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THE BANKRUPTCY AMENDMENTS OF 1966

*Frank R. Kennedy**

PUBLIC Law 89-495, hereinafter referred to as the statutory lien law, became law on July 5, 1966, after more than a dozen years' effort on the part of the National Bankruptcy Conference and others concerned generally with the improvement of bankruptcy law and in particular with the rationalization of the treatment of statutory liens in bankruptcy. The span of years marking the commencement and culmination of the campaign to enact Public Law 89-496, hereinafter referred to as the tax priority and dischargeability law, was even longer. One is reminded of the fifteen years it took sponsors of the original notice-filing provision of the federal tax lien law to get that reform through Congress,[1] and of the seven years required to get part of a comprehensive revision of the laws on federal tax liens, priorities, and procedures enacted after four sections of the American Bar Association and its Special Committee on Federal Tax Liens had devoted four years of extraordinary effort to the preparation of a draft.[2] The dimensions of the time and effort required to get these measures enacted are a measure of the effectiveness of the Treasury Department in opposing legislation which touches the revenues in ways it does not approve.[3]

* Professor of Law, Univ. of Michigan. A.B. 1935, Southwest Mo. State Coll.; LL.B. 1939, Washington Univ.; J.S.D. 1953, Yale University; Member of National Bankruptcy Conference; the first half of this article appears in the January issue of the JOURNAL OF THE NATIONAL CONFERENCE OF REFEREES IN BANKRUPTCY; the second half will appear in the April issue.

1 In 1898, five years after the decision in United States v. Snyder, 149 U.S. 210 (1893), the American Bar Association appointed a committee to call Congress' attention to the implications of the decision and to urge remedial legislation. 21 A.B.A. REP. 108, 261 (1898). Legislation supported by the Association was finally enacted in 1913. Ch. 166, 37 Stat. 1016 (1913).

2 See Plumb, *What Ever Happened to the A.B.A. Federal Tax Lien Legislation?*, 18 BUS. LAW. 1103 (1963). The Federal Tax Lien Act of 1966, Pub. Law 89-719, which is the product of the efforts described in the text became law on November 2, 1966. See 35 U.S.L. WEEK 38-46 (Oct. 25, 1966).

3 *Cf.*, H.R. REP. No. 2320, 82d Cong., 2d Sess. 12-13, 21 (1952), noting that the Treasury

The statutory lien bill and its predecessors were the subjects of two Congressional hearings[4] and one Senate hearing[5] and four House reports[6] and seven Senate reports.[7] Versions of the bill were passed by the House four times[8] and by the Senate twice.[9] When identical versions were passed by the House and Senate in 1960, death came by a pocket veto administered by President Eisenhower.[10] An apologetic message of Presidential disapproval failed to disclose the real ground of the Treasury Department's objection but referred only to the possibility under the bill that a chattel mortgage might be given an unwarranted priority[11] over a federal tax lien in a situation involving circular priority.

Department objected to certain of the proposed amendments of the Bankruptcy Act included in the Omnibus Bill of 1952, "not upon any ground that they would be ineffective or do not fairly and equitably deal with the rights and interests of the new and old creditors, but rather that they may have an effect upon the revenue laws and collection of revenue." The Report went on to point out that the interests of the Government were adequately protected, that, indeed, the Government was probably in a better position under the amendments than before.

4 *Hearing on H.R. 4158 Before the Subcommittee of the House Judiciary Committee*, 86th Cong., 1st Sess. (1959); *Hearing on H.R. 5195 and H.R. 6787 Before the Subcommittee of the House Judiciary Committee*, 85th Cong., 1st Sess. (1957).

5 *Hearing on S. 976 (H.R. 3438) and S. 1912 (H.R. 136) Before the Senate Committee on Finance*, 89th Cong., 1st Sess. (1965).

6 H.R. Rep. No. 686, 89th Cong., 1st Sess. (1965); H.R. Rep. No. 454, 88th Cong., 1st Sess. (1963); H.R. Rep. No. 708, 87th Cong., 1st Sess. (1961); H.R. Rep. No. 745, 86th Cong., 1st Sess. (1959).

7 S. Rep. No. 1159, 89th Cong., 2d Sess. (1966); S. Rep. No. 999, 89th Cong., 2d Sess. (1966); S. Rep. No. 997, 89th Cong., 2d Sess. (1966); S. Rep. No. 277, 89th Cong., 1st Sess. (1965); S. Rep. No. 1133, 88th Cong., 2d Sess. (1964); S. Rep. No. 1242, 87th Cong., 2d Sess. (1962); S. Rep. No. 1871, 86th Cong., 2d Sess. (1960).

8 August 25, 1959; August 7, 1961; July 8, 1963; and August 2, 1965.

9 August 25, 1960, and June 23, 1966. H.R. 1961, a predecessor of the statutory lien bill finally enacted, was approved by the Senate Judiciary Committee of the 87th Congress, but the bill was referred to the Senate Finance Committee, from which it did not emerge during the remainder of the 87th Congress. See S. Rep. No. 1133, 88th Cong., 2d Sess. 1 (1964). H.R. 5195, another predecessor, was likewise buried by a reference to the Senate Finance Committee after clearing the Senate Judiciary Committee during the 88th Congress.

10 Cong. Rec., 86th Cong., 2d Sess., 106 Cong. Rec. 19168 (1960).

11 The full text of the presidential veto message, dated September 9, 1960, is as follows:

> I have withheld my approval of H.R. 7242, to amend sections 1, 57j, 64a(5), 67b, 67c, and 70c of the Bankruptcy Act, and for other purposes.
>
> I recognize the need for legislation to solve certain problems regarding the priority of liens in bankruptcy, but this bill is not a satisfactory solution. It would unduly and unnecessarily prejudice the sound administration of Federal tax laws. In some cases, for example, mortgages would be given an unwarranted priority over Federal tax liens even though the mortgage is recorded after the filing of the tax lien.
>
> This and other defects of the bill can, I believe, be corrected without compromising its primary and commendable purpose. The Treasury Department and the proponents

Not only was this a result possible under the existing law,[12] but the Treasury Department had evinced no interest in a solution to that problem proposed by the National Bankruptcy Conference and ultimately incorporated in the new section 67c(3).[13]

The tax priority and dischargeability bill passed the House four times[14] before it finally stuck. It is favorably reported on in seven House and Senate reports.[15]

PUBLIC LAW 89-495

Public Law 89-495 amends four sections of the Bankruptcy Act—1, 64, 67, and 70—but its principal significance lies in its rationalization of the treatment of statutory liens by overhauling subdivisions b and c of section 67. The National Bankruptcy Conference recognized the

of H.R. 7242 have been working toward solution of recognized problems in present law. Further cooperative efforts should produce satisfactory legislation that would avoid the undesirable effects of this bill.

The persistent ground of disagreement between the National Bankruptcy Conference and the Treasury Department throughout the legislative career of the statutory lien bill related to the requirement that the federal tax lien be perfected by notice-filing in order to prevail against the trustee in bankruptcy. See, *e.g.*, S. REP. No. 999, 89th Cong., 2d Sess. 11-12 (1966).

The objection that a chattel mortgage might take priority over an earlier perfected tax lien was insubstantial. Since the Bankruptcy Act contained no guides for resolution of the conflicts engendered by the circuity of priority created by former § 67c(1), the result complained of was possible under existing law. *Cf.*, New Orleans v. Harrell, 134 F.2d 399 (5th Cir. 1943). Indeed, priority might be given a mortgagee outside bankruptcy over a federal tax lien notwithstanding the earlier perfection of the latter. See Gauvey v. United States, 291 F.2d 42, 47 (8th Cir. 1961); United States v. Lebanon Woolen Mills Corp., 241 F. Supp. 393, 398 (D.N.H. 1964); United States v. Anders Contracting Co., 111 F. Supp. 700, 703-04 (W.D.S.C. 1953); Schmitz v. Stockman, 151 Kan. 891, 893-94, 101 P.2d 962, 964-65 (1940).

12 This result was possible wherever a court chose the mode of resolution of circuity of priority adopted in New Orleans v. Harrell, 134 F.2d 399 (5th Cir. 1943).

13 See H.R. REP. No. 708, 87th Cong., 1st Sess. 3 (1961).

14 On August 25, 1959, August 7, 1961, July 3, 1963, and August 2, 1965. After passage by the House of Representatives in the 87th, 88th, and 89th Congresses, the bill was approved by the Senate Judiciary Committee and then referred to the Senate Finance Committee. By reason of extraordinary effort on the part of Senator Ervin of the Senate Committee on the Judiciary, the Senate Finance Committee was forced to make a report on the bill to the 89th Congress. See colloquy on the floor of the House as to the reasons for the delay and difficulties in getting this legislation through the Senate. 111 CONG. REC. 18247 (daily ed. Aug. 2, 1965).

15 S. REP. No. 1158, 89th Cong., 2d Sess. (1966); S. REP. No. 998, 89th Cong., 2d Sess. (1966); S. REP. No. 996, 89th Cong., 2d Sess. (1966); S. REP. No. 114, 89th Cong., 1st Sess. (1965); S. REP. No. 687, 89th Cong., 1st Sess. (1965); H.R. REP. No. 537, 87th Cong., 1st Sess. (1961); H.R. REP. No. 735, 86th Cong., 1st Sess. (1959). See also S. REP. No. 999, 89th Cong., 2d Sess. (1966).

difficulties with these two subdivisions back in 1953 when it appointed a committee to study and recommend revision of section 67c.[16] Early drafts considered by the Conference are discussed in an article published a dozen years ago in the *Minnesota Law Review*.[17] These drafts included the basic features of the rationalization of the treatment of statutory liens which was effected by Public Law 89-495.

Definition of "Statutory Lien"

The definition of a "statutory lien" in section 1(29a) was introduced into the bill to overrule a holding of the Court of Appeals for the Third Circuit in In re *Quaker City Uniform Co.* that a chattel mortgage is a statutory lien.[18] After listening to reargument, the court withdrew its opinion based on this ruling but declined to recant what it had said about the statutory character of the security interest there involved.[19] The *Quaker City* opinion thus intimated that consensual chattel security interests unaccompanied by possession might be immunized from attack as preferences, on the one hand,[20] but subject, on the other, to invalidation for failure to pass muster under section 67c.[21] This untoward development explains the exclusion from the

16 NATIONAL BANKRUPTCY CONFERENCE, SUMMARY OF PROCEEDINGS 7 (1953). There were readily evident these half-dozen objections to the Act's treatment of statutory liens: (1) Subdivisions b and c of § 67 were obscure, overlapping, and conflicting. (2) Section 67c discriminated against statutory liens on personalty. (3) Section 67c discriminated against statutory liens perfected otherwise than by possession. (4) Section 67c discriminated against liens created by state law. (5) Section 67c overshot its target in avoiding liens which were in no sense disguised priorities. (6) It generated circuity of priority. These objections are discussed in Kennedy, *Statutory Liens in Bankruptcy*, 39 MINN. L. REV. 697, 703-22 (1955).

17 Kennedy, *supra* note 16, at 723, 732-33. See also HANNA & MACLACHLAN, CASES AND MATERIALS ON CREDITORS' RIGHTS 710 (5th ed. 1957); Kennedy, *Priorities Under the Bankruptcy Act: Proposed Amendments to Section 67c and 70c*, 11 PERS. FIN. L.Q. REP. 51 (1957).

18 BANKR. L. REP. ¶ 58,778 (1956); see Kupfer, *Astounding Decision Affecting Secured Claims in Bankruptcy*, 10 PERS. FIN. L.Q. REP. 130 (1956); Kupfer, *A "Puzzlement": The Quaker City Uniform Case, Its Impacts and Aftermath*, 12 BUS. LAW. 280 (1957); Note, 70 HARV. L. REV. 1296 (1957); Note, 2 VILL. L. REV. 122 (1956).

19 *In re* Quaker City Uniform Co., 238 F.2d 155, 159 (3d Cir. 1956), *cert. denied*, 352 U.S. 1030 (1957). The court was able to reach the same result by another route and chose only to assume for the purposes of its second opinion that a Pennsylvania chattel mortgage was not a "statutory lien" within the purview of § 67c of the Act. The court did nevertheless cite the correct holding in *In re* Tele-Tone Radio Corp., 133 F. Supp. 739, 746-48 (D.N.J. 1955), which rejected an argument by the United States that a factor's lien drawn under the New Jersey and New York factors' lien acts was a statutory lien within § 67c of the Bankruptcy Act.

20 The new statutory lien law retains the immunity conferred by the Chandler Act on statutory liens from avoidance under § 60.

21 Since former § 67c(2) invalidated state statutory liens unaccompanied by possession, the potential impact on consensual security interests in personal property was drastic.

new definition of "any lien provided by or dependent upon an agreement to give security."

The definition is subject to a literal interpretation sufficiently broad to include a lien arising pursuant to judicial proceedings, such as the lien of a judgment, execution, attachment, garnishment, or proceedings auxiliary to execution.[22] In view of the explicitness of the reference to liens by judicial proceedings in section 67a and the well understood role of that subdivision in respect to such liens, the risk that any court will now assume that section 67c applies to them is surely minimal. There may nevertheless be argument whether statutory liens include such an interest as the security interest in proceeds provided by section 9-306(4)(d) of the Uniform Commercial Code.[23] Since this security interest is one dependent upon an agreement to give security, the definition seems to me to exclude this security interest.[24]

Section 67c(1)

It would be useful to discuss illustratively what happens to a statutory attorney's lien claimed on money coming into the attorney's hands after insolvency of his client-debtor if bankruptcy occurs while the funds are still in the attorney's possession. Let it first be noted that although the lien arose after insolvency and on the eve of bankruptcy, section 60, the preference provision, does not apply. The introductory language of section 67b excluding statutory liens from the operation of scope of section 60 has not been changed. But a statutory lien must pass the new three-way test of section 67c(1).

Disguised Priorities

The first clause invalidates any statutory lien which first becomes effective upon (a) insolvency of the debtor, or (b) upon distribution or liquidation of his property, or (c) upon execution against his property levied at the instance of some creditor. As the legislative reports accompanying the statutory lien bills point out, this clause (A) of section 67c(1) strikes at patent priorities which are disguised as liens.[25] Such liens are generally for the benefit of wage claimants.[26]

22 These liens do arise by force of statute upon the taking of certain steps and do not depend upon an agreement to give security.

23 See Kennedy, *The Impact of the Uniform Commercial Code on Insolvency: Article 9*, 67 COM. L.J. 113, 116-17 (1962); Marsh, *Book Review*, 13 U.C.L.A.L. REV. 898, 907-08 (1966).

24 *Ibid.*

25 See, *e.g.*, S. REP. No. 277, 89th Cong., 1st Sess. 6 (1965).

26 See, *e.g.*, CAL. CODE CIVIL PROC. §§ 1204, 1206; IOWA CODE ANN. §§ 626.69-626.73,

The attorney's lien does not fall under the condemnation of this clause although the debtor is insolvent when the attorney's lien arose. The statute requires the lien to be one which first becomes effective upon the debtor's insolvency. Concurrence of insolvency and the inception of the lien is not enough. The lien must be one which arises *upon* insolvency, distribution, liquidation or levy—that is, one which really is a rule of distribution because it does not apply if there is no distribution in prospect.[27]

The Bona Fide Purchaser Test

Is the attorney's lien perfected or enforceable as against a bona fide purchaser on the date of bankruptcy? This involves a study of state law, but I should surmise that under the law of practically every state a statutory lien against a fund in the attorney's possession can not be displaced by any transfer thereof by the debtor.

The introduction of the bona fide purchaser test into the Bankruptcy Act's scheme for adjusting the rights of statutory lienors rests on the premise that if a statutory lien does not follow the property into the hands of a bona fide purchaser, it is primarily a statutory device for establishing priority among competing creditors and ought not to prevail as against the order of priorities established by section 64 in the event of bankruptcy. Since a statutory lienor in possession of the collateral typically prevails against any bona fide purchaser of the encumbered property from its owner, the adoption of the bona fide purchaser test probably does not withdraw protection formerly ac-

681.13 (1950); N.C. GEN. STAT. §§ 44-51 (Supp. 1965). Other examples are found in United States v. Knott, 298 U.S. 544 (1936); United States v. Oklahoma, 261 U.S. 253, 258 (1923). The *Knott* case involved a trust fund described by the Supreme Court as an "inchoate general lien," embracing deposit of securities for the benefit of unsatisfied judgment creditors and Florida creditors at the date the debtor surety company was placed in liquidation. In the *Oklahoma* case, a statutory lien was given the state for the benefit of depositors against assets of a bank or trust company effective upon initiation of insolvency proceedings.

27 The term "insolvency" as used in § 67c(1)(A) presumably means insolvency in the bankruptcy sense whereas any state statute creating a lien "upon the insolvency of the debtor" may well contemplate insolvency in the equity or commercial sense. Since this clause also invalidates any statutory lien which becomes effective "upon distribution or liquidation" of the debtor's property or upon an execution levied by some other creditor, the lack of correlation in the usage of "insolvency" should be inconsequential. The alternatives in clause (A) clarify its purpose to reach liens intended to operate only to confer a priority in connection with a settlement or distribution to creditors. The invalidation of such a lien should depend neither on whether the debtor is actually insolvent under § 1(19) of the Bankruptcy Act nor on whether the statutory lien actuated by the inception of a liquidation or settlement requires concurrent insolvency in the bankruptcy sense.

corded such a lienor. Application of the test will undoubtedly require the court often to investigate a question which may not have previously been authoritatively determined under nonbankruptcy law, *viz.*, whether a particular statutory lien is effective against a bona fide purchaser. If no effort has ever been made to enforce the lien against a bona fide purchaser, that fact would be evidence of a practical construction tending to bring the lien within the invalidating language of section 67c(1). If the lien is a secret one never relied on except as against other creditors competing for shares of a debtor's property, the lien is vulnerable to the trustee's attack under this clause.

The Uniform Commercial Code has provided answers for a good many questions regarding rights in personal property hitherto in limbo. Does it help here? Not as much as you might think or like. While a statutory lien technically comes within the definition of a security interest in section 1-201(37) of the Code, it is not regulated by Article 9,[28] except in a minor respect shortly to be noted. It need not be perfected by notice-filing to be good against lien creditors under section 9-301, and its relative priority is not governed by section 9-312. There is a provision in the Code—section 9-310—which deals with the relative priority of statutory liens, but the operation of this section is limited to liens for persons who in the ordinary course of their business furnish services or materials with respect to goods subject to a security interest and who have possession. Such lienors have priority over perfected security interests unless a statute provides otherwise. Article 9 does not apply to rights in judgments,[29] to assignments of accounts, contract rights, and chattel paper for collection only,[30] or to assignments of tort claims.[31] Moreover, notice-filing is not required to perfect security interests in accounts or contract rights which are an insignificant part, either alone or in combination with other assignments to the same assignee, of the outstanding accounts or contract rights of the debtor.[32] It seems fair to say that the Code does nothing to make a statutory lien on personalty more vulnerable to frustration or defeat by a subsequent transfer by the debtor to a bona fide purchaser. At the most, the Code has only marginal relevance in the construction of section 67c.

Suppose a statutory lien is perfected by notice-filing as against a

28 See UNIFORM COMMERCIAL CODE § 9-102(2). [Hereinafter cited as UCC.]
29 UCC § 9-104(h).
30 UCC § 9-104(f).
31 UCC § 9-104(k).
32 UCC § 9-302(1)(e).

conventional bona fide purchaser but is not enforceable under applicable lien law against a buyer in the ordinary course of business.[33] Arguably the lien ought nevertheless to be effective against the trustee.[34] A statutory lien against collateral being sold in ordinary course is, in any event, likely to be a tax lien, which must be accompanied by possession in order to prevail against the first two classes of priority claimants,[35] or a landlord's lien for rent, which is invalidated by clause (c) of this paragraph without regard to its state of perfection.[36] Any other variety of statutory lien against inventory or accounts receivable subject to sale in the ordinary course was probably invalid under former section 67c(2). The absence of evidence of any legislative intent to validate such a lien against the trustee, the tenuousness of the suggestion that a bona fide purchaser does not include a buyer in the ordinary course, and the similarity of a statutory lien of shifting collateral held for sale to a priority serve to render the statutory lien on such collateral of doubtful validity.

The third test posed by section 67c(1) cuts down only statutory rent liens and liens of distress for rent. The attorney's lien runs into no difficulty.

What is the impact of the new legislation on the statutory lien of a landlord if he takes possession before bankruptcy? Section 67c no longer puts any premium on possession except insofar as it will save a tax lien on personalty from postponement under section 67c(3). Obtaining possession before bankruptcy may nevertheless be advantageous

33 For a definition of "buyer in the ordinary course of business," see UCC § 1-201(9).

34 That satisfaction of a bona fide purchaser test does not necessarily require the lien to be enforceable against buyers in the ordinary course of business, see Coin Machine Acceptance Corp. v. O'Donnell, 192 F.2d 773, 776 (4th Cir. 1951); Moore & Tone, *Proposed Bankruptcy Amendments: Improvement or Retrogression*, 57 YALE L.J. 683, 698 (1948); *cf.*, Bankruptcy Act §§ 60a(2), (6); UCC §§ 1-201(9), 2-403, 3-302, 7-501, 8-302, 9-307, 9-308, 9-309.

The history of the bona fide purchaser test as incorporated in § 60 of the Bankruptcy Act nevertheless argues against the position here suggested. A reason often mentioned for abandoning the bona fide purchaser test for timing a transfer of personal property under § 60 of the Chandler Act was that it could never be satisfied by security interests in collateral subject to sale in the ordinary course of trade by the debtor. See H.R. REP. No. 1293, 81st Cong., 1st Sess. 5 (1949); 40 GEO. L.J. 457, 458, 460 (1952).

The legislative history of the Federal Tax Lien Act of 1966 also suggests the prevalence of an opinion that prior to the enactment of § 6323(b)(3) of the Internal Revenue Code, a federal tax lien perfected by notice filing was effective against an innocent buyer in the ordinary course of trade. See 112 CONG. REC. 21309 (daily ed. Sept. 12, 1966). See also Schmitz v. Stockman, 151 Kan. 891, 895-96, 101 P.2d 962, 965-66 (1940).

35 See Bankruptcy Act § 67c(3) discussed at notes 45-64, *infra*.

36 See Bankruptcy Act § 67c(1)(C).

to a statutory lienor in two situations: (1) It may serve to perfect his lien against a bona fide purchaser and, if not for rent, to validate it against the trustee under section 67c(1)(B). (2) It may comply with a state prerequisite for a rent lien which, notwithstanding its invalidation by section 67c(1)(C), qualifies the landlord for priority under section 67c(2)'s last sentence. The same observation applies to the advantage of getting a distraint for rent before bankruptcy: Although neither a common-law nor a statutory distraint can support a valid lien in bankruptcy, it can serve to entitle the landlord to a priority.[37] In some states, *e.g.*, Pennsylvania,[38] there is a right of distress for rent which constitutes no lien or security interest prior to the actual distraint. Until there is a statutory or common-law lien effective as against a judicial lien creditor at the time of bankruptcy, there is nothing for section 67c to act on. If state law gives a landlord a priority anyway, the rent lien is superfluous in bankruptcy.

Preservation of Liens Under Section 67c(2)

Suppose now that a state tax lien against realty which is not invalidated by section 67c(1) is inferior to an unfiled federal tax lien because of inchoateness. Since the trustee prevails over the federal tax lien (under section 67c(1)(8)) but yields to the state tax lien, circuity of priority is created. How does the new law resolve it? The trustee may, pursuant to section 67c(2), ask the court to order the federal tax lien to be preserved for the benefit of the estate. In such event, the state tax lienor would receive the same portion that would have been its lot outside bankruptcy. The priority of the federal tax lien over the state tax lien would be formally preserved, but the proceeds allocated to the federal lien would be applied to the administrative expenses, wage claims, and creditors' expenses listed in section 64a(1), (2), and (3), before distribution of the balance on a parity among the tax claimants entitled to priority under section 64a(4). If the federal tax lien is not

37 All liens of distress for rent, whether statutory or common law, were postponed and restricted by the former § 67c, regardless of possession. 4 COLLIER, BANKRUPTCY ¶¶ 67.23, 67.27[2], 67.28 (14th rev. ed. 1964). Specific provisions directed at liens of distraint in bankruptcy have evolved because of the tendency of unrestricted rent liens to consume entire estates and because of the susceptibility of the use of distraint, a mode of self-help, to frustrate the objectives of bankruptcy distribution. See H.R. REP. No. 1409, 75th Cong., 1st Sess. 16 (1937).

38 *In re* George Townsend Co., 180 F. Supp. 625 (E.D. Pa. 1957); Kupfer, *The Quaker City Uniform Case—A Supplementary Note*, 12 BUS. LAW. 539 (1957). The law of New Jersey is apparently similar. See Note, 14 RUTGERS L. REV. 587, 597-99 (1960).

so preserved, the second sentence makes it clear that the state tax lien is benefited to the extent that it is relieved of the burden of the invalidated federal tax lien.

Enforcement By Sale before Bankruptcy

Suppose an attorney on the eve of his client's bankruptcy takes his fee out of the proceeds of a recovery on behalf of his client. Does the enforcement of the attorney's statutory lien against the proceeds in such a manner and under such circumstances render the attorney liable to the client's trustee? Section 67c does not apply to liens enforced by sale before bankruptcy.[39] This lien is enforced without sale, but that surely should cause no difficulty for the attorney. His statutory lien would have been valid if bankruptcy had befallen his client before enforcement, and nothing in the Act enables the trustee to invalidate the lien merely because it was enforced before bankruptcy. The case is like the numerous ones in the reports rejecting attacks on prebankruptcy enforcement of liens which would have been valid as against the trustee if not enforced.[40] The first clause of section 67c(5) is probably unnecessary, but it simply retains in the Act a feature found in the opening clause of former section 67c. The clause makes clear that the trustee cannot under section 67c reach back and strike down or impair any lien already enforced before bankruptcy takes over, even though the lien might have been vulnerable to postponement or indeed invalidation if bankruptcy had occurred before the sale.

Perfection Post Bankruptcy

The provisos of section 67c(2)(B) have puzzled some readers. The first proviso says in effect that any statutory lien which has not been perfected against a bona fide purchaser at the date of bankruptcy may nevertheless be so perfected if (1) the lien is good against the trustee under section 70c at the date of bankruptcy, and (2) the time allowed by state law for perfection against a subsequent bona fide purchaser has not expired.

Does this proviso in effect establish a lien creditor test for statutory liens? Section 70c establishes the lien creditor test in bankruptcy and all conflicting liens, interests, and claims against the property of the bankrupt must meet that test to survive against the trustee. This has

39 See Bankruptcy Act § 67c(5).

40 See 3 COLLIER, BANKRUPTCY ¶ 60.22 (14th rev. ed. 1966).

been the law for years, as the United States discovered to its dismay in *United States v. Speers*.[41]

The proviso authorizing perfection after bankruptcy was a feature of section 67b before the recent amendment. The United States as a tax lienor sought to take advantage of this provision of the former law, but the Supreme Court properly pointed out that although section 67b permits belated perfection to save a statutory lien from avoidance under section 60, there is nothing in the Act or its policy to exclude applicability of section 70c to unperfected tax liens at the date of bankruptcy.[42]

It nevertheless oversimplifies matters to say that the proviso goes no further than to impose a lien creditor test. If a statutory lien cannot be perfected so as to be made enforceable against a subsequent bona fide purchaser, it falls within the condemnation of Section 67c(1)(B). As the legislative reports have pointed out repeatedly, such a lien is a tenuous one, defeasible by the debtor's transfer,[43] and serves primarily the purpose of conferring priority on the statutory lienor over other creditors.

Although the proviso does not help the United States if it has failed to perfect its lien by notice-filing before bankruptcy, it enables mechanic lienors and other lien claimants whose liens are inchoate at bankruptcy to complete the state statutory procedure within the two limitations prescribed by the proviso. Suppose that a mechanic's lien need not be perfected against a lien creditor but does have to be notice-filed within a 60-day or 90-day grace period in order to prevail as against an intervening bona fide purchaser, *i.e.*, one who acquires his rights during such a period. If perfection after the lapse of the grace period nevertheless is effective as against a subsequent bona fide

41 382 U.S. 266 (1965). One of the exasperating aspects of the campaign for enactment of H.R. 89-495 was the insistence by the Treasury Department that the Supreme Court changed the law in *Speers* and thereby exposed the Government's unfiled federal tax lien to new risks of such seriousness that it would now have to notice file all tax liens without regard to (1) the cost and inconvenience to the government of adopting such a policy or (2) the hardship to the tax debtor resulting from such a step. The Treasury Department's views are reflected in S. REP. No. 999, 89th Cong., 2d Sess. 4, 11-12 (1966). The Treasury Department sought to amend the statutory lien bill to overrule *United States v. Speers* and indeed persuaded a majority of the Senate Finance Committee to recommend such an amendment. *Id.* at 12-13. A minority of that committee exposed the fallacies of the majority's report in a short dissent, *id.* at 22-24, and the Senate Committee on the Judiciary unanimously adopted the views of the minority of the Senate Finance Committee. S. REP. No. 1159, 89th Cong., 2d Sess. 13 (1966).

42 United States v. Speers, 382 U.S. 266, 277-78 (1965).

43 See, *e.g.*, S. REP. No. 1159, 89th Cong., 2d Sess. 7 (1966).

purchaser, can the mechanic's lien be perfected after bankruptcy as against the trustee? The answer most consistent with the literal language of the statute is in the affirmative. The prior law simply authorized perfection after bankruptcy of any lien arising before bankruptcy if perfection was required and occurred "within the time permitted by and in accordance with the requirements of such laws." The statute did not particularize the kind of perfection requirement it was talking about—*i.e.*, one requiring perfection within a prescribed time in order to relate back as against intervening lienors or purchasers or one requiring perfection within a prescribed period in order to be effective as against subsequent lienors or purchasers. The same kind of ambiguity is to be found in section 60a(7) and has given rise to a difference of opinion as to whether a purchase-money security interest must be notice filed within the ten-day period prescribed by section 9-301(2) of the Code in order to avoid a ruling that the security interest is a transfer for an antecedent debt under section 60.[44] It would appear that the ambiguity has been avoided in section 67c(1)(B)'s proviso. But, to repeat, perfection after bankruptcy is permitted only if at bankruptcy the lien is then good against the trustee under section 70c and if perfection occurs within the time required to validate the lien against subsequent bona fide purchasers. If, however, the mode of perfection required by the applicable lien law, is seizure, notice filed with the bankruptcy court continues to be the substitute prescribed by the Act.

The Postponement of Tax Liens

The provision of Public Law 89-495 which has caused the most trouble is section 67c(3), the postponement subdivision.[45] Paragraph

44 See 1 COOGAN, HOGAN & VAGTS, SECURED TRANSACTIONS UNDER THE U.C.C. 995, 1065-67 (1966); 2 GILMORE, PERSONAL PROPERTY SECURITY 1328-29 (1965).

45 Section 67c(3) is a revision of former section 67c(1), which postponed landlords' liens of distraint as well as tax liens. It was not a part of H.R. 5195, introduced on February 27, 1957, in the 85th Congress and embodying the proposal originally submitted by the National Bankruptcy Conference. The Conference wanted to get rid of all the agony and the anomalies caused by the novelty introduced in 1938 and aggravated in 1952 of subordinating certain liens to two classes of unsecured claims and restricting such liens in relation to inferior classes of unsecured claims. The case of *In re* Quaker City Uniform Co., 238 F.2d 155 (1956), *cert. denied*, 352 U.S. 1030 (1957), came along in 1956 to confirm the Conference's opinion that the postponement feature of the old law was a mischief to be eschewed in any new attack on the problems of the statutory lien. This thrust toward simplification stalled the whole bill, however, as the Administrative Office of the United States Courts saw in it a threat to the continued health of the Referees' Salary and Expense Fund and the Judicial Conference withheld its approval of the bill. Although the

(3) was the subject of numerous conferences between representatives of the National Bankruptcy Conference and the Treasury Department over the course of a half dozen years, held for the ostensible purpose of ironing out differences. The paragraph was considerably revised from time to time to accommodate stylistic preferences of Treasury Department conferees and to assure adherence to the *New Britain* formula[46] for solving the riddle of circular priority in lieu of the *New Orleans v. Harrell*[47] approach originally proposed by the National Bankruptcy Conference.

A good deal of the steam behind Public Law 89-495 was generated by In re *Quaker City Uniform Co.*, a Third Circuit opinion, which the Supreme Court refused to review.[48] As observed earlier,[49] the National Bankruptcy Conference had come to appreciate the defects of section 67c before the appearance of *Quaker City Uniform.* A construction by the Fifth Circuit back in 1943 in *New Orleans v. Harrell*[50] apparently did not disturb the Treasury Department or anybody else. That involved a postponable city tax lien which had priority over an indefeasible chattel mortgage on the bankrupt's property. The court very reasonably read section 67c(1) to subordinate the city's tax lien but not the chattel mortgage. The result was to allow the chattel mortgage to rise above the tax lien to the top.

The mischievous potentialities of section 67c were not fully or generally appreciated until 1956 when the Third Circuit delivered its infamous *Quaker City Uniform* decision.[51] The dispute involved the

bill as originally introduced had the support of the National Bankruptcy Conference, the American Bar Association, the National Commercial Finance Conference, the American Bankers Association, and other organizations, it became clear after a hearing before a subcommittee of the House Judiciary Committee on June 29, 1957, that the bill was going nowhere in its original form. And so paragraph (3) emerged.

46 As the Treasury Department preferred to describe the pattern of solution of the circularity program. See I.R.S. Technical Information Release No. 316, April 26, 1961. The *New Britain* formula resolved the problem arising out of priority for a city's liens over a mortgage, which was prior to a federal tax lien, which was in turn superior to the city's liens. United States v. New Britain, 347 U.S. 81 (1954). Since *New Britain* required the subordinated liens of the city to be paid out of the indefeasible lien of the mortgagee in order to protect the federal tax lien from encroachment by the city's liens, Professor Gilmore suggests that the *New Britain* formula would actually require a different ordering of the distribution than that adopted by the cases codified in § 67c(3). See 2 GILMORE, SECURITY INTERESTS IN PERSONAL PROPERTY 1035, 1045 (1965).

47 134 F.2d 399 (5th Cir. 1943). See text accompanying note 50 *infra.*

48 238 F.2d 155 (1956), *cert. denied,* 352 U.S. 1030 (1957).

49 See text accompanying note 16 *supra.*

50 134 F.2d 399 (5th Cir. 1943).

51 238 F.2d 155 (3d Cir. 1956), *cert. denied,* 352 U.S. 1030 (1957).

disposition of $10,000, the proceeds of the sale of a debtor's personalty subject to a chattel mortgage for $6000 and a landlord's lien of distraint for $4000. Though subsequent in time, the lien of distraint was accorded priority by Pennsylvania law over the chattel mortgage. This entailed no serious consequence for the chattel mortgage until bankruptcy. The debtor had accumulated wage obligations entitled to priority under section 64a(2) of over $10,000. Since the landlord's lien was superior to the chattel mortgage and the administrative expense and wage priorities were superior to the landlord's lien, the "necessary implication" was that neither security claimant could share in the $10,000 proceeds; both went down the drain locked together in place. That was the law of the Third Circuit[52] until the recent legislation codified the view taken by the Ninth Circuit,[53] Fifth Circuit,[54] and a district court opinion from New York.[55]

The postponement provision now applies only to tax liens unaccompanied by possession. The Treasury Department objected to the invidious discrimination against its tax collectors, ignoring the fact that the only other postponable liens under prior law were landlord's liens, which are now invalidated, whether or not perfected as against bona fide purchasers and whether or not accompanied by possession. The majority of the Senate Finance Committee, however, accepted the resolution of the circular priority problem prescribed by paragraph (3), recognizing that tax liens cause most of the circularity problems that arise.[56]

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52 *Quaker City Uniform* was followed in *In re* Einhorn Bros., Inc., 272 F.2d 434 (3d Cir. 1959), and *In re* Lehigh Valley Mills, Inc., 225 F. Supp. 494 (E.D. Pa. 1964), approving the postponement of a security interest of the Small Business Administration along with a state tax lien to administration expenses and wage claims. For evidence of persistent dissatisfaction with the *Quaker City Uniform* ruling, see 111 CONG. REC. 18246 (daily ed. Aug. 2, 1965).

The *Quaker City Uniform* case was also followed in *In re* Independent Truckers, Inc., 226 F. Supp. 440, 449-50 (D. Neb. 1963). The order of distribution approved by the court here was as follows: (1) claims entitled to priority under § 64a(1), (2); (2) county tax lien; (3) chattel mortgage; (4) federal tax lien.

53 California State Dep't of Employment v. United States, 210 F.2d 242 (9th Cir. 1954). *But cf.*, Gurabedian v. Griffin Steel & Supply Co., 340 F.2d 478 (9th Cir. 1965), criticized in Kennedy, *The Inchoate Lien in Bankruptcy: Some Reflections on Rialto Publishing Co. v. Bass*, 17 STAN. L. REV. 792, 819, 821 (1965).

54 Jordan v. Hamlett, 312 F.2d 121 (5th Cir. 1963), purporting to distinguish but apparently overruling New Orleans v. Harrell, 134 F.2d 399 (5th Cir. 1943), and reinstating *In re* Empire Granite Co., 42 F. Supp. 450 (M.D. Ga. 1942). *But cf.*, Brod v. Third Realty Co., 340 F.2d 591, 593 (5th Cir. 1965), where it appeared that the court was actually following *Quaker City Uniform* rather than either of its own prior rulings.

55 *In re* American Zyloptic Co., 181 F. Supp. 77 (E.D.N.Y. 1960).

56 S. REP. No. 999, 89th Cong., 2d Sess. 11 (1966).

Let us see how it works: Suppose that a debtor has personal property worth $10,000 subject to the following liens and that the indicated developments occur:

Federal tax lien arising on assessment 1/15	$5,000
Chattel mortgage executed and perfected[57] 1/30	$7,000
Federal tax lien notice-filed 2/1	
Bankruptcy of debtor 3/1	
Priority claims under section 64a(1) and (2)	$5,000

The disposition required by section 67c(3) is as follows:

Chattel mortgage	$7,000
Priority claimants	$3,000
Federal tax lien	0

Suppose now that the chattel mortgage is perfected after the federal tax lien is perfected but within 21 days so as to be indefeasible in bankruptcy. The disposition required by section 67c(3) is best understood if taken in two steps:

57 In the interest of avoiding collateral inquiries the assumption is made here that the chattel mortgagee makes a contemporaneous advance and perfects without knowledge of the existence of the tax lien. The definition of "security interest" introduced by the Federal Tax Lien Act of 1966 requires the interest to have become protected against a "subsequent judgment lien arising out of an unsecured obligation" and the holder to have "parted with money or money's worth." INT. REV. CODE of 1954 § 6323(h)(1). There is no requirement that the security interest be one for a contemporaneous advance or that the holder be without knowledge in order to prevail as against a federal tax lien not perfected by notice-filing. The test of the existence of a security interest that it have become protected against a "subsequent judgment lien" is novel and a little troublesome since ordinarily a judgment lien can attach only to real property, and in some states, like Michigan, a judgment lien attaches to neither personal nor real property. A reasonable assumption as to congressional intent here is that the security interest must have become perfected as against a creditor who obtains both a judgment on an unsecured obligation and a lien by judicial proceedings to enforce the obligation. Such a creditor would include one who obtains a judgment in proceedings initiated by attachment or garnishment, or one who levies an execution against his debtor's property to enforce a judgment, as well as one who obtains a lien against the debtor's realty by docketing a judgment. On such an assumption, however, the test poses a difficulty if applicable lien law differentiates between what is effective against an attachment creditor who has proceeded to judgment and what is required as against a judgment creditor who has obtained an execution. See, *e.g.*, *Mich. Title Standards 13.4 and 14.2*, 37 MICH. S. BAR J. 33-37 (1958). It cannot be doubted, in any event, that the trustee is a "judgment lien creditor" under the amended version of § 70c enacted by Pub. Law No. 89-495 and discussed hereinafter. See statements of Congressman Poff in regard to the relation of Pub. Law 89-495 and the Federal Tax Lien Act of 1966, 112 CONG. REC. 21310 (dailey ed. Sept. 12, 1966).

Step I:	Disposition outside bankruptcy:	
	Federal tax lien	$5,000
	Chattel mortgage	$5,000
Step II:	Disposition in bankruptcy:	
	Priority claimants	$5,000
	Chattel mortgage	$5,000
	United States	0

This is the pattern of distribution ordered under former section 67c(1) by the better considered and more numerous cases.[58]

Section 67c(3) is in effect a lien preservation provision of the kind bankruptcy judges and lawyers are familiar with.[59] That is, the trustee is enabled to preserve the postponable tax lien for the benefit of the claimants entitled to priority under section 64a(1) and (2). Lawyers in the Treasury Department, however, would not abide any version of the postponement provision that used that drafting approach.

The first sentence of the paragraph declares the rule when there is no other valid lien on the property. Priorities (1) and (2) are paid in full before the postponed tax liens are paid. Such postponed tax liens are nevertheless paid in full before unsecured tax claims are paid anything under the priority provision, section 64a(4).

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58 See cases cited notes 53-55 *supra*; 2 GILMORE, SECURITY INTERESTS IN PERSONAL PROPERTY ch. 39 (1965). The court noted in *In re* Meisel, 159 F. Supp. 879 (D. Md. 1958), that on the facts before it the same result would be reached by application of the rule adopted in either the Ninth Circuit or the Third Circuit and therefore did not choose between them.

It has been suggested that another solution of the circularity of priority is preferable to that chosen by these courts and codified in § 67c(3). Note, 14 RUTGERS L. REV. 587, 593 (1960). See also 2 GILMORE, SECURITY INTERESTS IN PERSONAL PROPERTY 1045 (1965), noting that this was the solution adopted by the district court in the case of *In re* Quaker City Uniform Co., 134 F. Supp. 596 (E.D. Pa. 1955). The suggested solution requires the amount allocable to the indefeasible lien to be first set apart and the balance applied to the claims entitled to priority under § 64a. The postponed tax lien is then paid out of the amount allocated to the indefeasible lien. This solution seems objectionable on the ground that it shifts the incidence of the lien postponement provision from the tax lien against whom it was directed to the indefeasible lien which was not intended to be affected by it. Indeed, it protects the postponed lien against postponement to the extent of the value of the indefeasible lien and at the expense of the indefeasible lien.

59 See Bankruptcy Act §§ 67a(3), 67d(6), 70c(2). Former § 67c of the act contained lien preservation provisions in its last sentence, and, indeed, paragraph (2) of present § 67c, previously discussed, includes a lien preservation provision. The Treasury Department apparently did not see any potential application or threat to federal tax liens posed by this paragraph. It is to be noted that the preservation effected by paragraph (3) is not a matter left to the discretion of the trustee or the court as preservation is in the provisions of the act explicitly authorizing it.

The second sentence declares the rule of priority when a postponed tax lien is superior in right to some other lien like a chattel mortgage which is unavoidable in bankruptcy, as in the hypothetical case considered in the preceding paragraphs. The amount allocable to the postponed tax lien goes to priorities (1) and (2), subject to these qualifications: (1) costs of the sale creating the distributable proceeds must first of all come out of them,[60] (2) if the total of the priorities is less than the amount allocable to the tax lien, the tax lien gets any difference,[61] (3) if the priorities exceed the amount of the tax lien, the priorities are nevertheless not allowed to cut into the amount allocable to the indefeasible lien or security interest.[62] It is to be remembered that the policy of section 67c is directed against accumulated tax liens, not chattel mortgages and like consensual security interests, which are subject to challenge under section 60 as well as section 70c and e; and not judicial liens, like attachment or judgment liens, which are vulnerable to attack under section 67a. If the indefeasible security interest or lien were not protected against collateral attack here by the priorities, a small tax lien of, *e.g.*, $50, coupled with a sizable accumulation of priority claims of, *e.g.*, $6,000, which but for bankruptcy was well protected by adequate collateral worth $10,000.

A reference to "prior indefeasible liens" in the third sentence of section 67c(3) has proved confusing to a number of readers.[63] It contemplates the situation where there are (1) an indefeasible lien, such as $5,000 duly perfected first security interest for a present advance, (2) a postponable tax lien for, *e.g.*, $4,000, and (3) a junior but indefeasible security interest for, *e.g.*, $3,000. The distributable proceeds are $10,000. Obviously the first $5,000, after defrayal of the cost of sale, goes to the holder of the senior indefeasible lien; the next $4,000

60 Both the second and third sentences of § 67c(3) recognize the necessity of first paying for the costs of any sale of personal property which produces proceeds for distribution under this paragraph. The cost of the sale is, of course, to be distinguished from administrative expenses entitled to priority under § 64a(1) of the Act but not incurred in connection with the conduct of the sale.

61 See the last sentence of Bankruptcy Act § 67c(3).

62 See the second sentence of Bankruptcy Act § 67c(3).

63 The Senate Finance Committee Report curiously explained its approval of the proposed § 67c(3) as resting on a belief that "the language relating to 'prior indefeasible liens' refers only to liens which are prior in time to tax liens." S. REP. No. 999, 89th Cong., 2d Sess. 11 (1966). Ordinarily a prior indefeasible lien will no doubt be prior in time, but since priority in time does not always confer priority in right, the committee's statement oversimplifies the role of the reference in the third sentence. Thus it may apply to the situation where a prior-in-time federal tax lien on personalty is not perfected by notice-filing until after a subsequent security interest is perfected by notice-filing.

allocable to the postponable tax lien goes to priorities (1) and (2) as far as required—if $2,000 suffices, the remaining $1,500 of the $4,000 goes to the tax lienor; and finally the balance of $1,000 remaining in the fund of $10,000 goes to the junior security interest holder.[64]

The purpose of the second and third sentences of section 67c(3) is to assure that neither the senior nor the junior security interest holder gets any more or less *in* bankruptcy than out. That fulfills the bankruptcy policy of neutrality toward these indefeasible liens. But it is not the policy of the Act to be neutral toward tax liens on personalty unaccompanied by possession. Congress decided back in 1938 that such liens should yield to administrative expenses and wage claims. Although the tax lienor in the hypothetical case just considered would get paid in full outside bankruptcy before the holder of the junior security interest would get anything, the latter is getting no advantage in bankruptcy at the expense of the former. The relative priority of the liens *inter se* is preserved, and the impact of the postponement is confined by the second and third sentences of the liens which Congress identifies in the first sentence of section 67c(3).

Amendment of Section 70c

This brings us to the amendment of section 70c. While this amendment does several things, an animating purpose was to make clear that the trustee in bankruptcy is a judgment lien creditor for the purposes of the federal tax lien statute.[65] The clarity of this proposition had become clouded after the Supreme Court's much misunderstood ruling in *Gilbert Associates*.[66] The Court there had sustained priority for an unfiled federal tax over a municipal tax lien notwithstanding a characterization of the latter by the state supreme court as having the "nature of a judgment."[67] As the Supreme Court pointed out in *United States v. Speers*,[68] the ruling in *Gilbert Associates* that "judgment creditor" was used in the federal tax lien statute "in the usual, conventional sense of a judgment of a court of record" was delivered in a quite

64 For an example of a case that would involve application of the third sentence of § 67c(3), see Brod v. Third Realty Co., 340 F.2d 591 (5th Cir. 1965). Although § 67c(3) was intended to codify the rule followed by the Fifth Circuit in Jordan v. Hamlett, 312 F.2d 121 (5th Cir. 1963), it is not clear that the Court of Appeals adhered to that rule in the *Brod* case. See note 54 *supra*.

65 See, *e.g.*, S. Rep. No. 1159, 89th Cong., 2d Sess. 10-11 (1966).

66 United States v. Gilbert Associates, 345 U.S. 361 (1953).

67 *Id.* at 364.

68 382 U.S. 266, 269-72 (1965).

different context from that presented when a trustee in bankruptcy challenges an unfiled federal tax lien. The *Speers* case noted that Congress had conferred the status of a judgment creditor on the trustee but three years before it required notice of the federal tax lien to be filed to validate it as against a judgment creditor.[69] For nearly forty years thereafter there had been no reason to suppose that the trustee did not have the rights of a judgment creditor against an unfiled federal tax lien or against any other variety of lien which has not been perfected in accordance with a law protecting judgment creditors.[70] In 1950, the reference to "judgment creditor" was deleted from the "strong-arm clause" of section 70c,[71] but as former Referee Archie Katcher of Detroit pointed out in the pages of the *Referees' Journal*,[72] the congressional purpose had been to strengthen the position of the trustee by giving him a specific judicial lien against all the property of the bankrupt as of the date of bankruptcy, irrespective of who then had possession. The Supreme Court took due note in *Speers* of this congressional purpose,[73] of the unsuccessful effort by the Treasury Department to exclude trustees in bankruptcy from the protection of the notice-filing provision in the Internal Revenue Code of 1954,[74] and of the congressional approval of including trustees within its protection

69 *Id.* at 272. The strong-arm clauses, now found in § 70c, were originally added to § 47a(2) of the act in 1910. For a clear indication that the congressional purpose was thereby to endow the trustee with the rights of a judgment creditor, see 45 CONG. REC. 2277 (1910). The original notice filing provisos of the federal tax lien law, REV. STAT. § 3186, were among the last measures approved by President Taft on March 4, 1913.

70 See 4 COLLIER, BANKRUPTCY ¶ 70.49 (14th rev. ed. 1964). An article by an attorney in the Office of the Chief Counsel of the Bureau of Internal Revenue, Feigenbaum, *Tax Problems*, 25 REF. J. 107, 109 (1951), 30 TAXES 440, 451 (1952), did cite Cooper v. Cantrell, 266 App. Div. 940, 46 N.Y.S.2d 29 (1943), a *per curiam* holding that a trustee in bankruptcy was not a judgment creditor within former § 276a of the New York Debtor and Creditor Law, which authorized an action to avoid a fraudulent transfer. The court acknowledged that the law had been changed shortly before the decision in order explicitly to protect the trustee in bankruptcy. Mr. Feigenbaum did not cite any of the numerous rulings listed in 4 COLLIER, *op. cit. supra*, at 1413 n. 3c, that a trustee is entitled to prevail over any interest in the bankrupt's property not perfected under state law against a judgment creditor.

71 64 Stat. 26 (1950).

72 Katcher, *Powers of Trustee Under Amended Section 70c—Weakened or Strengthened?* 27 REF. J. 29 (1953). See 4 COLLIER, BANKRUPTCY ¶ 70.47[3] (14th rev. ed. 1959). As the House report accompanying the 1950 amendment observed, "a trustee in bankruptcy occupies the position of a universal judgment or lien creditor with all such a creditor's remedies . . . ." H.R. REP. No. 1293, 31st Cong., 1st Sess. 4 (1949). The purpose of the amendment was ignored in Feigenbaum, *Tax Problems*, 25 REF. J. 107, 109 (1951).

73 United States v. Speers, 382 U.S. 266, 273 (1965).

74 *Id.* at 273-74. The Court's opinion noted that § 301.6323-1 of the Treasury Regula-

disclosed by the legislative history of the statutory lien bill itself[75] (although the bill was not finally to be enacted until over six months later). After the Government failed to convince the Supreme Court that the trustee had lost his status as a judgment creditor by virtue of the 1950 amendment of section 70c and of the decision in *Gilbert Associates* in 1953, it sought an amendment of the statutory lien bill to undo *United States v. Speers.*[76] The majority of the Senate Finance Committee blandly accepted the Treasury Department's argument which had been rejected two months earlier by the Supreme Court that "prior to the *Speers* decision unrecorded tax liens (assessed tax claims) generally were considered to be valid against the trustee in bankruptcy and therefore superior to claims of general creditors (represented by the trustee in bankruptcy)."[77] The minority of the committee pointed out that the proposal to validate unfiled federal tax liens against the trustee not only contradicted the Supreme Court's holding in *United States v. Speers* but would "relieve the Treasury Department of a burden Congress placed upon it over 50 years ago."[78] The Senate

tions on Procedure and Administration [26 C.F.R. § 301.6323-1 (1954)] nevertheless incorporated the material rejected by the 83d Congress.

[75] *Id.* at 274-75, citing the bills introduced in the 86th, 88th, and 89th Congresses and the reports of approval made by the House and Senate Judiciary Committees to the 88th Congress.

[76] S. Rep. No. 999, 89th Cong., 2d Sess. 4-7 (1966). The recommendation of the Senate Finance Committee was not a bald proposal that unfiled federal tax liens be validated against the trustee in bankruptcy but only that such liens be valid if filed within one year after assessment or one month after bankruptcy. If adopted, the bill, originally introduced to rationalize the treatment of statutory liens in bankruptcy, would have generated the following congeries of incongruities: (1) Although the federal tax lien must be perfected by notice filing in order to be valid against a judgment creditor and although the trustee is entitled to prevail against liens not perfected against a judgment creditor, an unperfected federal tax lien would for a year after assessment prevail against the trustee in bankruptcy if perfected within one month following bankruptcy. (2) Although a creditor who obtains a judgment lien against the bankrupt's property within four months before bankruptcy prevails over any unfiled federal tax lien against the property, and the trustee in bankruptcy can avoid the judgment lien unless he fails to carry the burden of proof on the issue of the bankrupt's insolvency under § 67a, a federal tax lien could still be perfected after bankruptcy against the trustee if the year following assessment had not elapsed. (3) Although the federal tax lien must be perfected by notice filing in order to be valid against a bona fide purchaser and although the trustee is entitled to prevail under § 67c(1)(B) against any statutory lien not perfected as against a bona fide purchaser, the unperfected federal tax lien would be deemed valid against a bona fide purchaser for a year following assessment though not filed until after bankruptcy. One can only conjecture as to the effect this provision would have had on the titles of bona fide purchasers of property subject to unfiled federal tax liens if their sellers had become bankrupt during the year following assessment.

[77] S. Rep. No. 999, 89th Cong., 2d Sess. 4 (1966).

[78] *Id.* at 22, 24.

Judiciary Committee unanimously adopted these minority views in its final report on the bill which preceded its enactment.[79]

The clarification of the status of the trustee *vis-a-vis* the unfiled federal tax lien was not the only objective of the amendment of section 70c. Those remedial rights which accrue to the judgment creditor with an execution returned unsatisfied were sheared off by the amendment of the subdivision in 1950.[80] A creditor seeking equitable relief in connection with the avoidance of a transfer—discovery, injunction, receivership, levy on an equitable asset, or reformation or cancellation of a writing—may be required by state law to show that he had exhausted his remedy at law by obtaining a judgment with an execution returned unsatisfied.[81] Moreover, the creditor who has pursued his legal remedies to this extent may be afforded the benefit of a presumption that the judgment debtor is insolvent.[82] This presumption may be of material assistance to the creditor, of course, in seeking to avoid a transfer by the debtor. The general deterioration of the distinction between law and equity and the legislative liberalization of the rules governing the availability of relief at the foot of the judgment have made the loss of the special rights reserved to a judgment creditor with an execution returned unsatisfied more theoretical than real. Moreover, the creditors of a bankrupt and their representatives, the trustee, are furnished by the Bankruptcy Act with a formidable battery of weapons which ordinarily make the availability of equitable relief under state law academic. Nonetheless, it was an inadvertence to deprive the trustee of any advantage given by nonbankruptcy law to a judgment creditor with an execution unsatisfied, and the amendment restores to him whatever rights inhere in this status. Accordingly the trustee is now accorded three different statuses by section 70c: (1) a creditor with a judgment as of the date of bankruptcy, (2) a creditor with an execution returned unsatisfied as of the date of bankruptcy, and (3) a judicial lien creditor as of that date.

A saving clause has been added to negative any implication that a transfer voidable in part under this provision is voidable *in toto*. The question has been raised whether this new third sentence of section 70c overrules *Moore v. Bay*.[83] It does not. *Moore v. Bay* is a construction of section 70e. The sentence in question validates interests only as

79 See note 41 *supra*.
80 See 4 COLLIER, BANKRUPTCY ¶ 70.47[3] (14th rev. ed. 1964).
81 See 1 GLENN, FRAUDULENT CONVEYANCES AND PREFERENCES § 86 (rev. ed. 1940).
82 See, *e.g.*, Bartlett v. Webber, 218 Iowa 632, 636-37, 252 N.W. 892, 895 (1934).
83 284 U.S. 4 (1931).

against the trustee's rights under section 70e. The applicability of *Moore v. Bay* has, of course, previously been significantly restricted by section 9-301 of the Uniform Commercial Code.[84] The new saving clause of section 70c is comparable to but distinguishable from section 9-401(2) of the Code. That provision saves any partially perfected security interest to whatever extent that perfection does comply with the Code. An example might be a security interest executed by an agreement covering an automobile and equipment, some affixed and some not affixed. Notice filing might be proper for some of the equipment collateral but not for the automobile or the fixtures. Both section 9-401(2) and section 70c allow the security interest to stand to the extent the law has been complied with.[85]

But section 9-401(2) says that the incomplete filing is effective against any person who has knowledge. Section 9-301(3) implies that the trustee is bound if all the creditors he represents have knowledge. The new amendment does not deal with notice or knowledge or good faith of the trustee any more than did prior versions of the strong arm clause of section 70c. It is to be inferred, that the cases treating the trustee as a judgment creditor without knowledge or actual notice of any unperfected lien[86] are still good law but the United States Supreme Court has never passed on the question of whether creditors' actual notice is relevant under section 70c.

The last sentence of section 70c, described as the "chameleon clause" in the legislative reports,[87] simply clarifies what has never been seriously doubted, *viz.*, that the trustee is not required to maintain consistency in his postures while attacking various liens and transfers.

An interesting historical sidelight is that several versions of the statutory lien bill, including H.R. 7242 which was vetoed in 1960,[88] contained language overruling *Constance v. Harvey*[89] by negativing any construction which would relate this trustee's status as a creditor

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84 *Moore v. Bay* was principally useful to the trustee in states where he could step into the shoes of a creditor entitled to attack a belatedly perfected security interest without being limited in his recovery by the amount of the creditor's claim, and even though perfection occurred before bankruptcy. 4 COLLIER, BANKRUPTCY ¶ 70.95[4] (14th ed. 1964). The impact of the Code on the doctrine of *Moore v. Bay* is discussed in 2 GILMORE, SECURITY INTERESTS IN PERSONAL PROPERTY § 45.3.1 (1965).

85 See S. REP. No. 1159, 89th Cong., 2d Sess. 12 (1966).

86 See 4 COLLIER, BANKRUPTCY ¶ 70.53 (14th rev. ed. 1964).

87 S. REP. No. 1159, 89th Cong., 2d Sess. 12-13 (1966).

88 See note 11 *supra*.

89 215 F.2d 571 (2d Cir. 1954), *cert. denied*, 348 U.S. 913 (1955).

to a date before bankruptcy.[90] In *Lewis v. Manufacturers Nat'l Bank*,[91] the Supreme Court delivered an opinion accomplishing the purpose of this feature of the bill and quoted from the House Reports accompanying the bill which had been vetoed,[92] and the language was thereafter deleted from the bill as no longer necessary.[93]

Section 67c(4)

For the same kind of reason, a provision invalidating a lien which secures a penalty not allowable under section 57j was deleted from the bill after the Supreme Court settled a conflict on this point which had developed among the circuits.[94] The Government had sought to use the Treasury-inspired veto of the statutory lien bill in 1960 as evidence of a congressional intent to limit applicability of section 57j to unsecured penalties. The Court pointed out dryly that the congressional failure to amend could not be deemed adoption of the Government's construction in view of the prevailing divergence of judicial holdings on the effect of section 57j as then written.[95] The bill as finally enacted retained a provision, *viz.*, section 67c(4), denying to the trustee an option to preserve a lien securing such penalty.

Public Law 89-496

Origin

The second of the two bills approved on July 5, 1966, innovates by limiting the priority of unsecured tax claims in bankruptcy and by enabling a bankrupt to obtain a discharge from certain tax claims. Although it is not clear where these proposals of long overdue reform originated, Professor MacLachlan reported in his hornbook that a proposal to discharge taxes due more than one year before bankruptcy except in cases of false returns and failure to file required returns originated in the Bankruptcy Committee of the American Bar Association under the leadership of Frank Olive, and that the National Bankruptcy Conference had embraced this idea and promoted it.[96] Professor J. W. Moore and Philip Tone discussed an early version of the Conference's

90 See, *e.g.*, H.R. 7242, 86th Cong., 1st Sess. § 6 (1959).
91 364 U.S. 603 (1961).
92 *Id.* at 607-08 n. 6.
93 See H.R. Rep. No. 708, 87th Cong., 1st Sess. 1-2 (1961).
94 Simonson v. Granquist, 369 U.S. 38 (1962).
95 *Id.* at 41-42.
96 MacLachlan, Bankruptcy 102 (1956), citing H.R. 5829, 80th Cong., 2d Sess. § 3 (1948), and H.R. 120, 81st Cong., 1st Sess. § 3 (1948).

tax dischargeability and money bill in a Yale Law Journal article published in 1948,[97] and they cited discussions of the need for a limitation on tax priorities published during the preceding five years.[98] Public Law 89-496 thus is the fruition of over twenty years' effort.[99]

Frank Olive and the others who launched this project and labored on it in its early days probably turned no cartwheels in the Elysian fields where they have since gone, when the President signed Public Law 89-496. The substitute of the three-year for the one-year limitation on the taxes to be accorded priority and nondischargeability and the provisos engrafted on section 17a(1) at the instance of the Treasury Department cut down significantly on the relief to be afforded bankrupt tax delinquents. But the bill as finally enacted is a step in the right direction, and the vigor with which the Treasury Department opposed it suggests that it may have a more potential impact than is readily apparent.

Section 2a(2A)

The new section 2a(2A) is a revision and transposition of section 64a(4)'s second proviso. Some difference of opinion has developed respecting the effect of the new language. Does it codify or change existing law? The Senate Finance Committee approved this amendment of the law, expressing at the same time its understanding that it made "no change in present law under which a bankruptcy court cannot adjudicate the merits of any claim, including a Federal tax claim, which has not been asserted in the bankruptcy proceeding by the filing of a proof of claim."[100] Even if it were true that the amendment effects no change, it has long been clear that the bankruptcy court may determine in summary proceedings the amount and legality of any tax claim against property in the custody of the court,[101] including any tax

97 Moore & Tone, *Proposed Bankruptcy Amendments: Improvement or Retrogression?*, 57 YALE L.J. 683, 699-705 (1948).

98 Furst, *Tax Problems in Bankruptcy and Reorganization*, 18 REF. J. 17, 66 N.J.L.J. 173 (1943); Montgomery, *Recent Developments and Proposed Reforms in Respect to Tax Claims in Bankruptcy*, 19 REF. J. 31 (1944); Musgrave, *The Tax Priority Bugaboo*, 46 CORP. REORG. 43 (1945); Olive, *Taxes in Bankruptcy Proceedings*, 25 TAXES 5 (1947).

99 Indeed, Professor Moore and Mr. Tone described efforts made in 1937 to eliminate the reference to federal tax claims in § 17 of the Chandler Act. A bill omitting the reference passed the House. Moore & Tone, *supra* note 97, at 700 n.68, citing H.R. REP. No. 1409, 75th Cong., 1st Sess. 27, 67 (1937).

100 S. REP. No. 999, 89th Cong., 2d Sess. 11 (1966).

101 New Jersey v. Anderson, 203 U.S. 483, 492-93 (1906); Katchen v. Landy, 382 U.S. 323, 329 (1966). "Numerous cases have held that the trustee in bankruptcy may litigate

claim secured by a lien,[102] whether or not a proof of claim is filed. The committee's reading of this explicit grant of jurisdiction would reduce it to a nullity, since it is clear without the provision that the bankruptcy court can determine the amount and legality of any claim duly filed in a bankruptcy case.[103]

Section 64a(4)'s second proviso as it read before the amendment was a broad, unqualified, and apparently exclusive grant of jurisdiction to the bankruptcy court to decide any and all questions as to the amount and legality of taxes which arise in the course of administration of the bankrupt estate. But Professor Moore and Mr. Tone pointed out in their *Yale Law Journal* article[104] that this provision had been substantially restricted, largely by reason of gratuitous observations of the Supreme Court in *Arkansas Corp. Comm'n v. Thompson* decided back in 1941.[105] It was gratuitous because the case actually involved questions concerning post-petition taxes arising during the course of the reorganization of the Missouri Pacific Railroad. Section 64 did not and does not apply to such taxes.

Placement of the jurisdictional grant in section 2a makes sense and eliminates any doubt that the bankruptcy court can decide questions regarding the amount and legality of taxes whether assessed or due before or after the petition is filed. Moreover, the applicability of the jurisdictional grant in reorganization proceedings under Chapter X and section 77 as well as in straight bankruptcy or any other proceeding under the Act is now made clear.

The Court in *Arkansas Corp. Comm'n v. Thompson* held that the bankruptcy court could not review a determination of the tax liability of the debtor in reorganization previously made by the Arkansas Commission, a quasi-judicial agency. The Court said that Congress did not

the amount of tax liability before the referee, rather than pay the tax and sue for refund." Cohen v. United States, 115 F.2d 505, 506 (1st Cir. 1940).

102 Van Huffel v. Harkelrode, 284 U.S. 225, 228-29 (1931); Klebanoff v. Mutual Life Ins. Co., 246 F. Supp. 935, 951-52 (D. Conn. 1965); *In re* New York & Philadelphia Package Co., 225 Fed. 219, 222 (D.N.J. 1915); 4 COLLIER, BANKRUPTCY ¶¶ 70.97[2], 70.98[11], 70.99 (14th rev. ed. 1964). Indeed, it has been held that seizure of the bankrupt's property by tax officials before bankruptcy does not divest the bankruptcy court of jurisdiction conferred by the proviso in former § 64a(4). *In re* Florence Commercial Co., 19 F.2d 468 (9th Cir.), *cert. denied,* 275 U.S. 542 (1927). When another court has prior custody, however, the bankruptcy court should yield its claim of jurisdiction under the statutory grant in the exercise of comity. *In re* White Star Ref. Co., 74 F.2d 269, 271 (5th Cir. 1934), *cert. denied,* 294 U.S. 727 (1935).

103 See Lyford v. City of New York, 137 F.2d 782, 786 (2d Cir. 1943).

104 Moore & Tone, *supra* note 97, at 700.

105 313 U.S. 132 (1941).

in section 64a(4) intend to make the federal courts super-assessment tribunals over state taxing agencies.[106] Congress certainly did mean to give some revising power to the bankruptcy courts over tax assessments, and section 2a (2A) is an attempt to spell out the extent of the court's jurisdiction to review tax questions.

The new paragraph is explicit that the bankruptcy court may determine "any question arising as to the amount or legality of any unpaid tax, whether or not previously assessed, which has not prior to bankruptcy been contested before and adjudicated by a judicial or administrative tribunal of competent jurisdiction." This paragraph codified the view taken in the better considered interpretations of the effect of the second proviso of former section 64a(4).[107] It negates whatever implication may be drawn from the Supreme Court's dictum in *Arkansas Corporation Comm'n v. Thompson* that the amount of an assessment of a property tax by a state agency, or of any other tax by any other agency, is beyond examination by the bankruptcy court.[108]

Although it is not as clear as it might be,[109] the trustee (or receiver) apparently may challenge the amount or legality of a tax in the bankruptcy court even though the time for raising this kind of question in any nonbankruptcy forum has run against the bankrupt. The need for protecting the creditors against the untoward consequences of neglect by the taxpayer to pursue remedies available to him was pointed out to Congress when it was considering a revision of Section 64a(4) in 1937.[110] The new provision bars the trustee from raising the question as to any unpaid tax only when a prior contest has resulted in an adjudication by a competent tribunal. It may be doubted that the trustee (or receiver) can successfully raise questions in the bankruptcy court regarding an assessment which the bankrupt was not

106 *Id.* at 145.

107 Lyford v. City of New York, 137 F.2d 782, 786-87 (2d Cir. 1943); 3 COLLIER, BANKRUPTCY ¶ 64.407[2] (14th rev. ed. 1966).

108 *Cf. In re* 168 Adams Bldg. Corp., 27 F. Supp. 247 (N.D. Ill. 1939), *aff'd,* 105 F.2d 704 (7th Cir. 1939), *cert. denied,* 308 U.S. 623 (1940); *In re* Gould Mfg. Corp., 11 F. Supp. 644 (E.D. Wis. 1935).

109 Referee Reuben Hunt of Los Angeles proposed an amendment of § 64a(4) which would have made clear the authority of the bankruptcy court to determine tax questions that had not previously been adjudicated, irrespective of any act or omission of the bankrupt before bankruptcy. House Hearings on H.R. 6439, 75th Cong., 1st Sess. 161-62 (1937). The reference to the bankrupt's prior conduct did not survive in the final version of the Chandler Act. See 3 COLLIER, BANKRUPTCY 2204-06 (14th rev. ed. 1966); Montgomery, *Recent Developments and Proposed Reforms in Respect to Tax Claims in Bankruptcy,* 19 REF. J. 31, 32 (1944).

110 *Ibid.*

entitled by either statutory or constitutional law to raise outside the bankruptcy court.

Even though the bankrupt has paid a questionable tax, the trustee may still challenge it under certain circumstances. The latter part of the new section 2a(2A) enacts the premise underlying the actual holding of *Arkansas Corporation Comm'n v. Thompson, viz.*, that the trustee or receiver can prosecute an appeal from or review of a determination of a tax question which has been contested before a judicial or administrative tribunal of competent jurisdiction if the time for appeal has not expired.[111] The implication is clear that in such case the bankruptcy court's jurisdiction is not to review but to authorize pursuit by the trustee or receiver of whatever recourse remains available under nonbankruptcy law. If the tax has not been paid and a prebankruptcy contest has not resulted in a determination, the first part of section 2a(2A) indicates that the bankruptcy court has discretion to hear and determine the question itself or to allow the other tribunal to decide the matter.[112] If a questionable tax has been paid before bankruptcy but no determination of the questions that might be raised as to its amount or legality has been made, the new paragraph is silent as to the bankruptcy court's jurisdiction. If the bankrupt retained at bankruptcy the right to challenge the tax, it seems clear that the trustee acquired the right under sections 11e and 70a(5) of

111 The trustee of the Missouri Pacific Railroad, which was undergoing reorganization in § 77 proceedings, had challenged an assessment of the railroad's property by the Arkansas Corporation Commission. After an adverse determination by the Commission, which the Supreme Court said was not ministerial but quasi-judicial, the trustee did not avail himself of the right to appeal to a state circuit court but sought relief in the bankruptcy court. In holding that the bankruptcy court should have dismissed the trustee's application, the Supreme Court said that "Nothing in this language [*i.e.*, of the second proviso of former § 64a(4)] indicates that taxpayers in bankruptcy or reorganization are intended to have the extraordinary privilege of two separate trials, one state and one federal, on an identical issue of controverted fact . . . ." Arkansas Corp. Comm'n v. Thompson, 313 U.S. 132, 142 (1941).

112 The Supreme Court has sometimes taken a rather generous view of its own role in reviewing the exercise of discretion by a bankruptcy court in retaining jurisdiction of a controversy which it might have allowed to proceed in a state court. See Texas v. Donoghue, 302 U.S. 284, 289 (1937); Thompson v. Magnolia Petroleum Co., 309 U.S. 478, 483-84 (1940). The countervailing considerations arguing for exercise of jurisdiction by the bankruptcy court are set out in Wurzel, *Taxation During Bankruptcy Liquidation*, 55 HARV. L. REV. 1141, 1150-51 (1942). There is no implication whatsoever that the trustee should contest taxes accruing during the administration in any forum other than the bankruptcy court, as he did in *Arkansas Corp. Comm'n v. Thompson*. "The bankruptcy court's jurisdiction over allowances for administrative expenses, such as current taxes, is exclusive." Wurzel, *supra* at 1176.

the Bankruptcy Act, but he would be compelled to pursue it in whatever forum would have been available to the bankrupt.

Section 17a(1): Taxes "Legally Due and Owing"

Section 17a(1) starts out now by saving taxes from discharge only if they become "legally due and owing" within three years preceeding bankruptcy. The Treasury Department objected strenuously to the term "legally due and owing." Those words have been on the books longer than has the Sixteenth Amendment.[113] There is a redundancy and perhaps some inelegancy in the expression "legally due and owing," but these words have served fairly well the needs of bankruptcy administration in section 64a(4), as has the single word "due" in section 17a(1).[114] The words apply to all kinds of tax liabilities incidentally—not just those of concern to the Internal Revenue Service. In any event, the meaning of "legally due and owing" is for the courts to interpret, as it has been for over sixty-five years. The referees will continue to apply the standards of section 64a(4), and the courts passing on the effect of a discharge will apply the language of section 17a(1). A good deal of case law bears on this question, and this writer has not undertaken a study of when the various kinds of federal, state, and local taxes become "legally due and owing" for the purposes of the Bankruptcy Act. Collier has not neglected the question, however.[115]

Section 17a(1): The First Proviso

Whatever "legally due and owing" means, the first proviso of section 17a(1) makes determination of the due date of a tax academic in many situations falling within the contemplation of the original sponsors of this measure.

Clauses (a) and (b) of the first proviso deal with a type of case recognized from the beginning as one requiring special treatment, that of the taxpayer who does not make a return required by law.[116] No time limit applies to taxes which were not assessed before bankruptcy against such a taxpayer, but it is not to be supposed that this clause has

113 They were part of the original provision on conferring priority for tax claims in the act of 1898. See 3 COLLIER, BANKRUPTCY 2047 (14th rev. ed. 1966). The single word "due" had been used in § 17a(1) since 1898. 1 COLLIER, BANKRUPTCY ¶ 17.01[2] (14th rev. ed. 1966).

114 See 3 COLLIER, BANKRUPTCY ¶ 64.405[1] (14th ed. rev. 1966); 1 *id.* ¶ 17.14.

115 *Ibid.*

116 See note 96 *supra* and accompanying text.

any effect on taxes for years when the taxpayer did make a return. A curious corollary of the first two clauses is that government is in a better position *vis-a-vis* such a bankrupt tax delinquent if no assessment is made before bankruptcy, since an assessment sets a one-year statute of limitations in motion.

Clause (d) of the proviso, saving taxes "with respect to which the taxpayer made a false or fraudulent return, or willfully attempted to in any manner to evade or defeat," is also one which the original proponents of the bill were willing to accept.[117] It makes a good deal more sense, however, as a ground for denying relief from discharge than it does as a consideration in ordering priorities in the distribution of bankrupt estates.[118]

Clause (c) of the proviso saves from discharge any tax liability not reported on the bankrupt's return and not assessed before bankruptcy because of the pendency of proceedings by the bankrupt challenging the tax. Counsel for the Government undoubtedly will view the taking of any improper deduction on a duly filed income tax return as well as the failure to include any taxable income on such a return as an instance of an unreported tax. Again the Government is in a more vulnerable position if assessment precedes the taxpayer's bankruptcy than if bankruptcy comes first. If the assessment is made first, the three-year limit applies, and its period runs from the date the tax was "legally due and owing." If bankruptcy occurs before assessment, no time limit applies at all in determining the priority, or immunity from discharge, of the taxes ultimately assessed.

Clause (e) of the proviso, protecting the Government's claim against a bankrupt for taxes collected or withheld from others, reflects the firm and familiar policy of special liability and accountability imposed on the collector or holder of such taxes.

The Saving Clause for Exempt Property

An unlettered clause of the first proviso of section 17a(1) denies the defense of discharge to a bankrupt when and if a tax collector pursues any remedy available by non bankruptcy law against property set apart as exempt to the bankrupt under the Bankruptcy Act. It is to be noted that there is no requirement in this clause that the tax

117 *Ibid.*

118 Contrast the treatment of tax penalties, which are not allowable even as general claims against bankrupt estates but which are not dischargeable. 1 COLLIER, BANKRUPTCY ¶ 17.13 (14th rev. ed. 1966).

have attached as a lien to such property, let alone that the lien have been perfected as against the trustee. Perfection might of course be a factor in settling a conflict between two or more claimants entitled to proceed against such property, but whether a lien is perfected against exempt property is a matter of no concern to the trustee in bankruptcy.[119] There is, moreover, no reason why a failure to comply with a requirement designed to make a lien a matter of public notice should ever afford the debtor a defense. It deserves emphasis that the clause does *not* withhold the defense of discharge when and if the tax collector proceeds against exempt property acquired by the debtor after his bankruptcy.

The Saving Clause for Liens

The second proviso of section 17a(1) states simply "That a discharge in bankruptcy shall not release or affect any tax lien." Counsel for both the Treasury and Justice Departments seem to have been completely mystified by the last two clauses of the amendment of section 17a(1).[120] The notion that a claim should be discharged and yet be enforceable against exempt property or to the extent secured by a lien against preexisting property transcended their conception of a discharge as either an absolute bar or utter nullity. The objection of the Government that the clauses created "an internal inconsistency" which would raise "many grave problems"[121] could not be taken seriously, however, by anyone who has examined the nature and operation of a discharge in bankruptcy.[122]

It has been reported that the Government now intends to rely on the second proviso as a basis for enforcing discharged tax claims against after-acquired property whenever notice of assessment has been filed

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119 Sears, Roebuck & Co. v. Schulein, 282 F.2d 267 (9th Cir. 1960); *In re* Espelund, 181 F. Supp. 108 (W.D. Wash. 1959); Charnesky v. Urban, 245 Wis. 268, 14 N.W.2d 161 (1944).

120 See letters of opposition to the bill from the Treasury and Justice Departments quoted in S. REP. No. 114, 89th Cong., 1st Sess. 10-11, 13-14 (1965).

121 *Id.* at 14.

122 A discharge does not extinguish a debt but affords the bankrupt an affirmative defense. It does not prevent enforcement of any valid security arrangement effective at the date of bankruptcy, either against property then in existence or against a surety on the obligation discharged. The enforceability of liens against nonexempt property notwithstanding discharge was established under the 1841 Bankruptcy Act, Peck v. Jenness, 7 How. (U.S.) 612 (1849), and the same rule was applied to liens on exempt property under the Act of 1867 in Long v. Bullard, 117 U.S. 617 (1886). The rules of these cases have been accepted unquestioningly under the present Act. See COUNTRYMAN, CASES ON CREDITORS' RIGHTS 596 (1964). The enforceability of discharged claims against sureties and co-debtors rests on § 16 of the act.

before bankruptcy. Whether a tax lien is perfected by notice filing is an irrelevancy insofar as its enforceability against the tax debtor is concerned, but if all federal taxes assessed before bankruptcy survive discharge, section 17a(1)(b) saving only certain taxes if assessed within a year before a bankruptcy makes no sense at all. As the discussion of the second proviso in the legislative reports indicates,[123] its purpose is to accord the same post-discharge treatment to tax liens as that accorded to mortgages and other consensual security interests. The discharge of tax claims over three years old will not affect their enforceability against valid security held at bankruptcy. The clear implication of the discussion is that after such security is exhausted, no deficiency may be asserted against any after-acquired property.

The role of a discharge in withdrawing any basis "for the creation of an enforceable lien upon a subject not existent when the bankruptcy became effective" was established in the classic case of *Local Loan Co. v. Hunt.*[124] That case also established the extraordinary jurisdiction of the bankruptcy court to enjoin state court litigation which threatened to frustrate the benefits of the decree of discharge, and which would have gone against the bankrupt unless and until he had carried his case from the municipal court through the intermediate court of appeal and supreme court of the state to the Supreme Court of the United States.[125] If the Government does take the position that the filing of a notice of assessment before bankruptcy immunizes a federal tax claim from discharge as against post bankruptcy acquisitions, a case falling more clearly within the scope of both aspects of *Local Loan Co. v. Hunt* would be difficult to imagine.[126] The summary remedies available to the Government, the smallness of the stake, the unequal position of the taxpayer and the Government in litigating the merits of the controversy, and the notorious unwillingness of the Service to abide by adverse rulings by lower courts all argue for exercise by the bankruptcy court of its power to vindicate its decree particularly when and if the Government seeks to enforce a discharged tax liability against post bankruptcy earnings.

123 S. REP. No. 114, 89th Cong., 1st Sess. 3 (1966).

124 292 U.S. 234, 243 (1934).

125 *Id.* at 241-42.

126 See, *e.g.*, United States v. Mighell, 273 F.2d 682, 685 (10th Cir. 1959); Sword Line, Inc. v. Industrial Comm'n, 212 F.2d 365, 370 (2d Cir.), *cert. denied*, 348 U.S. 830 (1954); *cf.*, Allen v. Regents of the University of Georgia, 304 U.S. 439, 445 (1938); Miller v. Standard Nut Margarine Co., 284 U.S. 498, 510-11 (1932); Hill v. Wallace, 259 U.S. 44, 46 (1922); 1 CASEY, FEDERAL TAX PRACTICE § 2.26 (1955). *But cf.*, Enocks v. Williams Packing & Nav. Co., 370 U.S. 1, 6-7 (1962).

An issue which can easily arise under this reading of the proviso involves marshalling: Can the Government insist that its lien against property in existence at bankruptcy be enforced so far as possible to collect therefrom taxes that are not entitled priority or immunity from discharge and so as to maximize the portion of any tax deficiency that will survive bankruptcy as a nondischargeable liability? The answer is undoubtedly affirmative.

Correlation of Nondischargeability and Priority

The amendment of section 64a(4) by Public Law 89-496 correlates the priority of taxes precisely with their nondischargeability. Such correlation is not new,[127] but, as earlier indicated,[128] considerations bearing on dischargeability do not necessarily operate in the same way with respect to priority. Thus, fraud or wilful neglect on the part of the bankrupt may be a sufficient justification for withholding discharge from a liability arising out of or otherwise related to the bankrupt's conduct, but it does not necessarily furnish a reason for according priority to such liability over debts owing other innocent creditors.

The list of provable debts provided by section 63a has never included taxes, but the provision for priority of taxes in section 64a(4) has rendered the omission inconsequential. Moreover, the explicit exception of tax debts from the operation of a discharge by former section 17a(1) was tantamount to a recognition that tax claims were provable: otherwise the exception would have been unnecessary. Are the taxes which are neither entitled to priority under section 64a(4) now immunized from discharge by section 17a(1) nevertheless provable as general claims? If Congress had intended to exclude such claims from any share in bankrupt estates, it would surely have made its purpose more clear.[129]

A new proviso added to clause (4) negatives any priority for taxes other than that provided by the clause. This proviso anticipates and rejects the Government's invocation of section 3466 of the Revised Statutes[130] as a basis for asserting priority under section 64a(5) for those federal taxes falling outside the scope of 64a(4). The phraseology of

127 *Compare* § 17a(5) *with* § 64a(2) of the act.

128 See text accompanying note 104 *supra.*

129 Taxes were regarded as quasi-contractual and therefore provable under § 63a(4) in *In re* Mercury Engineering, Inc., 68 F. Supp. 376, 382 (S.D. Cal. 1946).

130 31 U.S.C. § 191 (1964), which is a law of the United States granting priority to the United States within the contemplation of § 64a(5). See 3 COLLIER, BANKRUPTCY ¶ 64.502 (14th rev. ed. 1966).

the proviso is indicative of a Congressional understanding that taxes denied priority may nevertheless be proved as general unsecured claims. It would at any rate be curious of Congress to deny priority for a class of claims if it intended that such claims should not even be proved or allowed as general claims.

It is conceivable that a tax collector may occasionally face a difficult choice: Should he waive his right to file a tax claim entitled to priority in bankruptcy distribution in order to collect a larger amount on a general tax claim which will be discharged if not paid? Ordinarily, no doubt, it will be advantageous to assert priority for as much of any tax claim as the law permits.

The Boiler Plate of Section 5

Section 5 of Public Law 89-496 has puzzled many readers. It does not amend any section of the Bankruptcy Act. It purports to save from release or extinction "any penalty, forfeiture or liability incurred under the Bankruptcy Act before the effective date of this Act." The tax liabilities dealt with by Public Law 89-496 are not incurred under Bankruptcy Act. What relevant penalty, forfeiture, or liability is or can be incurred under the Bankruptcy Act? The criminal provisions of the Act were taken out and put in Title 18 of the United States Code back in 1948.[131] Although it is not clear who was responsible for including section 5 in this law, it would seem that this provision is additional evidence of the ancient origin of the bill. This kind of section was boiler plate at the time it was originally drafted,[132] and it has little or no role to play now.

Applicability to Pending and in Future Cases

An important question now presented is, to what extent do these bills apply to cases pending when the bills took effect and to operative facts that occurred before they became effective. This kind of question may arise with respect to every act that does not deal explicitly with it,

131 18 U.S.C. § 151 (1964).

132 Substantially identical clauses were included in the Chandler Act, 11 U.S.C. §§ 1-1255 (1954); the Referees' Salary and Expense Act, 11 U.S.C. § 53 (1946); the 1950 amendments of §§ 60 and 70c, 64 Stat. 27 (1950); and the Omnibus Act of 1952, 66 Stat. 438 (1952). It did not appear in the Omnibus Act of 1962, 76 Stat. 570, or, indeed, in any other recent amendments of the Bankruptcy Act. Weinstein attributed derivation of the provision as included in the Chandler Act to the 1926 amendment of the Bankruptcy Act (44 Stat. 667). He added, "It is a necessary and sound protecting provision." WEINSTEIN, THE BANKRUPTCY LAW OF 1938, 363 (1938).

and Public Law 89-495 does not deal with it. Insofar as the statute codifies existing law, there is, of course, no problem. The new sections 1 (29a), 67b, 67c(3) in most circuits, 67c(5), and 70c except new clause (2) codify existing law. The other parts will not present many questions of retroactive applicability.

Public Law 89-496 says in section 5(b) that it governs cases pending when it took effect, October 3, 1966. Nevertheless, it is doubtful that this contemplates a redistribution in every case not closed when tax collectors have already received more than they are entitled to under the new legislation, or that a discharge already granted in a pending proceeding cuts off state tax claims (*i.e.*, those over three years old and not excepted).