the IRS] even though it may arise after a notice of Federal tax lien has been filed." The emphasized language indicates that the post-notice nature

343. See U.C.C. § 9-107(a).

344. CopyCorp can successfully invoke the protection of U.C.C. § 9-312(4) because it timely perfected its security interest within 10 days after TFC first possessed the copiers on September 3. See U.C.C. § 9-312(4) (providing that a PMSI has priority over a conflicting security interest when perfected within 10 days from the date the debtor receives possession of the collateral). See also infra notes 367-68 and accompanying text.

Many states have amended their versions of U.C.C. § 9-312(4) by extending the post-possession perfection period to 20 days. See 9 HAWKLAND, supra note 110, § 9-312, at 219.

345. But see Chrysler Credit Corp., 73-1 U.S. Tax Cas. (CCH) at 80,519 ("The government concedes that, even though its tax lien was prior in time . . . the purchase money security agreement between [the secured creditor] and [the taxpayer] had priority over the tax lien on the car itself.") (emphasis added).


346. Rev. Rul. 68-57, 1968-1 C.B. 553 (emphasis added). In full, the ruling reads as follows:

The Federal Tax Lien Act of 1966, P.L. 89-719, C.B. 1966-2, 623, does not refer to a purchase money security interest or mortgage. However, the General Explanation of the Act, as set forth in House of Representatives Report No. 1884, C.B. 1966-2, at page 817, states as follows:

Although so-called purchase money mortgages are not specifically referred to under present law, it has generally been held that these interests are protected whenever they arise. This is based upon the concept that the taxpayer has acquired property or a right to property only to the extent that the value of the whole property or right exceeds the amount of the purchase money mortgage. This concept is not affected by the bill.

In view of the legislative history of the Federal Tax Lien Act of 1966, the Internal Revenue Service will consider that a purchase money security interest or mortgage valid under local law is protected even though it may arise after a notice of Federal tax lien.
of the CopyCorp-TFC transaction does not prevent CopyCorp’s interest in the photocopiers from enjoying priority over the competing interest of the IRS. In fact, in order to successfully invoke the protection of Revenue Ruling 68-57 the purchase money creditor is only required to prove that its security interest is “valid under local law.” But what does that mean? Does a PMSI become valid under local law at the moment of attachment? Or is perfection required? And if perfection is required, is perfection at any time and in any manner sufficient to render a PMSI valid under local law? Or must the creditor perfect its PMSI in a manner that permits it to enjoy the superpriority protection afforded by the “second-in-time-but-first-in-right” provisions of the U.C.C.?

To date, First National Bank of Marlton v. Coxson is the only reported case that has interpreted Revenue Ruling 68-57 in resolving a priority
dispute between the IRS and a secured party.\(^{349}\) In this case, First National Bank of Marlton (the Bank) financed Major Coxson’s purchase of a new car on March 6, 1972.\(^{350}\) The IRS filed a tax lien notice against Coxson the next day.\(^{351}\) The Bank did not perfect its PMSI until May 9, 1972.\(^{352}\) The IRS subsequently seized the car and sold it for approximately $6,900.\(^{353}\) The IRS placed the proceeds in an escrow account maintained by the Bank, pending the outcome of the priority dispute between the IRS (whose tax lien was for approximately $80,000) and the Bank (to whom Coxson owed approximately $5,500).\(^{354}\) As phrased by the court, “[t]he issue to be resolved in this case [was] whether a purchase money security interest perfected two months after attachment [was] entitled to priority over

\(^{349}\) 76-1 U.S. Tax Cas. (CCH), ¶ 9450, at 84,201 (D.N.J. 1976). Although this is the only case in which a court used Revenue Ruling 68-57 to resolve a priority dispute, the United States Supreme Court has mentioned Revenue Ruling 68-57 while discussing the purchase money priority in dicta. In Slodov, 456 U.S. at 258, the Court stated:

Decisional law has long established that a purchase-money mortgagee’s interest in the mortgaged property is superior to antecedent liens prior in time... United States v. New Orleans R. Co., 12 Wall. 362 (1871), and, therefore, a federal tax lien is subordinate to a purchase-money mortgagee’s interest notwithstanding that the agreement is made and the security interest arises after notice of the tax lien. The purchase-money mortgage priority is based upon recognition that the mortgagee’s interest merely reflects his contribution of property to the taxpayer’s estate and therefore does not prejudice creditors who are prior in time.


\(^{350}\) Coxson, 76-1 U.S. Tax Cas. (CCH) at 84,202. According to the case, the purchaser was a “local celebrity now deceased.” Id.

\(^{351}\) Id.

\(^{352}\) Id.

\(^{353}\) Id.

\(^{354}\) Id.
a federal tax lien perfected during that two month period.\footnote{355} The Bank conceded that it did not enjoy priority under I.R.C. § 6323(a) because its security interest was not perfected when the IRS filed its tax lien notice.\footnote{356} Nevertheless, the Bank argued that it enjoyed priority under Revenue Ruling 68-57 because its PMSI became "valid under local law" upon attachment.\footnote{357} The court disagreed.\footnote{358} Using analysis that has been described as "circuits and questionable" and "somewhat murky,"\footnote{359} the court relied on the superpriority afforded by U.C.C. § 9-312(4) and concluded that "at most, Revenue Ruling 68-57 grants priority to purchase money security interests perfected after a federal tax lien has been filed against the debtor but within ten days after the debtor takes possession of the collateral."\footnote{360} And as the Bank had not timely perfected its security interest, the court awarded priority in the cash proceeds to the IRS.\footnote{361}

Under Coxson, the interest of a purchase money creditor is not valid under local law unless the creditor qualifies for the superpriority afforded by U.C.C. § 9-312(3) (inventory) or U.C.C. § 9-312(4) (non-inventory). Technically, a priority dispute between the IRS and a purchase money creditor must be decided under the conflicting provisions of I.R.C. § 6323(c) and U.C.C. § 9-312(4) (non-inventory).

\footnote{355} \textit{Id.} \footnote{356} \textit{Id.} at 84,203. The Bank would not enjoy the protection afforded by I.R.C. § 6323(d) for the same reason. See I.R.C. § 6323(d)(2). Nor could the Bank successfully invoke I.R.C. § 6323(c). The Bank's interest became perfected not only after the IRS filed its notice but also after (rather than at the moment) Coxson purchased the car. Furthermore, perfection occurred more than ten days after Coxson first possessed the car on March 6. Therefore, the Bank's interest was not protected under local law against the rights of a lien creditor arising on the date of the tax lien notice. See I.R.C. § 6323(c)(1)(B); U.C.C. § 9-301(1)(b), (2). Even if Coxson's interest was protected under local law, he might have trouble proving that the car was inventory in his hands and thus qualified property. See I.R.C. § 6323(c)(1)(A) (limiting protection to interests in qualified property); \textit{id.} § 6323(c)(2)(B) (defining "qualified property" in the context of commercial transactions financing agreement as "commercial financing security" timely acquired by the taxpayer); \textit{id.} § 6323(c)(2)(C) (defining "commercial financing security").\footnote{357} Coxson, 76-1 U.S. Tax Cas. (CCH) at 84,203. \footnote{358} \textit{Id.} at 84,205. \footnote{359} Fetzer, \textit{supra} note 345, at 899. \footnote{360} Coxson, 76-1 U.S. Tax Cas. (CCH) at 84,205. In commenting on Revenue Ruling 68-57, the court said:

This revenue ruling is a rather vague statement of policy based upon an ambiguous paragraph of legislative history. Although revenue rulings are entitled to great weight as opinions of a government agency possessing experience and expertise in the administration of the federal tax laws, it should not be forgotten that an administrative agency has no power to rewrite or overrule an Act of Congress. If there are two possible interpretations of a revenue ruling, one of which conflicts with the language and policy of the statute and one of which is consonant with it, the latter should be adopted by a reviewing court. \footnote{361} \textit{Id.} at 84,203.
creditor should not be resolved by the two superpriority provisions of U.C.C. § 9-312. Those two provisions resolve conflicts between two security interests in common collateral, one of which is a PMSI. However, Article 9 does not treat the lien held by the IRS as a security interest because it arises statutorily, rather than contractually. Article 9 does resolve priority disputes between statutory lien creditors and holders of consensual liens, but it does so through U.C.C. § 9-301(1)(b). Under this section, the lien creditor enjoys priority if its interest arises before (rather than after or at the same time as) the secured party perfects its interest; if the secured party’s interest attaches and becomes perfected before or at the same time as the interest of the lien creditor arises, the secured party’s interest enjoys priority over the competing interest of the lien creditor. And even if the secured party’s interest attaches before—but is perfected after—the interest of the lien creditor arises, the interest of the secured party may still enjoy priority under U.C.C. § 9-301(2) if the secured party has a PMSI and perfects the interest by filing a financing statement no later than the tenth day after the debtor first possesses the collateral. However, U.C.C. § 9-301(2) only applies when the interest of the lien creditor arises between attachment and filing. The protection afforded by U.C.C. § 9-312(3) and (4) is not so restrictive. Therefore, although reliance on the two superpriority provisions of U.C.C. § 9-312 is linguistically improper when determining whether a PMSI is “valid under local law” under Revenue Ruling 68-57, such reliance does, in the end, favor many more purchase money creditors.

This point can be illustrated by resolving the priority dispute between CopyCorp and the IRS under both U.C.C. § 9-301 and U.C.C. § 9-312(4). CopyCorp’s security interest attached no later than September

362. See U.C.C. § 9-102(2).
363. See id. § 9-301(1)(b).
364. See id. § 9-301(1) (expressly subjecting its provisions to clause (2)); id. § 9-301(2).
365. See id. § 9-301(2).
366. If the copiers were classified as inventory in the hands of the taxpayer, the dispute presumably would be resolved under U.C.C. § 9-312(3). In order to benefit from the superpriority of U.C.C. § 9-312(3), the purchase money creditor must perfect its interest no later than when the debtor receives possession of the inventory. See id. § 9-312(3)(a); cf. id. § 9-312(4) (permitting post-possession perfection for ten days). Additionally, the creditor must send written notice to other secured parties that have previously filed financing statements against the debtor’s inventory, and these other creditors must receive the written notice (which must indicate the sender’s purchase money interest and describe the inventory) before the debtor receives possession of the inventory. See id. § 9-312(3)(b)-(d). Query whether a court would require the purchase money creditor to send the same written notice to the IRS if the IRS had previously filed its tax lien notice against the debtor in the same place where a financing statement against inventory would be filed. The question may be more academic than realistic. Why? In order to know who already has filed a financing
3. By that date, CopyCorp had extended value in the form of a credit sale, TFC had executed an agreement granting CopyCorp a security interest in the three described photocopiers, and TFC had acquired rights in the photocopiers.³⁶⁷ Because the IRS had previously filed its tax lien notice, its lien attached to the photocopiers at the moment TFC first acquired rights in them. Under U.C.C. § 9-301(1)(b), the interest of the IRS would enjoy priority because CopyCorp did not perfect its security interest until September 5,³⁶⁸ at least two days after its interest, and the interest of the IRS, attached.

In addition, U.C.C. § 9-301(2) offers no remedy to CopyCorp because its interest attached to the photocopiers at the same time as, rather than before, the interest of the IRS attached. Therefore, the IRS enjoys priority under U.C.C. § 9-301, the only Article 9 provision that addresses disputes between a lien creditor and a secured party. In fact, an IRS lien will always enjoy priority over the competing security interest of a purchase money creditor under U.C.C. § 9-301 unless the creditor’s interest (i) is perfected before the IRS files its notice, (ii) attaches before the IRS files its notice and is perfected thereafter by a financing statement filed before the eleventh (or, in many states, the twenty-first³⁶⁹) day after the taxpayer initially possesses the collateral, or (iii) attaches after the IRS files its notice, but is perfected at the very moment that the taxpayer acquires rights in the collateral as a result of a previously-filed financing statement.

Although never intended to resolve non-inventory disputes between a lien creditor and a purchase money creditor, the superpriority provision of U.C.C. § 9-312(4) offers a result much more favorable to the purchase money creditor. A creditor can achieve superpriority under U.C.C. § 9-312(4) over the competing lien of the IRS as long as the creditor perfects its post-notice PMSI before the eleventh (or in many states, the twenty-first³⁷⁰) day after the taxpayer first possesses the collateral.³⁷¹ CopyCorp enjoys such superpriority because it perfected its interest in the photocopiers by filing its financing statement on September 5, two days after deliv-

³⁶⁷. See U.C.C. § 9-203(1) (describing the elements of attachment). Attachment may have occurred as early as September 1 if TFC acquired rights in the collateral on that date under applicable law. See supra note 297. CopyCorp’s interest could not attach earlier than September 1 because TFC did not execute the contract until that date.

³⁶⁸. See supra note 208.

³⁶⁹. See supra note 110.

³⁷⁰. See supra note 344.

³⁷¹. See U.C.C. § 9-312(4).
Armed with superpriority under the U.C.C. and the holding of Coxson, CopyCorp's interest is valid under local law and enjoys the protection afforded to a post-notice PMSI by Revenue Ruling 68-57.

B. Protection for Proceeds

Hypothetical #17

On June 1, AmeriBank loaned $5,000,000 to TFC. To secure repayment of the loan, and any future loans from AmeriBank, TFC executed a security agreement on June 1 that created an enforceable security interest in all of its accounts receivable, inventory, and equipment, whether then owned or thereafter acquired or created. AmeriBank filed a proper financing statement with the appropriate filing officer on June 3. TFC did not disclose that the IRS had assessed a $2,500,000 federal tax lien against the property of TFC on March 1 for overdue corporate income taxes. The IRS filed a proper tax lien notice with the appropriate filing officer on August 1. AmeriBank discovered the notice on September 1 after ordering a routine lien search report on TFC.

On November 1, AmeriBank and the IRS each seeks a declaratory judgment stating that its interest in the collateral is superior to the interest of the other. Evidence indicates that on November 1 TFC has inventory of $2,000,000, receivables of $3,000,000, and equipment of $1,000,000. Additional evidence concerning this collateral follows:

<table>
<thead>
<tr>
<th>Inventory</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Acquired by TFC before the IRS filed its notice</td>
<td>$ 500,000</td>
</tr>
<tr>
<td>Acquired by TFC after the IRS filed its notice</td>
<td>$ 750,000</td>
</tr>
<tr>
<td>but before September 16</td>
<td></td>
</tr>
<tr>
<td>Acquired by TFC on October 1 by check drawn</td>
<td>$ 500,000</td>
</tr>
<tr>
<td>against a bank account into which only credit</td>
<td></td>
</tr>
<tr>
<td>customers have made payments</td>
<td></td>
</tr>
<tr>
<td>Acquired by TFC on October 15 by check</td>
<td>$ 250,000</td>
</tr>
<tr>
<td>drawn against general operating account</td>
<td></td>
</tr>
</tbody>
</table>

372. See supra notes 367-68 and accompanying text.
373. Coxson, 76-1 U.S. Tax Cas. (CCH) at 84,205.
Additionally, evidence indicates that TFC has two bank accounts. One is an account into which credit purchasers of inventory make their payments (the “lockbox account”). The other is a general operating account. On November 1, the lockbox account has a balance of $400,000 and the general operating account has a balance of $700,000. All of the money in each account was deposited after the IRS filed its notice. A review of account activity reveals that TFC transferred $200,000 from the lockbox account into the general operating account on October 25. Additionally, $100,000 of the balance in the general operating account represents cash sales of inventory.

Whose interest enjoys priority? In what collateral?

AmeriBank can claim priority in some of the collateral under I.R.C. § 6323(a), which protects holders of security interests that exist when the IRS files its notice. AmeriBank can satisfy the two property-related requirements of I.R.C. § 6323(a) (through I.R.C. § 6323(h)(1)): AmeriBank’s property interest was created by a contract that predates the tax lien
and TFC acquired some of the collateral before August 1. The “money or money’s worth” requirement was met because AmeriBank made the $5,000,000 loan to TFC two months before the IRS filed its notice. With respect to collateral that TFC owned when the IRS filed its notice, AmeriBank’s interest is protected by U.C.C. § 9-301(1)(b) because prior to August 1 AmeriBank had given value and filed its financing statement, and TFC had acquired rights in the collateral and executed a security agreement that granted a security interest in the collateral described therein. Therefore, I.R.C. § 6323(a) permits AmeriBank to claim priority in all pre-notice collateral. However, this collateral has a value of only $2,000,000. AmeriBank needs additional collateral of at least $3,000,000 to ensure full repayment of the $5,000,000 loan. I.R.C. § 6323(d) offers no extra benefits; it also limits priority to property interests in pre-notice collateral. Thus, AmeriBank will invoke the protection of I.R.C. § 6323(c).

AmeriBank’s interest in the collateral arises from the security agreement dated June 1. This satisfies the statutory requirement that the interest in the collateral be “covered by the terms of a written agreement entered into before [the IRS makes its] tax lien filing,” which did not occur until August 1.

Additionally, the facts permit AmeriBank to argue that its interest in the collateral (including post-notice collateral) is protected under local law against the competing claims of a lien creditor arising on August 1. As of that date, AmeriBank had given value and filed its financing statement, and TFC had executed a security agreement that granted a security interest

374. See I.R.C. § 6323(a) (giving priority to a holder of a security interest that exists when the IRS files notice of its tax lien); id. § 6323(h)(1) (indicating that a “security interest means any interest in property acquired by contract”).

375. See id. § 6323(a) (giving priority to a holder of a “security interest” that exists when the IRS files notice of its tax lien); id. § 6323(h)(1)(A) (indicating that a security interest does not exist when the IRS files notice of its tax lien unless “at such time, the property is in existence”).

376. See id. § 6323(a) (giving priority to a holder of a security interest that exists when the IRS files notice of its tax lien); id. § 6323(h)(1)(B) (indicating that a security interest is limited “to the extent that, at such time, the holder has parted with money or money’s worth”).

377. See U.C.C. § 9-203(1) (describing elements of attachment); id. § 9-301(1)(b) (resolving a priority dispute between a secured party and a lien creditor in favor of the former if its interest is perfected when the interest of the lien creditor arises); id. § 9-302(1)(a) (stating that a filed financing statement may perfect a security interest in collateral not possessed by the secured party); id. § 9-303(1) (indicating that perfection occurs upon attachment and an additional act, which may include filing a financing statement).


379. Id. § 6323(c)(1)(A).

380. See id. § 6323(c)(1)(B).
in the described collateral. Therefore, AmeriBank’s interest in the post-notice collateral attached and became perfected at the very moment that TFC acquired rights in the post-notice collateral.\textsuperscript{381} The lien creditor’s interest will not attach to the post-notice collateral until the same moment. Because the lien creditor’s interest in post-notice collateral arises at the same time (rather than before) AmeriBank’s interest is perfected, AmeriBank’s interest in the post-notice collateral enjoys priority under U.C.C. § 9-301(1)(b).\textsuperscript{382}

At this point in the analysis, the U.C.C. permits AmeriBank to claim priority in inventory, receivables, and equipment with an aggregate value of $6,000,000. In order to secure repayment of not only the $5,000,000 loan, but also accrued and unpaid interest and related legal costs (which will partially, if not completely, eliminate the $1,000,000 collateral cushion), AmeriBank may look beyond just the equipment, inventory, and receivables and attempt to include other assets (such as the cash in the two bank accounts) within its collateral package. AmeriBank can successfully argue that its priority under the U.C.C. in the post-notice collateral also includes the $400,000 in the lockbox account and perhaps up to $300,000 of the amount in the general operating account. This $700,000 falls within the U.C.C. definition of “proceeds” as $600,000 represents collections of accounts receivable and $100,000 represents cash sales of inventory.\textsuperscript{383} Unless AmeriBank and TFC agreed that the collateral would not include proceeds, AmeriBank’s interest extends to any cash that is “identifiable”\textsuperscript{384} as proceeds.\textsuperscript{385} AmeriBank should be able to prove that the $400,000 in the lockbox account is identifiable as proceeds of accounts receivable by introducing evidence that only payments made by credit customers are deposited into the account. Whether AmeriBank can prove that $300,000

\textsuperscript{381.} See U.C.C. § 9-203(1) (describing elements of attachment); id. § 9-302(1)(a) (stating that a filed financing statement may perfect a security interest in collateral not possessed by the secured party); id. § 9-303(1) (indicating that perfection occurs upon attachment and an additional act, which may include filing a financing statement).

\textsuperscript{382.} See supra note 186 and accompanying text.

\textsuperscript{383.} See U.C.C. § 9-306(1) (“Proceeds’ includes whatever is received upon the sale, exchange, collection or other disposition of collateral or proceeds.”). As a general rule, AmeriBank continues to retain a security interest in the collateral sold by TFC. See id. § 9-306(2). However, AmeriBank probably consented to TFC’s sale of inventory in the ordinary course of TFC’s business. This consent terminates AmeriBank’s security interest in the inventory at the time of sale. Id. However, it should not terminate any interest in the proceeds. See WHITE & SUMMERS, supra note 91, § 31-11, at 151 (“Some courts have held, erroneously in our view, that the authorization of sale of the collateral destroys not only the security interest in the collateral but also in its proceeds.”) (emphasis added).

\textsuperscript{384.} “The term ‘identifiable’ is not defined in the Code, but it presumably requires that the secured party show that the cash or noncash items were actually received upon the sale, exchange, collection or other disposition of the collateral or proceeds.” 9 HAWKLAND, supra note 110, § 9-306:03, at 37-38 (footnote omitted).

\textsuperscript{385.} See U.C.C. § 9-203(3); id. § 9-306(2).
of the $700,000 in the general operating account represents identifiable proceeds will be dictated by the relevant jurisdiction’s treatment of commingled funds.\textsuperscript{386} To the extent that AmeriBank identifies the $700,000 as proceeds, its security interest in that cash is automatically perfected.\textsuperscript{387} And its perfected status in the cash proceeds enjoys the same priority as the accounts receivable and the inventory that generated the proceeds.\textsuperscript{388}

AmeriBank should be able to prove the additional requirement under clause (c) that its contract with TFC is a commercial transactions financing agreement.\textsuperscript{389} First, AmeriBank entered into the contractual relationship with TFC in the ordinary course of its business as a financial institution that regularly extends credit to corporate customers.\textsuperscript{390} Second, pursuant to the contract, AmeriBank agreed to loan money to TFC.\textsuperscript{391} Third, repayment of the loan is secured by receivables and inventory, collateral that is commercial financing security.\textsuperscript{392} However, neither the equipment nor the cash is commercial financing security\textsuperscript{393} and thus will not be part of AmeriBank’s collateral protected by clause (c).\textsuperscript{394} Fourth, with one probable exception, TFC acquired the inventory and generated the receivables in the ordinary course of its business of selling and leasing furniture.\textsuperscript{395} Included within the receivables balance is a $150,000 receivable from TFC’s credit sale of a piece of equipment. TFC is in the business of selling and leasing furniture, not equipment. Therefore, this

\textsuperscript{386} Many cases have permitted the secured party to use equitable tracing methods to prove the identifiability of proceeds in a commingled account. See 9 Hawkland, supra note 110, § 9-306.03, at n.20 and accompanying text. A common equitable tracing method used in such situations is the “lowest intermediate balance rule.” For a discussion of the rule and its mechanics, see Robert H. Skilton, The Secured Party’s Rights in a Debtor’s Bank Account Under Article 9 of the Uniform Commercial Code, 1977 S. Ill. U. L.J. 120, 140-43 (1977).

\textsuperscript{387} See U.C.C. § 9-306(3)(b).

\textsuperscript{388} See id. § 9-312(6) & cmt. 8.

\textsuperscript{389} See I.R.C. § 6323(c)(1)(A). The facts do not suggest that the contractual relationship between AmeriBank and TFC involves real estate construction, real estate improvements, or farm crops or livestock. Therefore, the contract is not a real property construction or improvement financing agreement. See id. § 6323(c)(3)(A) (defining “real property construction or improvement financing agreement”). And because the facts do not suggest that anyone other than TFC enjoys the right to demand advances from AmeriBank, the contract cannot be an obligatory disbursement agreement. See id. § 6323(c)(4)(A) (defining “obligatory disbursement agreement”).

\textsuperscript{390} See id. § 6323(c)(2)(A) (first parenthetical).

\textsuperscript{391} See id. § 6323(c)(2)(A)(i).

\textsuperscript{392} See id. § 6323(c)(2)(C)(ii), (iv).

\textsuperscript{393} See id. § 6323(c)(2)(C) (defining “commercial financing security”).

\textsuperscript{394} However, I.R.C. § 6323(a) permits AmeriBank to enjoy priority in the pre-notice equipment worth $600,000. See supra notes 374-77 and accompanying text.

\textsuperscript{395} See I.R.C. § 6323(c)(2)(A)(i).
$150,000 receivable is not generated by TFC in the ordinary course of its business and will not be part of AmeriBank’s collateral protected by clause (c). Fifth, AmeriBank made the $5,000,000 loan long before September 16, the forty-sixth day following the filing date of the tax lien notice. Finally, AmeriBank made the loan before it acquired actual notice or knowledge on September 1 that the IRS had filed its notice. Because all six elements are present, the security agreement is a commercial transactions financing agreement.

If the analysis stopped here, AmeriBank would enjoy priority in collateral worth $5,450,000. However, the protection afforded to property interests arising under a commercial transactions financing agreement is limited to commercial financing security that is qualified property. For a receivable or an item of inventory to be qualified property, TFC must generate or acquire it before September 16, the forty-sixth day following the tax lien filing. Evidence indicates that TFC acquired inventory worth $750,000 and generated receivables of $1,100,000 after September 16. Therefore, this collateral is not qualified property and is not entitled to the protection of I.R.C. § 6323(c).

Based on the foregoing analysis, AmeriBank enjoys priority under clauses (a) and (c) in collateral worth $3,600,000, but this amount is much less than the loan amount of $5,000,000. No other provision of I.R.C. § 6323 awards priority to AmeriBank in any additional collateral. However, property acquired or generated by TFC after the forty-fifth day following the tax lien filing may qualify for protection under the following relevant part of Treasury Regulation § 301.6323(c)-1(d):

Identifiable proceeds, which arise from the collection or disposition of qualified property by the taxpayer, are considered to be acquired at the time such qualified property is acquired if the secured party has a continuously perfected security interest in the proceeds under local law. The term "proceeds" includes whatever is received when collateral is sold, exchanged, or collected. For purposes of this paragraph, the term "identifiable proceeds" does not include money, checks and the like which have been commingled with other cash proceeds. Property acquired by the

396. See 26 C.F.R. § 301.6323(c)-1(f) example 3; cf. U.C.C. § 9-307 cmt. 2 (suggesting that in order to qualify as a buyer in the ordinary course of business, the buyer must be purchasing inventory).
398. Id.
399. This amount is comprised of inventory worth $2,000,000, receivables of $2,850,000, and equipment valued at $600,000.
400. I.R.C. § 6323(c)(1)(A).
401. See id. § 6323(c)(2)(B) (defining “qualified property”).
402. This amount consists of inventory worth $1,250,000, receivables of $1,750,000, and equipment valued at $600,000.
The quoted language permits a creditor to claim protection for collateral acquired or generated by the taxpayer beyond the forty-fifth day after the tax lien filing if (i) the collateral is proceeds, (ii) the proceeds are identifiable, (iii) the secured party has a continuously perfected property interest in the proceeds under local law, and (iv) the assets from which the proceeds are derived are qualified property. If the collateral satisfies these four requirements, the collateral is entitled to the statutory protection afforded to qualified property, even if the collateral does not fall within the definition of “qualified property” either because it is not commercial financing security or because it was acquired or created by the taxpayer more than forty-five days after the IRS filed its notice.

AmeriBank will attempt to cloak the cash, equipment, receivables, and inventory previously excluded from the priority protection of I.R.C. § 6323 with the benefits extended by the Treasury Regulation. It will be partially successful, as the following analysis illustrates.

403. 26 C.F.R. § 301.6323(c)-1(d). Treasury Regulations have the force and effect of law. LMS Holding Co., 50 F.3d at 1528.

404. One might argue that the proceeds must be “qualified property” because the first sentence of the Treasury Regulation merely allows a creditor to contend that assets acquired by the taxpayer after the forty-fifth day following the tax lien filing were timely acquired if those assets are identifiable proceeds of qualified property and are subject to a continuously perfected security interest under local law; the creditor still must prove that these assets (acquired outside the grace period but deemed to be timely acquired under the Treasury Regulation) are qualified property and thus entitled to the benefits of I.R.C. § 6323(c). However, failure to expressly mention this requirement within either the language of the Treasury Regulation itself or in the subsequent explanatory examples suggests that the perceived requirement is no requirement at all. Furthermore, the Treasury Regulation expressly states that money, checks, and the like are “identifiable proceeds” absent any commingling with other cash proceeds. Perhaps checks constitute “qualified property.” See I.R.C. § 6323(c)(2)(B)(defining “qualified property” as commercial financing security timely acquired by the taxpayer); id. § 6323(c)(2)(C)(i) (limiting “commercial financing security” to four distinct types of property, including “paper of a kind ordinarily arising in commercial transactions”); 26 C.F.R. § 301.6323(c)-1(c)(1) (including “negotiable instruments” within the definition of “paper of a kind ordinarily arising in commercial transactions”); U.C.C. § 3-104(a) (listing the elements of a “negotiable instrument”). But the taxpayer’s customers may use forms of payment other than checks, such as cash, debit cards, or wire transfers. Certainly cash, and presumably the other common forms of payment, are “money” or “the like,” but they are not “negotiable instruments” (and thus not qualified property). See, e.g., U.C.C. § 3-102(a) (“This article applies to negotiable instruments. It does not apply to money [or] to payment orders governed by Article 4A . . . .”). This further reduces the likelihood that the Treasury Regulation implicitly requires “identifiable proceeds” to be “qualified property.” To conclude otherwise results in an extremely narrow interpretation of the phrase “money, checks and the like.”
1. Cash

None of the cash in the general operating account, including the $200,000 transferred by TFC from the lockbox account on October 25 and the $100,000 representing cash sales of inventory, is entitled to protection because the general operating account holds cash from other sources. The general operating account therefore holds commingled funds, which are excluded from the term "identifiable proceeds." Collateral that does not fall within the quoted term is not eligible for the protection afforded by the Treasury Regulation.

Some or all of the $400,000 in the lockbox account may be protected. The cash is proceeds because the funds were collections of accounts receivable. Because the lockbox account contains only collections of accounts receivable, the cash is identifiable proceeds. AmeriBank enjoys a perfected security interest in the $400,000 because a financing statement perfected the security interest in the accounts receivable that generated the $400,000, and the $400,000 represents identifiable cash proceeds. Because the $400,000 is generated from the collection of accounts receivable, a type of commercial financing security, the cash appears to "arise from the collection . . . of qualified property . . . ." However, "[p]roperty acquired by the taxpayer after the 45th day following tax lien filing, by the expenditure of proceeds, is not qualified property." This sentence effectively limits protection to first-generation proceeds; future generation proceeds, or proceeds of proceeds, receive no benefit. For

405. 26 C.F.R. § 301.6323(c)-(1)(d) ("[T]he term 'identifiable proceeds' does not include money, checks and the like which have been commingled with other cash proceeds.").
406. Id. ("Identifiable proceeds, which arise from the collection or disposition of qualified property by the taxpayer, are considered to be acquired at the time such qualified property is acquired . . . .") (emphasis added).
407. Id. ("The term 'proceeds' includes whatever is received when collateral (e.g., accounts receivable) is . . . collected.").
408. Id.
409. See U.C.C. § 9-306(3)(b) (stating that a security interest in identifiable proceeds continues to be perfected after the automatic, but temporary, 10 day period of perfection if "a filed financing statement covers the original collateral (e.g., the accounts receivable) and the proceeds are identifiable cash proceeds"). The U.C.C. defines "cash proceeds" as "[m]oney, checks, deposit accounts, and the like . . . ." Id. § 9-306(1) (defining "cash proceeds").
411. 26 C.F.R. § 301.6323(c)-1(d).
412. Id.
413. See Donald v. Madison Indus., Inc., 483 F.2d 837, 845 (10th Cir. 1973) ("[I]t should be noted that [Treasury Regulation § 301.6323(c)-1(d)] suggests that once protected collateral is reduced to cash proceeds, it may not be reinvested in similar products and still be considered qualified property. We concur in this conclusion . . . ."); In re National Fin.
example, assume that the $400,000 represents cash collections of two accounts receivable. One receivable resulted from a $150,000 credit sale of inventory on September 1 and the other resulted from a $250,000 credit sale of inventory on October 1. Cash of $150,000 qualifies as first-generation proceeds of an account receivable because the receivable existed before September 16, the forty-sixth day after the IRS filed its notice. The cash of $250,000 represents at least second-generation proceeds, or proceeds of proceeds. The account receivable that generated the cash of $250,000 did not exist before September 16. Therefore, the receivable itself is proceeds of inventory. If the inventory that generated the receivable existed on September 15, the receivable is first-generation proceeds and the cash payment of the receivable is second-generation proceeds. If TFC had not yet acquired the inventory on September 15 that generated the receivable, then at least one more generation results. What does all of this mean to AmeriBank? In order for it to bring the $400,000 within the scope of protection afforded by the Treasury Regulation, AmeriBank must prove that the receivables that generated the cash had been generated by credit sales of inventory on or before September 15. If the receivables arose after that date, cash collections of those receivables do not qualify for protection.

2. Equipment

TFC acquired equipment on September 10 by issuing a $300,000 check drawn against the lockbox account. Cash is not a type of commercial financing security \(^4\) and thus cannot be qualified property. \(^5\) Therefore, this equipment does not fall within the scope of the Treasury Regulation because it does not represent proceeds “which arise from the collection or disposition of qualified property . . . .” \(^6\)

Alternatives, Inc., 96 B.R. at 854 (“Any inventory (or other asset) so purchased [after the 45-day period following the filing date of the IRS tax lien notice]—even though purchased with proceeds of ‘qualified property’ under 6323(c)—is deemed not to be qualified property, pursuant to 26 C.F.R. § 301.6323(c)-1(d) . . . ”); 26 C.F.R. § 301.6323(c)-1(f) example 1(ii) (illustrating that the priority of a creditor’s security interest in qualified property held by the taxpayer on the forty-fifth day following the tax filing extends to proceeds received after that date from the liquidation of those assets if the proceeds are identifiable and the security interest in the proceeds is continuously perfected under local law; nevertheless, “the priority of [the creditor’s] security interest will not extend to other property acquired with such proceeds”) (emphasis added); cf. U.C.C. § 9-306(1) (including future-generation proceeds within the scope of “proceeds” by defining “proceeds” to include “whatever is received upon the sale, exchange, collection or other disposition of collateral or proceeds”) (emphasis added).

4. See I.R.C. § 6323(c)(2)(C) (defining “commercial financing security”).
5. See id. § 6323(c)(2)(B) (defining “qualified property” as commercial financing security timely acquired by the taxpayer).
6. 26 C.F.R. § 301.6323(c)-1(d).
TFC also acquired equipment worth $100,000 on October 15 by exchanging inventory of comparable value. TFC had acquired the inventory in June. The equipment represents proceeds because it was received in exchange for inventory. Knowing the form of consideration used to purchase the equipment makes the equipment, as proceeds of the inventory, identifiable. The equipment also is proceeds of qualified property because it was acquired in exchange for inventory that TFC had acquired before the forty-sixth day after the IRS had filed its tax lien notice. Furthermore, AmeriBank's interest in the equipment is continuously perfected because the original financing statement covered inventory and equipment. Having jumped through all of the hoops of the Treasury Regulation, AmeriBank's interest in this equipment enjoys priority over the competing claim of the IRS.

3. Receivables

TFC generated accounts receivable of $600,000 on or after September 16 by selling inventory that it had acquired before September 16. TFC also generated accounts receivable of $500,000 on or after September 16 by selling inventory that it had acquired on or after September 16. Additionally, TFC generated an account receivable of $150,000 by making a credit sale of equipment on September 10. All of these receivables qualify as proceeds because they were generated when TFC sold the inventory and equipment. Because evidence permits AmeriBank to trace the receivables to specific inventory and equipment, the receivables are identifiable proceeds. However, the $150,000 receivable is not entitled to any protection under the Treasury Regulation because it was derived from the sale of equipment, which is not "qualified property." Nor are the accounts receivable of $500,000 eligible for protection. These receivables are not first-generation proceeds because they arose from the sale of

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417. Id. ("The term 'proceeds' includes whatever is received when collateral is . . . exchanged . . . .").
418. Id.
419. See I.R.C. § 6323(c)(2)(B) (defining "qualified property" as commercial financing security timely acquired by the taxpayer); id. § 6323(c)(2)(C)(iv) (including inventory within the definition of "commercial financing security").
420. See U.C.C. § 9-306(3)(a), (d). Absent multistate concerns, financing statements covering inventory and equipment are recorded in the same office. See id. § 9-401(1).
421. 26 C.F.R. § 301.6323(c)-1(d). ("The term 'proceeds' includes whatever is received when collateral is sold . . . .").
422. Id.
423. Id. (limiting protection to identifiable proceeds arising from "the collection or disposition of qualified property"); see I.R.C. § 6323(c)(2)(B) (defining "qualified property" as commercial financing security timely acquired by the taxpayer); id. § 6323(c)(2)(C) (defining "commercial financing security").
inventory that TFC did not own on September 15. As discussed earlier, the Treasury Regulation limits its protection to first-generation proceeds.\textsuperscript{424} The receivables of $600,000 are protected, however. They are first-generation proceeds because TFC owned the related inventory on September 15. Furthermore, they arose from TFC’s disposition of inventory, which is qualified property.\textsuperscript{425} Additionally, AmeriBank’s interest in the receivables is continuously perfected because it previously filed a financing statement covering inventory and receivables.\textsuperscript{426} Having satisfied all of the elements of the Treasury Regulation, AmeriBank enjoys priority over the competing interest of the IRS in the receivables of $600,000.

4. Inventory

TFC acquired inventory worth $500,000 on October 1 by issuing a check drawn against the lockbox account. TFC acquired additional inventory of $250,000 on October 15 by issuing a check drawn against the general operating account. In both instances, TFC acquired the inventory by paying or disposing of cash. Cash is not a type of commercial financing security\textsuperscript{427} and thus cannot be qualified property.\textsuperscript{428} The Treasury Regulation limits its protection to collateral derived from “the collection or disposition of qualified property . . . .”\textsuperscript{429} Because TFC acquired the inventory by paying cash for it, and cash is not qualified property, AmeriBank cannot include this inventory of $750,000 within the ambit of the Treasury Regulation.\textsuperscript{430} The IRS enjoys priority in this collateral.

\textsuperscript{424} See supra notes 412-13 and accompanying text.
\textsuperscript{425} See 26 C.F.R. § 301.6323(c)-1(d) (proceeds must arise from “the collection or disposition of qualified property”); I.R.C. § 6323(c)(2)(B) (defining “qualified property” as commercial financing security timely acquired by the taxpayer); id. § 6323(c)(2)(C)(iv) (including inventory within the definition of “commercial financing security”).
\textsuperscript{426} See U.C.C. § 9-306(3)(a), (d). Absent multistate concerns, financing statements covering inventory and receivables are recorded in the same office. See id. § 9-401(1).
\textsuperscript{427} See I.R.C. § 6323(c)(2)(C).
\textsuperscript{428} See id. § 6323(c)(2)(B) (defining “qualified property” as commercial financing security timely acquired by the taxpayer).
\textsuperscript{429} 26 C.F.R. § 301.6323(c)-1(d).
\textsuperscript{430} Inventory acquired by the taxpayer after the forty-fifth day following the tax lien filing rarely will qualify for the protection afforded by the Treasury Regulation because the Treasury Regulation requires the taxpayer to purchase the inventory by using qualified property. See 26 C.F.R. § 301.6323(c)-1(d). However, qualified property is limited to “(i) paper of a kind ordinarily arising in commercial transactions, (ii) accounts receivable, (iii) mortgages on real property, and (iv) inventory,” I.R.C. § 6323(c)(2)(C), that is timely acquired by the taxpayer. id. § 6323(c)(2)(B). Most taxpayers use cash or rely on credit to purchase inventory, and neither cash nor an account payable are qualified property. See id. § 6323(c)(2)(C).
5. Summary

In summary, AmeriBank enjoys priority in the following collateral:

Through I.R.C. § 6323(a):

<table>
<thead>
<tr>
<th>Collateral</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Inventory</td>
<td>$500,000</td>
</tr>
<tr>
<td>Receivables</td>
<td>$900,000</td>
</tr>
<tr>
<td>Equipment</td>
<td>$600,000</td>
</tr>
</tbody>
</table>

Through I.R.C. § 6323(c):

<table>
<thead>
<tr>
<th>Collateral</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Inventory</td>
<td>$750,000</td>
</tr>
<tr>
<td>Receivables</td>
<td>$850,000</td>
</tr>
</tbody>
</table>

Through Treasury Regulation:

<table>
<thead>
<tr>
<th>Collateral</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Receivables</td>
<td>$600,000</td>
</tr>
<tr>
<td>Equipment</td>
<td>$100,000</td>
</tr>
<tr>
<td>Cash in lockbox account representing first-generation proceeds</td>
<td>$0 - $400,000</td>
</tr>
<tr>
<td>TOTAL</td>
<td>$4,300,000 - $4,700,000</td>
</tr>
</tbody>
</table>

The IRS enjoys priority in the following collateral:

<table>
<thead>
<tr>
<th>Collateral</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Inventory</td>
<td>$750,000</td>
</tr>
<tr>
<td>Receivables</td>
<td>$650,000</td>
</tr>
<tr>
<td>Equipment</td>
<td>$300,000</td>
</tr>
<tr>
<td>Cash in general operating account</td>
<td>$700,000</td>
</tr>
<tr>
<td>Cash in lockbox account not representing first-generation proceeds</td>
<td>$0 - $400,000</td>
</tr>
<tr>
<td>TOTAL</td>
<td>$2,400,000 - $2,800,000</td>
</tr>
</tbody>
</table>
Ignoring the effect of interest and penalties, the collateral in which the IRS enjoys priority will almost, if not completely, satisfy the $2,500,000 tax lien. Any surplus collateral in which AmeriBank continues to enjoy a perfected, but junior, Article 9 security interest can be applied by AmeriBank to reduce its collateral shortfall of $300,000 to $700,000.

C. Circular Priority

Hypothetical #18

In desperate need of cash, the Metropolitan Medical Clinic (the Clinic) borrowed $500,000 from AmeriBank on June 1 and $250,000 from CityBank on July 1. To secure repayment of both loans, the Clinic executed a security agreement that created a security interest in a single piece of medical equipment previously purchased by the Clinic with a value at the time of the loans of about $1,000,000. The Clinic executed each security agreement at the time the respective bank made its loan. AmeriBank and CityBank filed proper financing statements with the appropriate filing officer on June 20 and June 15, respectively. Unknown to either lender, the IRS had assessed a tax lien against the property of the Clinic on March 1 for unpaid income taxes of $750,000. The IRS filed a proper notice of its tax lien with the appropriate filing officer on June 25. Each lender discovered the notice in September after ordering a routine lien search report on the Clinic.

On October 1, with the consent of all parties, the Clinic sold the medical equipment for its fair market value of $750,000. The sale proceeds have been deposited with the court. To whom should the court distribute the $750,000?

To illustrate the circular priority posed by this hypothetical, the three two-party disputes are analyzed in the following order: (i) AmeriBank v. CityBank, (ii) AmeriBank v. IRS, and (iii) CityBank v. IRS.

1. AmeriBank v. CityBank

Each lender has a perfected security interest in the collateral. AmeriBank’s interest in the equipment attached on June 1, when it gave value in the form of a loan and the Clinic executed a security agreement that granted a security interest in collateral that it already owned. AmeriBank perfected its interest by filing a financing statement on June 20. CityBank’s interest in the equipment attached on July 1, when it

431. See U.C.C. § 9-203(1).
432. See id. § 9-302(1)(a); id. § 9-303(1).
loaned $250,000 to the Clinic and the Clinic executed a security agreement that granted a security interest in collateral previously acquired. Having previously filed a financing statement on June 15, CityBank’s interest became perfected at the moment of attachment on July 1. Because the Clinic already owned the equipment at the time of each loan, neither bank can claim that its interest is a PMSI. Therefore, the dispute between the two banks is resolved by the general priority rule of U.C.C. § 9-312(5). This general rule awards priority to CityBank because it filed its financing statement on June 15, before AmeriBank filed its financing statement on June 20. AmeriBank perfected its security interest on June 20, before CityBank perfected its security interest on July 1. Nevertheless, AmeriBank did not become perfected before CityBank filed its financing statement, so CityBank enjoys priority.

2. AmeriBank v. IRS

AmeriBank enjoys the protection afforded to creditors by I.R.C. § 6323(a). As of June 25, when the IRS filed its tax lien notice, (i) AmeriBank had acquired an interest in the collateral by contract to secure repayment of a loan, (ii) the Clinic had acquired the equipment, (iii) AmeriBank had made the $500,000 loan, and (iv) AmeriBank’s interest was protected by the local law of U.C.C. § 9-301(1)(b) against the competing interest of a lien creditor because AmeriBank’s interest had become perfected earlier on June 20. Therefore, AmeriBank has a security interest in the medical equipment under I.R.C. § 6323(h)(1) and enjoys the protection afforded to holders of security interests by I.R.C. § 6323(a).

3. CityBank v. IRS

The IRS enjoys priority over CityBank’s interest. CityBank cannot successfully claim the protection afforded by any of the relevant sections of I.R.C. § 6323 because each of the relevant sections mandates that CityBank’s interest in the collateral must arise by contract or written agreement that predates the filing date of the tax lien notice. CityBank fails this common requirement because the Clinic executed the CityBank

433. See id. § 9-203(1).
434. See id. § 9-302(1)(a); id. § 9-303(1) & cmt. 1.
435. See id. § 9-312(5)(a) (“Conflicting security interests rank according to priority in time of filing or perfection. Priority dates from the time a filing is first made covering the collateral or the time the security interest is first perfected, whichever is earlier . . . .”) (emphasis added); see also id. § 9-312 cmt. 5 example 1.
436. See I.R.C. § 6323(a), (h)(1).
437. See id. § 6323(a), (c)(1)(A), (d)(1)(B), (h)(1).
security agreement on July 1, about one week after the IRS filed its tax lien notice on June 25.

4. Resolving the Circular Priority

The foregoing discussion illustrates the circular priority posed by the hypothetical. The interest of AmeriBank enjoys priority over the interest of the IRS, which has priority over the interest of CityBank, whose interest trumps AmeriBank's interest. Claims total $1,500,000, but the sale of the medical equipment ought only $750,000. Who enjoys the first (and possibly only) bite at the $750,000?

The United States Supreme Court confronted a circular priority dispute in *United States v. City of New Britain*. The Court was asked to allocate mortgage foreclosure proceeds of approximately $28,000 among parties with claims aggregating nearly $31,000. The parties included the IRS (seeking payment of unpaid withholding and unemployment taxes and insurance contributions), the City (seeking payment of delinquent real estate taxes and water rent), and at least one mortgagee. Circular priority resulted because the mortgagee's interest trumped the IRS's claim as the mortgage had been recorded earlier, the IRS lien was senior to at least part of the City's claim under applicable federal tax law, and the City's claim enjoyed priority over the mortgagee's claim under applicable state law.

Applying the result in *City of New Britain* to Hypothetical #18, an amount equal to AmeriBank's claim (which enjoys priority over the tax lien) is set aside for allocation between AmeriBank and CityBank in accordance with applicable U.C.C. provisions. Because CityBank enjoys priority over AmeriBank, CityBank receives the first $250,000 (and is fully paid) and

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439. *Id.* at 82.
440. *Id.*
441. *Id.* at 82-83.
442. *Id.* at 88; *see also* Plumb, *supra* note 66, at 280 (concluding that the Supreme Court's result "was as logical as it was astonishing to the mortgagees who were its victims"). As Plumb notes, Congress subsequently resolved the predicament presented in *City of New Britain* by expressly subordinating federal tax liens to property tax liens that arise after the IRS has filed its tax lien notice. *See id.* at 280-81; I.R.C. § 6323(b)(6)(A). Because AmeriBank and CityBank have Article 9 security interests rather than property tax liens, the statutory fix is inapplicable to the facts of Hypothetical #18.
443. 347 U.S. at 81.
AmeriBank receives the remaining $250,000 (and remains unpaid for the $250,000 balance). The IRS receives the $250,000 not set aside for allocation between the two secured lenders. At the end of the day, CityBank’s claim is fully paid, AmeriBank suffers a $250,000 shortfall, and the IRS has an unpaid claim for $500,000 that can be satisfied out of the Clinic’s other assets.

In a circular priority dispute, it is virtually impossible to reach a result that makes all participants happy. However, the approach proposed above seems most equitable because it preserves the integrity of both the I.R.C. (the IRS claim is junior to an amount mandated by I.R.C. § 6323) and the U.C.C. (CityBank’s claim enjoys priority over AmeriBank’s claim under the “first to file or perfect” rule of U.C.C. § 9-312(5)). No other approach achieves a similar result. A court could permit the IRS to satisfy its lien first (on the theory that the tax lien has priority over the security interest of CityBank under I.R.C. § 6323), but this result ignores the subordination of the tax lien to the security interest of AmeriBank under I.R.C. § 6323. A court also might first liquidate AmeriBank’s claim (because its security interest is expressly protected by I.R.C. § 6323(a)), but this result fails to consider the priority that CityBank enjoys over AmeriBank under the U.C.C. Finally, a court could award CityBank the initial grab at the collateral (because its interest enjoys priority over AmeriBank’s interest under the U.C.C.), but in doing so the court would completely ignore the impact of I.R.C. § 6323 on the priority dispute.

V. CONCLUSION

We may debate whether Congress effectively carries out its duties as custodian of the public fisc, but the fact that the collection of our federal tax dollars is vital to the continued existence of essential government services...
cannot be denied. Therefore, one must wonder why the drafters of the I.R.C. did not craft a statute that subordinates all consensual security interests to federal tax liens. In light of the present concern over the size of the federal deficit and the perceived, if not real, need for a balanced federal budget, perhaps the arrival of such a statute is just around the corner.

Nevertheless, for the moment, the IRS continues to be a willing participant (albeit an involuntary creditor) in priority disputes with Article 9 secured parties. Resolving these disputes requires a journey through not one, but two sets of complex statutes—quite a formidable task. The task becomes less formidable, and the statutes not so complex, by taking small analytical steps on the journey. Hopefully this Article makes a welcome traveling companion.