



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

OFFICE OF
CHIEF COUNSEL

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MEMORANDUM FOR ASSOCIATE AREA COUNSEL (SB/SE),

FROM: Lawrence H. Schattner
Chief, Branch 2 (Collection, Bankruptcy and Summonses)

SUBJECT: Personal Liability of Receiver under 31 U.S.C. § 3713(b)

This Chief Counsel Advice responds to your memorandum dated November 2, 2001. In accordance with I.R.C. § 6110(k)(3), this Chief Counsel Advice should not be cited as precedent.

ISSUES

1. Whether a receiver in a state insolvency proceeding can be held personally liable under 31 U.S.C. section 3713(b) for the amount of the Internal Revenue Service's (Service) unpaid tax claim against an insolvent corporation when the Service filed a claim in the state proceeding but failed to object to the receiver's proposed distribution, which was approved by the state court.
2. Whether the Service can foreclose a federal tax lien attached to proceeds of the sale of a receivership asset that were distributed by the receiver to another creditor in a state insolvency proceeding in frustration of the government's priority under 31 U.S.C. section 3713(a).

CONCLUSIONS

1. Yes. The receiver has an affirmative duty to ensure that the government's claim is paid first under section 3713(a) even when the Service has filed a claim in the state proceeding and failed to object to the proposed distribution.
2. Although we conclude that the Service's liens have priority over the Bank, we do not have enough facts to determine whether a lien foreclosure suit is warranted.

FACTS

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Two corporations (Stations) owe the Service a substantial amount of unpaid employment taxes. The Service filed several Notices of Federal Tax Lien (NFTL).

Prior to the creation of the tax liens, a Bank loaned the Stations money. Part of the security for this loan included a security interest in and collateral assignment of all the Stations' personal property. The personal property includes the Stations' broadcast licenses granted by the Federal Communications Commission (FCC) to the extent they can be encumbered. The Bank filed financing statements for its security interest in the Stations' personal property before the Service filed its NFTLs, however, the Bank allowed these statements to lapse. The Bank did not refile its financing statements until after the Service had filed its NFTLs. The Bank claims to have an assignment of the broadcast licenses, however, the FCC never approved such an assignment.

Unable to collect the unpaid loan balance, the Bank filed an action under state insolvency laws in state court. A receiver was appointed by the state court to liquidate and distribute the Stations' assets. The receiver filed a motion with the state court to approve a sale of the Stations' property, including the broadcast licenses, free and clear of all encumbrances. Notice was given to all creditors and parties in interest and a hearing was held. No objections to the sale were made, thus the court approved the sale and transferred all of the liens, to the extent they were valid against the original property, to the sale's proceeds.

Several months later, at the trustee's request, the Service filed a proof of claim in the receivership proceeding. The receiver had funds available to satisfy all of the Service's claim, however, the receiver proposed a distribution that paid substantially all of the assets to the Bank. This distribution was based on the receiver's belief that the Bank's liens had priority over the Service's liens in most of the property and that one of the broadcast licenses was properly assigned to the bank.

The state court ordered that notice of the proposed distribution be sent to all of the creditors, including the Service, and that objections to the distribution be filed by a certain date. The receiver sent the Service's notice to an address used for bankruptcy cases, not the address used for insolvency proceedings that was listed on the Service's proof of claim. It is not clear what happened to the notice, but apparently it was never received at the correct address. The Service did not object to the proposed distribution. The court then approved the receiver's distribution and entered a final decree. After receiving payment the Service realized there was a problem with the receiver's distribution but the time for objections had passed.

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LAW AND ANALYSIS

The Receiver's Personal Liability

We agree with your conclusion that the receiver can be held personally liable under 31 U.S.C. section 3713(b) for failing to pay the Service's tax claim first. Section 3713(b) makes a receiver personally liable for the amount of the government's unpaid claim when he or she pays any part of a debt owed by the receivership to another creditor before paying the government's claim.

In this case, the Service was entitled to be paid first from the proceeds of the sale of the broadcast licenses. See 31 U.S.C. § 3713(a). It is the Service's policy not to assert its priority under section 3713(a) over a prior perfected interest that otherwise has priority under section 6323 of the Internal Revenue Code. CCDM 34.1.8.¹ In this case, the Bank does not have a prior perfected security interest that would normally have priority under section 6323 because it allowed its financing statements to lapse and did not refile for two years. Thus, as you point out, the federal tax lien took priority over any security interest the Bank could have had in the broadcast licenses. Further, we agree with your conclusion that the Bank does not have a valid assignment of a broadcast license since no such assignment was approved by the FCC as required by law.

In order to be held personally liable under section 3713(b), a receiver must have actual knowledge of the government's claim. King v. United States, 379 U.S. 329, 339 (1964). The United States need not participate in an insolvency proceeding in order for the receiver to become personally liable. United States v. Blumenfeld, 128 B.R. 918, 926 n.6 (E.D. Pa. 1991); United States v. Boots, 675 F. Supp. 550, 552 (E.D. Mo. 1987). You cite two cases, however, that hold upon filing a claim in a state proceeding the United States subjects itself to the jurisdiction of the state court and relieves the receiver of responsibility over its claim. United States v. Muntzing, 69 F. Supp. 503 (N.D. W. Va. 1946); United States v. Pate, 47 F. Supp. 965 (W.D. Ark. 1942). The rationale behind these cases has been repudiated by the Supreme Court's holding in King v. United States, 379 U.S. 329 (1964).

¹This policy is a result of the U.S. Supreme Court's decision in United States v. Estate of Romani, 523 U.S. 517 (1998). The Court held that section 3713(a) does not require that a federal tax claim be given priority over a judgment creditor's prior perfect lien on real property.

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In King, a corporation filed for bankruptcy and defaulted on contracts with the United States.² Id. at 331. A distributing agent was appointed by the court to oversee payment to the corporation's various creditors. Id. The United States filed a proof of claim alleging first priority in the bankruptcy, however, the distributing agent paid the corporation's assets to other creditors. Id. at 332. The bankruptcy court approved the distributing agent's final report. Id. at 333. Despite the bankruptcy court's involvement, the Supreme Court held that the distributing agent could be held personally liable for the unpaid amount of the United States' claim. Id. at 338. The Court clarified that the distributing agent could not hide behind the bankruptcy court's approval of the distribution to shield himself from liability. King, 329 U.S. at 338. Instead, the Court found that the distributing agent "was possessed of a sufficient degree of control over the allocation among creditors of the assets in his possession to give rise to responsibility . . . for seeing that the government priority was paid." Id. at 339. The Court further clarified that as a person with responsibility over the estate's assets, the distributing agent had a high duty of care to see that the government's claim was paid. Id. As you noted, the Supreme Court held that the distributing agent's responsibilities "required more . . . than an honest belief that the Government would be paid. It imposed upon him a duty to see that this was done." Id. at 339-40. At the very least, the distributing agent had a duty to present the United States' claim to the court, recommend it be paid first and object if the court attempted to categorize the claim as a lower priority. Id. at 338. Thus, the government's failure to object to the distribution is irrelevant because the burden was on the receiver.

The courts in Pate and Muntzing held that the trustee had no special duty to the United States once the government became a party to the court proceedings.³ Yet

²Under the predecessor to section 3713 bankruptcies were included within the list of situations that give rise to the federal priority. 31 U.S.C. § 191 (1958). Now, title 11 cases are specifically exempted from the statute. 31 U.S.C. § 3713(a)(2).

³There are other reasons for distinguishing these cases. First, in Pate, the court was not convinced that the government's claim was entitled to priority under former 31 U.S.C. section 191, the predecessor statute to section 3713(b). 47 F. Supp. at 969. However, courts should construe the government's priority liberally. See e.g. Bramwell v. United States Fidelity & Guaranty Co., 269 U.S. 483. Second, the court held that the government did not have any rights greater than any other creditor. Id. at 968. At that time the priority statute was codified separately from the personal liability statute. 31 U.S.C. §§ 191, 192 (1958). In considering the trustee's personal liability under former section 192 the court failed to take into account the special status Congress granted for debts owed to the United States under section 191. In King the Court made clear that those two statutes had to be read together and that "taken together, these sections

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in King the United States filed a claim in the court proceeding and the trustee was still held liable for failing to pay the government's claim first. See also United States v. Burczyk, 556 F.2d 394 (7th Cir. 1977). The Supreme Court made clear that "[t]he burden . . . is placed on the representative or the person in control the assets to see that the United State is paid first." United States v. Morris, 2001 U.S. Dist. LEXIS 17531 (E.D. Tex. 2001). The trustee is not absolved of responsibility just because the United States has given notice of its claim by filing in a court proceeding.

In the recent case of SEC v. Credit Bancorp, Ltd., 138 F. Supp. 2d 512 (S.D.N.Y. 2001) a district court held that a receiver had discharged his responsibility under section 3713(b) simply by bringing the government's potential claim to the court's attention. The United States has appealed this decision to the Second Circuit Court of Appeals. In Credit Bancorp, the receiver sought an order from the court finding that other creditors had priority over the government in certain funds and an order declaring that he had met his obligations under section 3713(b). Id. at 543. The court granted both orders. Id. The court found that a declaratory order relieving the receiver of liability under the statute was appropriate since the court itself had decided the government was not entitled to a priority in the funds. Id. The court mistakenly relied on Pate and excerpts from King to conclude that once the receiver brought the government's claim to the court's attention the burden for attending to the government's priority shifted to the court. Id. at 544. The court, however, ignores the Supreme Court's statement that, before he can be relieved of liability, the receiver must object to the court's treatment of the government's claim. King, 138 F. Supp. 2d at 338.

A receiver's duty under section 3713(b) is an affirmative duty to ensure payment of the government's claim. Section 3713 is more than just a notice provision. Instead, the receiver in this case was duty-bound to propose a distribution that would satisfy the government's claim first.⁴ Further, if the court attempted to confirm a plan providing otherwise, the receiver would have an affirmative duty to object. This is based on Congress' desire to ensure that debts owed to the United States are paid

mean that debt due the United States is required first to be satisfied when the possession and control of the estate of the insolvent is given to any person charged with the duty of applying it to the payment of debts of the insolvent as the rights and priorities of the creditors may be made to appear." 379 U.S. at 336. To the extent Muntzing relies on Pate it too can be distinguished on these grounds.

⁴Because the receiver had an affirmative duty to pay the government's claim first, even though the Service filed a claim in the court proceeding, there is no need to address the improper address issue.

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in order to secure adequate revenue for the federal government. Bramwell v. United States Fidelity & Guaranty Co., 269 U.S. 483 (1926); United States v. Coppola, 85 F.3d 1015, 1020 (2d Cir. 1996). In light of this public policy, courts construe section 3713 liberally in order to ensure the government's claims are paid. Bramwell, 269 U.S. at 487; United States v. Whitney, 654 F.2d 607, 609 (9th Cir. 1981).

Priority of Federal Tax Liens⁵

When the Stations failed to pay their employment taxes federal tax liens were created on all the Stations' property and rights to property. I.R.C. § 6321. A broadcast license granted by the FCC constitutes a property interest to which a federal tax lien can attach. In re Atlantic Business Community Dev. Corp., 994 F.2d 1069 (3d Cir. 1993). The Service protected its interests by filing notices of federal tax lien in the appropriate county offices. See I.R.C. § 6323(a). Although the Bank had a prior lien on the Stations' personal property, arguably including the broadcast licenses,⁶ it allowed its financing statement to lapse, thus, the Service's liens took priority over the bank. See 13 Pa.C.S. § 9706. Pursuant to the court order allowing the sale of the broadcast licenses, all liens on the licenses shifted to the proceeds of the sale. Thus, when the receiver distributed the proceeds to the Bank they were encumbered by the Service's prior tax liens. See e.g. United States v. Cache Valley Bank, 866 F.2d 1242, 1244-45 (10th Cir. 1989) ("The transfer of property subsequent to the attachment of the lien . . . does not affect the lien because no matter into whose hands the property goes, the property passes . . . with the lien attached."); United States v. Bank of Celina, 721 F.2d 163, 169 (6th Cir. 1983) ("We hold that once a federal tax lien has attached to a taxpayer's property, that property remains subject to the lien when transferred from the taxpayer to a third party.").

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS

Even though the Service has priority over the Bank, the Service must be able to identify the proceeds of the sale to which the liens are attached before we can

⁵Your memorandum also requested us to consider any potential transferee liability of the Bank. Based on the facts presented we see no grounds to consider such a claim.

⁶As you note in your memorandum, it is unclear whether a private creditor's lien can attach to a broadcast license. See Stephens Industries, Inc. v. McClung, 789 F.2d 386 (6th Cir. 1986); In re Tak Communications, Inc., 985 F.2d 916 (7th Cir. 1993). The FCC has adopted a policy against recognizing private liens or security interests in broadcast licenses. See In re Merkley, 94 F.C.C.2d 829 (1983).

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foreclose our liens. This would involve application of tracing methods in order to determine to which funds the Service is entitled. Because we cannot tell if and to what extent the proceeds may have been commingled with other funds in the Bank we cannot determine whether a lien foreclosure suit is warranted.

This writing may contain privileged information. Any unauthorized disclosure of this writing may have an adverse effect on privileges, such as the attorney client privilege. If disclosure becomes necessary, please contact this office for our views.

If you have any further questions please contact the attorney assigned to this matter at (202) 622-3620.