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"Spearing" the Secured Creditor: Sixth Circuit Applies "Bluebook" Rule to IRS Lien Notice Requirements

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Journal Article:

Once again highlighting the tension between federal and state law involving lien priority disputes, the Sixth Circuit recently held that federal law—including, not insignificantly, federal policy considerations—essentially excused what would have otherwise been an ineffective IRS notice of lien filing under the Michigan Uniform Commercial Code. *United States v. Crestmark Bank (In re Spearing Tool and Manufacturing Co. Inc.)*, 412 F. 3d 653 (6th Cir. 2005). Reversing the district court and affirming the bankruptcy court, the *Spearing Tool* ruling provides that the appropriate test for determining the adequacy of an IRS notice of lien—as it relates to the debtor name requirement—is whether a "reasonable and diligent search would have revealed the existence of the notices of the federal tax lien." *Id.* at 656 (citing *Tony Thornton Auction Serv. Inc. v. U.S.*, 791 F.2d 635 (8th Cir. 1986)).

The facts of *Spearing Tool* are relatively straightforward, and the underlying case was decided on summary judgment. The procedural history of the case and the well-reasoned analyses of the bankruptcy and district courts, however, are particularly noteworthy. Both lower-court opinions reflect differing approaches to the relevancy and remaining vitality of more-dated decisional authority, viewed in context with varying judicial recognition of the technical evolutions (and limitations) of modern electronic filing and search techniques. Both the lower courts explored the degree of deference, if any, to be given to the resulting desire of the business community for increased "uniformity" and standardization of such techniques manifested by the framework of the revised Uniform Commercial Code. The Sixth Circuit's opinion, in unfortunate contrast, pays little heed to these topical and emergent issues, applying instead a more subjective and parochial analysis, laced heavily with federal policy concerns, resting within the precedential aegis of being "limited to these facts." *Id.*

Turning to the facts, in April 1998 Crestmark entered into a loan transaction with Spearing Tool and Manufacturing Co. Inc. (*Spearing*). Crestmark properly perfected its security interest in all of Spearing's assets by filing and recording appropriate notices and financing statements under Spearing's precise legal name, as registered with the Michigan Secretary of State. In April 2001, Crestmark entered into a secured financing transaction with Spearing involving the purchase of Spearing's accounts receivable, perfecting in the same manner and again using Spearing's precise legal name.

It is not, quite frankly, too much to ask that the government get the name right.

On Oct. 15, 2001, the IRS filed two notices of federal tax lien with the Michigan Secretary of State under the name "Spearing Tool & Mfg. Co. Inc.," which was neither Spearing's legal name nor any registered fictitious name.¹

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On April 16, 2002, Spearing filed a voluntary chapter 11 petition. At that time, Crestmark first discovered the IRS lien filings and ultimately filed a declaratory action against the IRS to determine priority to \$153,058.33 remaining in a reserve account established under a first-day cash collateral order.²

The bankruptcy court began its analysis with a discussion of the undisputed premise that federal law applies in determining the priority of tax liens. The issue posed by that analysis, however, is this: What law should apply to the federal requirement that the notice of federal tax lien must "identify the taxpayer"? Crestmark argued that the bankruptcy court should apply M.C.L.A. §440.9503 (UCC §9-503) to that requirement, mandating that the IRS should have made all filings and recordings under the debtor's name as it appears in the official public record.

Recognizing that federal law requires that the IRS look to state law as to the *place* of filing its notices, the bankruptcy court nevertheless rejected any notion that state law could have any bearing on any other federal requirement, especially as to the form of the notice, citing *U.S. v. Union Cent. Life Ins. Co.*, 368 U.S. 291 (1961). *Union Central* is a pre-UCC case premised on the concern that permitting states to legislate the form of notice would result in "radically differing forms" of notice: a result contrary to "the principle of uniformity which has long been accepted in the field of federal taxation."

Accordingly, the bankruptcy court applied the "reasonably diligent search" standard developed under federal common law. In that vein, the bankruptcy court found that the IRS made no error in identifying the taxpayer in the notice because the IRS used the accepted Bluebook abbreviations for "manufacturing" and substituting an ampersand (&) in place of "and." The bankruptcy court also noted that Crestmark had itself used such abbreviations when referring to Spearing Tool in its internal credit memoranda. Thus, in granting summary judgment to the IRS, the bankruptcy court applied purely federal statutory and common law analyses to the notice-requirement issue.

In reversing, the district court took a much different approach in an attempt to harmonize the seemingly competing interests of state and federal law in achieving a common policy goal: commercial certainty through uniformity and accuracy. First, the district court qualified the bankruptcy court's reliance on *Union Central*, finding the case to control only the issue of whether states could prescribe the form of IRS notices—not whether the IRS correctly completed those forms. As the district court noted, "filling out a form correctly does not implicate the same concerns as creating a different form for different states."

Like the bankruptcy court, however, the district court framed the issue as whether the lien in this case complied with federal law. The IRS conceded that the most applicable test of compliance is one of "reasonableness" (*i.e.*, whether a reasonable search of the index would have discovered the otherwise erroneous federal tax lien).

Bridging that analysis, the district court opined that courts applying the reasonableness test necessarily consider the recording method used by the applicable state or county. The district court also balanced the IRS's arguments that Crestmark had constructive notice of Spearing Tool's abbreviated name against Crestmark's contention that the search logic employed in Michigan is programmed, in accordance with UCC §9-503, only to find the exact legal name of the debtor entity.

Weighing the respective burdens imposed on creditors to search every possible version of a debtor's name, versus the burden on the IRS to get the debtor's name right, the district court concluded that the burden on the IRS would be slight by comparison. Thus, the district court reframed the issue, in the context of state law, to address the question of who should bear the burden of recording systems that use rigid computerized search logic rather than physical, alphabetized indexes.

The district court concluded that, given the relative weight of burdens, the advent of modern electronic filing and the constraints created by state law-based search mechanisms, fairness dictated that inaccurate IRS liens should not have priority over secured lenders.

The Sixth Circuit, however, took a slightly different approach, applying a more subjective analysis than that of either lower court. While the *Spearing Tool* court acknowledged that older federal precedent regarding the reasonableness of a lien search held little analogy in light of modern electronic searches, it nevertheless applied similar principles. Affirming the bankruptcy court's reference to the Bluebook, *Spearing Tool* found that "Mfg." and the ampersand are "most common abbreviations" and should have been included in the search.

In addition, the *Spearing Tool* court, in *Poirot*-like fashion, revealed the existence of a February 2002 handwritten note from the Michigan Secretary of State's office suggesting to Crestmark: "You may wish to search using Spearing Tool & Mfg. Company Inc."

Id. at 655. While the existence of such a note is admittedly interesting, it is perhaps more significant that neither lower court relied upon it—or even referred to it—in their respective opinions. Further, the date of the note was approximately four months after the IRS filed its notices of lien. Yet the *Spearing Tool* court twice referred to the note as subjective evidence of the unreasonableness of Crestmark's search.

Moving to the relative policy concerns implicated by the district court's opinion, the Sixth Circuit summarily dismissed any argument that requiring secured creditors to conduct a multiplicity of searches under various iterations of a debtor's name was in any way unreasonable. Rather, the court opined that requiring the IRS to identify a taxpayer "with absolute precision" would be "unduly burdensome to the government's tax-collection efforts." Such a burden on the IRS, speculated the court, "might burden the government at least as much as Crestmark's claim it would be burdened by having to perform multiple lien searches" (emphasis added).

Hence, the *Spearing Tool* court rejected any contention that the IRS should be required to meet the stringent standard imposed on every other lien creditor pursuant to UCC §9-503. As additional support for such a lower, non-uniform standard, the Sixth Circuit pointed to the fact that the UCC applied only to contract transactions and that federal policy favoring "prompt, effective tax collection" effectively trumped any inconvenience to the entire nationwide body of secured creditors. *Id.* at 656 (citing *U.S. v. Kimbell Foods Inc.*, 440 U.S. 715, 734-35 (1979) (where the court stated, in *dicta*, that national revenue policy justified the extraordinary priority accorded tax liens through choateness and first-in-time doctrines, but also qualified that federal policy opining that it must be tempered so as not to be disruptive to credit markets and state priority rules). Thus, the *Spearing Tool* court reversed the district court and affirmed summary judgment for the government.

While the holding of *Spearing Tool* is limited to its facts and therefore of questionable precedent, from a policy perspective the ruling is troubling for at least two reasons. This case presented an excellent opportunity for the court to address the modern electronic filing environment and keep tax-collection practices in pace with the evolving changes in state law and private commerce. As it stands, the ruling only serves to increase the disconnect between state and federal law as the former struggles to adapt to technical evolution and the latter appears intransigent and unmoved by the resulting dilemma to secured creditors.

To shield this anachronism within the bulwark of federal policy only serves to question the limits of such doctrines. It is not, quite frankly, too much to ask that the government get the name right. Such judicial paternalism seems to go too far if it essentially says, "we have to do everything in our power to save the government from itself just to keep the lights on around this place." The district court should be applauded for its efforts to reconcile these recurring tensions, however ephemeral and unrewarded they might have been.

Footnotes

¹ Although it was the name under which Spearing Tool filed some—but not all—of its tax returns. Return to article

² "Notice" is significant in this context, because despite having a prior filed financing statement, the Internal Revenue Code provides an exception to state law lien priority for any loans made more than 45 days after a notice of tax lien has been filed. Return to article

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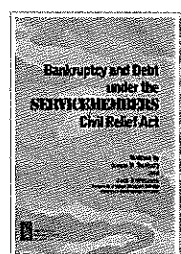
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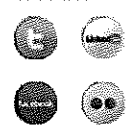
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44 Canal Center Plaza, Suite 400
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Tel. (703)-739-0800
Fax. (703) 739-1060
support@abiworld.org

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