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# The Bankruptcy Act: Some Effects of the 1966 Amendments to Sections 17(A), 67(C), & 70(C)

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# THE BANKRUPTCY ACT: SOME EFFECTS OF THE 1966 AMENDMENTS TO SECTIONS 17(a), 67(c), AND 70(c)

Article I, Section 8, Clause 4 of the Constitution gives Congress the power to "establish uniform Laws on the subject of Bankruptcies throughout the United States." Attempts were begun in 1789 to establish a system of bankruptcy laws and from time to time until 1898 various laws were enacted to give temporary relief to debtors, but were subsequently repealed for one reason or another. Finally in July of 1898, the Bankruptcy Statute of 1898 was enacted. This statute, known as the Bankruptcy Act,[1] has been amended eighty-six times.[2] The most recent of these amendments were added in the summer of 1966,[3] when the last session of the 89th Congress passed legislation amending the Bankruptcy Act in an attempt to provide for a more equitable discharge and to clear up some of the existing inconsistencies while not completely controverting the status of the federal tax lien. These additions should have a significant effect, not only on the power of the trustee and the debtors' discharge in bankruptcy, but also on the policies of the Treasury Department as to the administration and collection of taxes. A look at three of the most far reaching of these amendments will perhaps demonstrate the significance they will have on the law of bankruptcy and give some indication as to the effects these changes will cause on the current tax policies of the federal government.

The Bankruptcy Act was designed in an attempt to distribute the bankrupt's assets equitably among his creditors. Equal distribution among creditors, however, did not always prove to be the just solution, and so priorities and security interests were accorded to certain classes of creditors. Thus, creditors with liens received satisfaction before assets became available to other or general creditors. This of course put unsecured creditors in an unfavorable position, and they began seeking legislation under state law which would give them priority. The government anticipated trouble and, when enacting the Chandler Act of 1938,[4] destroyed state priorities, except for those of the landlords which were postponed, in an effort to insure uniformity of distribution. Although

1. Short title added by 64 Stat. 1113 (1950).
2. Laube, 1966 COLLIER PAMPHLET EDITION BANKRUPTCY ACT, VIII-X (1966).
3. Pub. L. 89-495, 8 Stat. 268 (1966). Pub. L. 89-496, 8 Stat. 270 (1966).
4. Pub. L. 699, 52 Stat. 840-940 (1940).

state priorities were destroyed, the validity of a statutory lien was recognized. Thus, a general creditor might obtain state legislative action making his debt a lien and so raise himself to a position of superiority among general creditors and, in some cases, among other priority claimants. Problems began to arise with both liens on specific assets and disguised liens designed to take effect only on the insolvency of the debtor. Tax claims compounded the problem as they also assumed the position of statutory liens. It became apparent that the federally created priorities under the Bankruptcy Act would be totally disrupted if all statutory liens were given effect. The Chandler Act, in attempting to solve this problem by creating priorities for the cost of administration and wage claims over statutory liens on personal property not accompanied by possession, and by providing that liens should be restricted "except as against other liens," [5] inadvertantly paved the way for the unanticipated judicial interpretation that followed.[6]

Amendment was made in 1952 deleting the controversial clause "except as against other liens" and section 67(c)(2) was added invalidating all statutory liens against the trustee in bankruptcy on personal property not accompanied by possession, levy, sequestration or distraint.[7] This settled the "circuity problem" [8] with regard to wages and rents, but the problem continued to exist where a state law placed a lien, postponed under the Bankruptcy Act, in a senior position to a lien unaffected by postponement.[9]

The problem culminated in a Pennsylvania decision, *In re Quaker City Uniform Company*,[10] where the bankrupt had given two chattel mortgages to creditors long before bankruptcy. The creditors held validly recorded chattel mortgages and the contest was to determine relative order of distribution among: (1) chattel mortgage holders prior in time to any claimants; (2) the landlord of the bankrupt who had not sold any property; (3) various wage claimants; and (4) administration

5. Weinstein, THE BANKRUPTCY LAW OF 1938, SECTION 67(c) 144 (1938).

6. In Re Eakin Lumber Co., 39 F. Supp. 787, (N.D. W.Va. 1941). In this case, a junior lien intervened and the rent or wage lien became unrestricted at the expense of general creditors. Aff'd., R.F.C. v. Sun Lumber Co., 126 F.2d 731, 48 Am. B.R. (N.S.) 96 (1942).

7. Pub. L. 82-456, 66 Stat. 427 (1952).

8. S. Rep. No. 277, 89th Cong. 1st Sess. 265 (1965). "Circuity of liens results when lien B is subordinated to lien A but prior in right to lien C which, however, is in turn entitled to priority over lien A."

9. H.R. Rep. No. 686, 98th Cong. 1st Sess. 265 (1965).

10. 134 F. Supp. 596 (E.D. Pa.), 238 F.2d 155 (C.A. 3d Cir. 1956), *cert. den.* 352 U.S. 1030 (1957). The referee, the district court, and the court of appeals all arrived at different conclusions as to the proper order of distribution.

expenses. In Pennsylvania a distraint for rent is superior to a chattel mortgage. The referee, the district court, and the court of appeals arrived at different conclusions as to the proper order of distribution. In the final decision, the court of appeals followed the federal order of distribution in allowing the cost of administration and wage claims ahead of the other claims, but followed the state priorities placing the distraint for rent ahead of the chattel mortgages. The cost of administration and wage claims used up all the assets so that the landlord and the secured creditors received nothing. Thus the question arose as to the value of secured credit.

However, this Pennsylvania interpretation has not been followed in other jurisdictions. In *New Orleans v. Harrell*,[11] chattel mortgages were paid first. The court reasoned that since secured priorities were not postponed in section 67(c)[12] of the Bankruptcy Act, they should be paid first, then the cost of administration, wage claims, and finally city tax claims. In a California case,[13] involving priorities between federal tax liens and state tax liens coupled with possession of the bankrupt's personal property, the court interpreted section 67(c) to be intended to postpone payment of the federal tax lien on personal property not accompanied by possession. This was in order to insure payment of the administrative expenses and wage claims under section 64(a)(1) and (2), and not to subordinate the lien to another lienholder who secures possession of the property prior to bankruptcy. The court thus upheld the contention of the federal goverment in stating that the postponement of federal tax liens under section 67(c) is provided for the benefit of unsecured creditors, not for the benefit of other secured claimants.

These various interpretations have obviously thwarted attempts to produce a uniform Bankruptcy Law and, as early as 1957, revisions to section 67(c), arising from the *Quaker City*[14] dilemma, were introduced in Congress.[15] Subsequently Congress passed a bill which provided for the postponement of tax liens on personal property not accompanied by possession, not only to administration expenses and wage claims, but also to all liens indefeasible in bankruptcy.[16] The bill was designed to

11. 134 F.2d 399 (5th Cir. 1943).

12. 11 U.S.C.A. Section 107 (1940).

13. California State Department of Employment v. U.S., 210 F.2d 242 (C.A. 9th Cir. 1954).

14. *Supra* note 10.

15. H.R. 5195, 85th Cong., 1st Sess. (1957).

16. H.R. 7242, 86th Cong. 1st Sess., Section 6 (1960).

prevent the interpretation which appeared in the *Quaker City* case,[17] but the Treasury Department objected on the basis that such an interpretation would result in a windfall to secured claims filed after the notice of a tax lien,[18] and the bill was subsequently vetoed by the President.[19]

## SECTION 67(c)

The first of the 1966 amendments to be considered herein is the latest change in section 67(c)[20] which again tries to solve the "circuity problem." The first part of this amendment lists three types of statutory liens which are to be invalidated against the trustee in bankruptcy.[21] The purpose of this part of the amendment is to do away with the so-called spurious and secret liens by invalidating disguised priorities which are not coupled with property rights by specifically doing away with statutory liens which spring to life only at the date of the debtor's insolvency. It also invalidates liens against a trustee which would not be enforceable against a bona fide purchaser from the debtor on that date, and liens for rents and distresses for rents which are provided for in Part 2 of the amendment to this section.

The Senate Finance Committee was concerned as to the effect this would have on the federal tax lien and proposed an additional clause to

17. *Supra* note 10.

18. *Supra* note 8.

19. *Supra* note 16, vetoed by the President on September 8, 1960, 106 Cong. Rec. 19168.

20. 11 U.S.C.A. Section 107(c) (1966).

21. *Supra* note 20, at (1), which provides:

> (A) every statutory lien which first becomes effective upon the insolvency of the debtor, or upon distribution or liquidation of his property, or upon execution against his property levied at the instance of one other than the lienor.
>
> (B) every statutory lien which is not perfected or enforceable at the date of bankruptcy against one acquiring the rights of a bona fide purchaser from the debtor on that date, whether or not such purchaser exists; Provided, That where a statutory lien is not invalid at the date of the bankruptcy against the trustee under subdivision c of section 70 of this Act and is required by applicable lien law to be perfected in order to be valid against a subsequent bona fide purchaser, such a lien may nevertheless be valid under this subdivision, if perfected within the time permitted by and in accordance with the requirements of such law: And provided further, That if applicable lien law requires a lien valid against the trustee under section 70, subdivision c, to be perfected by the seizure of property, it shall instead be perfected as permitted by this subdivision c of section 67 by filing notice thereof with the court;
>
> (C) every statutory lien for rent and every lien of distress for rent, whether statutory or not. A right of distress for rent which creates a security interest in property shall be deemed a lien for the purposes of this subdivision c.

this part of the amendment which would have followed clause B of section 67(c)(1).[22] The clause provided:

> That, in the case of a statutory lien for taxes which were assessed within one year prior to the date of bankruptcy, notice of such lien shall be considered as being enforceable at the date of bankruptcy against one aquiring the rights of a bona fide purchaser from the debtor on that date, if notice of such lien is filed within one year after the date of the assessment of the taxes to which the lien relates or within one month after the date of bankruptcy.[23]

This would have given the government a one-year period in which its unfiled tax claims would still be considered superior to the general creditor's represented by the trustee in bankruptcy, providing notices of these liens were subsequently filed. The majority contended that this would give the government time to decide whether or not it should file notice of a tax lien, which might force some taxpayers into bankruptcy, while retaining a secured position. However, the minority pointed out that this proposal would "turn the bill against its sponsors and pervert its purpose."[24] The minority argument was based upon the intended purpose of the amendment to section 67(c) and the holding in *United States v. Speers*.[25] The arguments were successful and the clause was not added.

One of the most significant changes of this section of the amendment comes in part (1)(B) which provides:

> . . . if applicable lien law requires a lien valid against a trustee under section 70, subdivision c, to be perfected by the seizure of property, it shall instead be perfected as permitted by this subdivision c of section 67 by filing notice thereof with this court.[26]

Prior to this addition, a tax lien which required seizure of property to become secured was not invalidated by failure to seize the property but only postponed to clauses (1) and (2) of section 64(a). Now these

22. *Supra* note 20, which invalidates against the trustee "every statutory lien which is not perfected or enforceable at the date of bankruptcy against one acquiring the rights of a bona fide purchaser from the debtor on the date, whether or not such purchaser exist."

23. S. Rep. No. 999, 89th Cong., 2d Sess., at IX, Sec. 4 (1)(B) (1966).

24. *Id.* at XI.

25. *Infra* note 54.

26. *Supra* note 20, at (1)(B).

tax liens will be invalidated as a lien and fall into clause (4) of section 64(a) to receive priorities entitled to thereunder unless notice of the lien has been filed with the proper court. The Treasury Department, of course, objects to this reduction of priority, and is faced with a major policy decision in regard to the filing of notice of tax liens.[27] Until now, the Treasury Department could examine the position of a taxpayer and use its discretion as to whether to file a tax lien or to extend the due date for taxes owed, giving the taxpayer a chance to recover financially. It now seems quite logical that liens will have to be filed promptly when the taxes become due, which may force many businesses and taxpayers into bankruptcy that previously might have been avoided.

The second section of the amendment to subsection c of section 67[28] tries to clear up some of the confusion which resulted in the *Quaker City* case in an attempt to once and for all answer the controversial circuitry problem." [29] By making liens previously invalidated and subsequently not preserved by the court invalid against all liens indefeasible in bankruptcy this section eliminates the problem which was created in the *Quaker City* case where the landlord prevailed over the chattel mortgagee. Thus the chattel mortgage in that case which was an indefeasible lien in bankruptcy would not have been subordinated to the landlord's lien for rents. The section continues to build up an assured order of distribution while seemingly strengthening the value of secured credit which was weakened by the Pennsylvania decision.

The amendment to section 67(c)(3)[30] also provides for the post-

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27. Letter from Treasury Department (Asst. Sec. Stanley S. Surrey) relating to H.R. 1961 in 87th Cong. carried forward as H.R. 136 with the deletion of Sec. 2 of H.R. 1961. IRB No. 1966-38, p. 129.

28. *Supra* note 20, at (2), which provides:

> (2) The court may, on due notice, order any of the aforesaid liens invalidated against the trustee to be preserved for the benefit of the estate and in that event the lien shall pass to the trustee. A lien not preserved for the benefit of the estate but invalidated against the trustee shall be invalid as against all liens indefeasible in bankruptcy, so as to have the effect of promoting liens indefeasible in bankruptcy which would otherwise be subordinate to such invalidated lien. Claims for wages, taxes, and rents secured by liens hereby invalidated or preserved shall be respectively allowable with priority and restricted as are debts therefore entitled to priority under clauses (2), (4), and (5) of subdivision a of section 64 of this Act, even though not otherwise granted priority.

29. 134 F. Supp. 596 (E.D. PA.), 238 F.2d 155, (C.A.3d Cir. 1956), *cert. den.* 352 U.S. 1030 (1957).

30. *Supra* note 20, at (3), which provides:

> (3) Every tax lien on personal property not accompanied by possession shall be postponed in payment to the debts specified in clauses (1) and (2) of subdivision a of section 64 of this Act. Where such a tax lien is prior in right to liens

ponement of all tax liens on personal property not accompanied by possession to (1) cost of administration and (2) wage claims under section 64(a) of the Act. As to other liens indefeasible in bankruptcy and tax liens, where notice was properly filed under the amendment to 67(c)(1)(B),[31] the common law principle of "prior in time, prior in right" determines the order of distribution.[32] The results of this section are more clearly seen through two hypothetical situations:

(A) D is bankrupt. The federal government holds a valid tax lien of $5,000 for back taxes on his personal property which has not been reduced to possession. This lien is prior in time to a subsequent chattel mortgage of $4,000 on the same property. There are also wage claims of $1,500 due $500 each to three workmen of D. The cost of administration of the bankrupt's estate is $1,000. The bankrupt's personal property is sold for $8,000 and the cost of the sale is $200. Under the new amendment to 67(c)(3) the distribution would be as follows:

| | |
|---|---|
| Cost of sale of personal property | $ 200 |
| The amount remaining of the tax lien, $5,000 to be paid as follows: | |
| Cost of administration | $1,000 |
| Wage Claims | 1,500 |
| Tax lien | 2,500* |
| Chattel mortgage | 2,800 |
| | $8,000 |

indefeasible in bankruptcy, the court shall order payment from the proceeds derived from the sale of the personal property to which the tax lien attaches, less the actual cost of the sale, of an amount not in excess of the tax lien, to the debts specified in clauses (1) and (2) of subdivision a of section 64 of this Act. If the amount realized from the sale exceeds the total of such debts, after allowing for prior indefeasible liens and the cost of the sale, the excess up to the amount of the difference between the total paid to the debts specified in clauses (1) and (2) of subdivision a of section 64 of this Act and the amount of the tax lien, is to be paid to the holder of the tax lien.

31. *Supra* note 26.

32. State ex. rel. State Highway Commission v. Mecher, 75 Wyo. 210, 212, 294 P.2d 603, 605 (1956).

(B) Same facts as above only the chattel mortgage is prior in time to the federal government's tax lien:

| | |
|---|---|
| Cost of Sale | $ 200 |
| Chattel mortgage | $4,000 |

The amount remaining to be paid as follows:

| | |
|---|---|
| Cost of administration | $1,000 |
| Wage Claims | 1,500 |
| Tax liens | 1,300* |
| | $8,000 |

*It should be noted here that the remaining taxes owed are not discharged unless they fall under the new amendment to 17(a) but are entitled to priority under section 64(a)(4) on the unsecured assets of the estate.

These changes seem to remedy the shortcomings of the *Quaker City* distribution[33] and that proposed in H.R. 7242.[34] The postponement of the tax lien to (1) cost of administration and (2) wage claims, while not completely controverting the status of the federal tax lien, seems to be a more logical and equitable distribution. It is interesting to note that the solution Congress adopts here in solving the "circuity problem" was already being used in various jurisdictions.[35]

The Treasury Department until this time[36] was following the de-

33. *Supra* note 29. Under the Quaker City order of distribution in either example would be: cost of the sale of the property–$200, cost of administration–$1,000, wage claims–$1,500, tax lien–$5,000, and chattel mortgages–$300. In the second example then, the chattel mortgage, recorded prior to the tax lien received only $300 of the $4,000 due while the subsequent tax lien was paid in full. See H.R. Rep. No. 686, 89th Cong., 1st Sess. 265 (1965).

34. H.R. 7242, 86th Cong., 1st Sess. (1960). Under both cases H.R. 7242 would have distributed the assets as follows: cost of sale–$200, chattel mortgages $4,000, cost of administration–$1,000, wage claims–$1,500, and tax lien–$1,300. Under this case in example one, the subsequent chattel mortgage is paid in full but the tax lien prior in time receives only $1,300 of the $5,000 due. See H.R. Rep. No. 686, 89th Cong. 1st Sess. 265 (1965).

35. *See* California State Department of Employment v. U.S., 210 F.2d 242 (C.A. 9th Cir. 1954); In Re American Zyloptic Co., Inc., 181 F. Supp. 77 (E.D. N.Y. 1960); In Re Empire Granite Co., 42 F.Supp. 450 (M.D.G.A. 1942). These three courts have already interpreted the existing statute to mean what the present amendment assures.

36. TIR 316, April 26, 1961.

cision of *United States v. City of New Britain*[37] in the administration of its policies. In the *New Britain* case the court adopted the "prior in time, prior in right" rule which the present amendment to section 67(c)(3) adopts.[38] Although the Treasury has followed this case and thus supports to an extent the present solution provided by the new section 67(c) for remedying the "circuity problem," the Treasury feels that there is still room for judicial interpretation due to the use of the term "indefeasible lien." The Department speculates that there is a possibility that indefeasible liens would be paid immediately after cost of administration and wage claims, thus subordinating tax claims once again.[39] In hopes of finding a solution that would have a more general application to the "circuity problem," the Department offered an alternate amendment to section 67(c)(3) which would cause not only tax liens but other statutory liens to share the burden of payments for cost of administration and wage claims. The Treasury Department has an obvious point in trying to protect its position and spread the burden of administrative costs and wage claims, but Congress has failed to adopt this solution. However, they have moved in the right direction by this amendment in eliminating the existing state of the law, and if interpretation follows their intent, the "circuity problem" should be solved.

## SECTION 70(c)

The second 1966 amendment to the Bankruptcy Act to be discussed is the change in section 70(c),[40] popularly known as the "strong arm clause," which enumerates the rights and powers of the trustee in bankruptcy, and which is designed to provide broad powers so that an equitable distribution of the bankrupt's assets may be effected among the creditors. In order to insure the rights and remedies provided for the trustee in bankruptcy and at the same time to clarify the existing confusion as to the trustee's position, this section was amended as follows:

> The trustee may have the benefit of all the defenses available to the bankrupt as against third persons, including statutes of limitation,

37. 347 U.S. 81, which remanded sub. nom. Brown v. General Laundry Service, 19 Conn. Sup. 335, 113 A.2d 601 (1955).

38. *Supra* note 32.

39. *Supra* note 27.

40. 11 U.S.C.A. Section 110(c) (1966).

> statutes of frauds, usury, and other personal defenses; and a waiver of any such defense by the bankrupt after bankruptcy shall not bind the trustee. The trustee shall have as of the date of bankruptcy the rights and powers of: (1) a *creditor who obtained a judgment against the bankrupt upon the date of bankruptcy*, whether or not such a creditor exists, (2) a creditor who upon the date of bankruptcy obtained an execution returned unsatisfied against the bankrupt, whether or not such a creditor exists, and (3) a creditor who upon the date of bankruptcy obtained a lien by legal or equitable proceedings upon all property, whether or not coming into possession or control of the court, upon which a creditor of the bankrupt upon a simple contract could have obtained such a lien, whether or not such a creditor exists. If a transfer is valid in part against creditors whose rights and powers are conferred upon the trustee under this subdivision, it shall be valid to a like extent against the trustee. In cases where repugnancy or inconsistency exists with reference to the rights and powers in this subdivision conferred, the trustee may elect which rights and powers to exercise with reference to a particular party, a particular remedy, or a particular transaction, without prejudice to his right to maintain a different position with reference to a different party, a different remedy, or a different transaction.[41] [Emphasis added.]

The importance of the trustee in bankruptcy and his remedies against other claimants is very crucial, and from time to time the position he holds has been subject to various interpretations. Until 1950, the Act provided that a trustee had "all the rights of a judicial lien creditor as to the property coming into the possession of the bankruptcy court, and the rights of a judgment creditor holding an unsatisfied execution on all other property." [42] An amendment in 1950 transferred the trustee to the position of a judicial lien creditor in regard to all property. It was fairly obvious from the committee report which accompanied that legislation that the Congress did not intend to lessen the trustee's powers, but rather to put him in a more satisfactory position, reasoning that a lien holder is in a better position than a judgment creditor with an execution returned unsatisfied.[43] It seems that if the legislative pur-

41. *Id.*, This amendment retained the first sentence of the prior section 70(c) but goes on to give the trustee the powers of an actual judgment creditor rather than the status of a hypothetical lien creditor which the previous act gave him.

42. H.R. Rep. No. 686, 89th Cong., 1st Sess. 265 (1965).

43. H.R. Rep. 1293, 81st Cong., 2d Sess., p. 7 (1949).

pose and intent had prevailed, the jurisdictional differences which followed would have been eliminated.[44]

The major dispute which resulted from judicial interpretation was whether or not the trustee was a judgment creditor. The importance of this relates to section 6323 of the Internal Revenue Code which provides:

> Except as otherwise provided in subsection (c) and (d), the lien imposed by section 6321 shall not be valid as against any mortgagee, pledgee, purchaser, or *judgment creditor* until notice thereof has been filed by the Secretary or his delegate . . . in the appropriate office.[45] [Emphasis added.]

Depending then on the interpretation concerning the status of a trustee in bankruptcy, tax liens imposed without notice might be invalidated against him.

Until recently, most of the decisions held that the trustee was not a judgment creditor, thus tax liens did not have to be recorded to be valid secured liens in bankruptcy.[46] Although *In re Taylorcraft Aviation Corporation*[47] was perhaps the earliest case to hold that the trustee was not a judgment creditor, the court offered no explanation of its decision, and so most cases agreeing with this decision are based upon the holding of *United States v. Gilbert Associates, Inc.*[48] The *Gilbert* case involved neither a bankruptcy proceeding nor the rights of a trustee in bankruptcy, but rather a state insolvency proceeding. The issue was whether an unrecorded federal tax lien was valid as against a municipal tax assessment which had neither been reduced to a judgment nor accorded "judgment creditor" status by any statute. The state court conveniently gave the tax assessment the character "in the nature of a judgment." The Supreme Court reversed this decision, stating that on the basis of uniformity a judgment creditor should have the same application in all states, thus interpreting Congressional use of the words "judgment creditor" in the conventional sense of a judg-

44. *Supra* notes 35-40.

45. INT. REV. CODE of 1954, § 6323.

46. See Brust v. Sturr, 237 F.2d 135 (2d Cir. 1956); In re Fidelity Tube Corp. 278 F.2d 776 (3d Cir. 1960); Simonson v. Granquist, F.2d 489 (9th Cir. 1961); In re Taylorcraft Aviation Corp., 168 F.2d 808 (6th Cir. 1948); United States v. England, 226 F.2d 205 (9th Cir. 1955).

47. *Id.*

48. 345 U.S. 361 (1953). *Accord* U.S. v. Aeri, 348 U.S. 211 (1955).

ment of a court of record.[49] The majority of decisions which have followed this holding, that the trustee was not a judgment creditor for the purpose of section 6323 of the Internal Revenue Code, have thus used the language of the Supreme Court in the *Gilbert* case to support their position, even though the case had nothing to do with the interrelationship of section 6323 and the Bankruptcy Act.

The opposite view, holding that a trustee in bankruptcy is a judgment creditor, first appeared in the 1940 case of *United States v. Sands*[50] in which it was asserted as dicta that a trustee in bankruptcy comes within the meaning of a judgment creditor. Although this case was subsequently overruled in its own jurisdiction by *Brust v. Sturr*,[51] decided after the *Gilbert* case, it was, prior to that time, the leading authority on that subject. The reversal evolved from an unsuccessful attempt in Congress in 1954 to exclude from section 6323 "artificial" judgment creditors like the trustee in bankruptcy.[52] The proposal was rejected, deeming it "advisable to continue to rely upon judicial interpretation of existing law instead of attempting to prescribe statutory rules." [53] The reference was apparently meant to be to the *Gilbert* decision. Thus, through a misinterpretation of Congressional intent, the *Gilbert* case, thought prior to this time not used to decide the rights of a trustee in bankruptcy against unrecorded tax liens, paved the way for the resulting decision in *United States v. Speers*.[54]

The case of *United States v. Speers* directly presented the question of whether a federal tax lien, unrecorded at the time of bankruptcy, was valid as against the trustee in bankruptcy and whether the trustee was a "judgment creditor" within the meaning of 70(c) of the Bankruptcy Act, thus taking priority to tax liens imposed without notice under section 6323. On a writ of certiorari, the Supreme Court upheld the judgment in the *Speers* case, giving the trustee in bankruptcy the position of a judgment creditor and clearing up the once existing dispute.[55]

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49. *Id.* at 364.

50. 174 F.2d 384, 385 (2d Cir. 1949). *Accord* In re Fisher Plastic Corp., 89 F.Supp. 446, 448 (D. Mass. 1950); In re Sport Coal Co., 125 F.Supp. 517 (S.D. W.Va. 1954); F. Avery and Sons Co. v. Davis, 226 F.2d 9429 (4th Cir. 1955); In re Sayre Village Manor, Inc., 120 F. Supp. 215 (N.D.J. 1954).

51. *Supra* note 44.

52. H.R. Rep. No. 1337, 83d Cong., 2d Sess., to accompany H.R. 8300, P. A407.

53. S. Rep. No. 1622, 83d Cong., 2d Sess., to accompany H.R. 8300, P. 875.

54. 382 U.S. 266 (1965).

55. The referee, the District Court, and the Court of Appeals for the Sixth Circuit

The new section 70(c), besides codifying the *Speers* case and thus clearing up the existing confusion as to the trustee's position, also gives the trustee the express rights of a creditor who, upon the date of bankruptcy, obtains an execution return unsatisfied. This addition gives the trustee powers, such as discovery to inquire as to property over which he gains title but the extent and location of which is not known, which are available under some state laws only to creditors occupying this position. The effect of this revision is to reinstate the trustee to his former position of a judgment execution creditor which the 1950 amendment had taken away from him.[56]

The obvious effect of this amendment, as well as 67(c), is that the Treasury Department will be forced to file notice of tax liens in most cases where they previously have recognized a policy of discretion in allowing extensions of time for taxes due. Prior to the enactment of the amendments to 67(c) and 70(c), the Department recognized the possibility that such consequences might result and unsuccessfully proposed deleting those portions of the amendments which made the trustee a judgment creditor.

## SECTION 17(A)

The last of the 1966 amendments to be considered here is section 17 of the Bankruptcy Act which provides for the release of a bankrupt from his provable debts except those listed therein. Prior to the 1966 amendment, section 17(a)(1) provided: "a. A discharge in bankruptcy shall release a bankrupt from all his provable debts, whether allowable in full or in part, except as such are due as a tax levied by the United States, or any State, county, district, or municipality . . . ."[57] The 1966 amendment to section 17(a)(1),[58] possibly the most significant of the new amendments to the law of bankruptcy, provides

all found for the Trustee. The Supreme Court granted certiorari to resolve the conflict which existed between the decision of the lower court and the decisions from the Second, Third, and Ninth Circuits. *Supra* note 44.

56. Laube, 1966 COLLIER PAMPHLET EDITION BANKRUPTCY ACT, A144.2 (1966).

57. *Id.* at A32.1 (1966).

58. 11 U.S.C.A. Section 35(a)(1), which provides for release of debts except as to:

> . . . taxes which become legally due and owing by the bankrupt to the United States or to any State or any subdivision thereof within three years preceding bankruptcy: Provided, however, That a discharge in bankruptcy shall not release a bankrupt from any taxes (a) which were not assessed in any case in which the bankrupt failed to make a return required by law, (b) which were assessed within one year preceding bankruptcy in any case in which the bankrupt failed to make a return required by law, (c) which were not reported on

for an absolute release of a debtor in bankruptcy of all taxes except those which became "legally due and owing by the bankrupt to the United States or to any State or any subdivision thereof within three years preceding bankruptcy." The section does not, however, release a bankrupt in situations where he has failed to make returns, made omissions from returns, or has not payed taxes he has collected or withheld for others, and specifically provides that this release does not bar or place any time limit on any valid tax liens.

The Congress was faced here with the problem of, on the one hand, wanting to provide for an absolute discharge of tax debts, absent fraud and other stated conditions, and, on the other, with the problem which would arise if they enacted into the statute a provision which would make voluntary bankruptcy a tax-evasive device. An alternative proposal was considered in lieu of this amendment which suggested that a limitation be made on the collection of prebankruptcy Federal tax liens, limiting them in any one year to 10% of the taxpayer's income after taxes. The Senate believed that this would be a better solution than an absolute discharge of certain prebankruptcy Federal taxes, and would discourage voluntary bankruptcies while enabling rehabilitation.[59]

Congress finally chose to enact the three-year limit coinciding with the three-year statute of limitations for tax assessments under the Internal Revenue Code[60] which they felt should prevent petitions in bankruptcy to avoid tax liabilities and also enable a complete recovery after bankruptcy for any energetic individual. However, this amendment makes it clear that there is no discharge or effect on tax debts which have been made valid tax liens.[61] The exceptions to this three-year limitation were incorporated in order to guard against the situa-

a return made by the bankrupt and which were not assessed prior to bankruptcy by reason of a prohibition on assessment pending the exhaustion of administrative or judicial remedies available to the bankrupt, (d) with respect to which the bankrupt made a false or fraudulent return, or willfully attempted in any manner to evade or defeat or (e) which the bankrupt was collected or withheld from others as required by the laws of the United States or any State or political subdivision thereof, but was not paid over; but a discharge shall not be a bar to any remedies available under applicable law to the United States or to any State or any subdivision thereof, against the exemption of the bankrupt allowed by law and duly set apart to him under this Act.

59. S. Rep. No. 999, 89th Cong., 2d Sess. (1966).

60. INT. REV. CODE of 1954, § 6501.

61. *Supra* note 58, ". . . but a discharge shall not be a bar to any remedies available under applicable law to the United States or . . . ."

tion where the fraud of a taxpayer would make this section a tax-evading device in bankruptcy.

Prior to 1966, section 17(a) was perhaps morally sound, but presented certain inequities. A comparison between a single taxpayer and a corporate taxpayer both discharged in bankruptcy points out some of these inequities. The single taxpayer would have to pay any remaining tax debts out of any assets he might acquire after discharge; while the discharged corporation, although technically not released from tax debts, could simply change its corporate form, and thereby avoid future recovery of its remaining debt.

The importance of this amendment is obvious for the very reasons for the enactment of a bankruptcy law. The theory that a bankrupt should be able to start on a fresh path of rehabilitation after a discharge in bankruptcy has been prevented due to the nondischargability of tax debts under the previous law. The ever-increasing propensity of the tax burden has caused this factor to become one of the major drawbacks to a discharge in bankruptcy.

## Summary

In amending Federal statutes, Congress must always weigh the potential benefits of the amendment against any harm that might be caused, not only to the law itself, but also to any interrelated law or administrative policy. The amendments discussed herein present just such a dilemma. In enacting these amendments to the Bankruptcy Act, Congress had to weigh the benefits of a more uniform code for the financially unfortunate against the harm which might result when such persons are relieved of paying their portion of the tax burden.

It seems that the enactment of these amendments may also force the Treasury Department to change its policy in regard to filing notices of tax liens, in order that it might secure its position in a bankruptcy proceeding. Due to such a policy change, there is an indication that the number of bankruptcies may increase, as the Treasury Department's previous use of discretion regarding postponement of the filing of notices of tax liens will now not generally be exercised so readily. Thus with the notice of the tax lien filed against him, the taxpayer may have a hard time obtaining the necessary credit to run his business, and he may be forced into bankruptcy. Even more far-reaching effects may be caused where the bankruptcy puts the taxpayer's employees out of work, stops orders for materials, and generally disrupts the economic pattern. Hopefully, however, although the Treasury Department will be forced to readjust its policies concerning the filing of notices of liens, the use of technological advances such as data processing which is currently being put into effect will enable it to still use some discretionary policies, by providing more accurate and readily available information concerning the position of the taxpayer.

Although it is thus apparent that these amendments will cause definite changes in the Administration's Federal tax policies, the benefits derived from the settling of the "circuity problem," the invalidation of secret and other spurious liens against a trustee in bankruptcy, the affirmance of the trustee's position as a judgment creditor, and the release of a bankrupt by a discharge in bankruptcy of all taxes except those which became legally due and owing within three years prior to bankruptcy, seem to outweigh any disadvantage of such policy changes. The amendments will cause the loss of some tax funds, but with effective administration and enforcement, this effect should be minimized and far outweighed by the benefits of a more uniform and equitable Bankruptcy Act.

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