Calendar No. 972

89TH CONGRESS
2d Session

SENATE

REPORT
No. 999

STATUS OF TAXES AND TAX LIENS IN BANKRUPTCY PROCEEDINGS

FEBRUARY 16, 1966.—Ordered to be printed

Mr. LONG of Louisiana, from the Committee on Finance, submitted the following

REPORT

[To accompany H.R. 136]

The Committee on Finance, to which was referred the bill (H.R. 136) to amend sections 1, 17a, 64a(5), 67(b), 67c, and 70c of the Bankruptcy Act, and for other purposes, having considered the same, reports favorably thereon with recommendations.

I. SUMMARY

S. 1912 and S. 976 were reported by the Committee on the Judiciary on June 8 and March 10, 1965, respectively. On July 28, 1965, after having been favorably reported by that committee, they were re-referred to the Committee on Finance for consideration of their tax aspects with instructions to return them to the Senate within 30 days. The House bills, H.R. 136 and H.R. 3438, passed the House of Representatives on August 2, 1965. On August 3, 1965, they were referred to the Committee on Finance since they were identical to Senate bills S. 1912 and S. 976, as reported. After the committee concluded public hearings on these bills the original order to report them within 30 days was extended, first to February 15, and then to February 16, 1966, in view of the technical and complicated nature of their provisions. These bills provide for a number of amendments which directly affect the revenue laws and their administration. Generally, these bills alter the status of tax liens, the priority of tax claims, and the dischargeability of taxes in bankruptcy.

The provisions of the Bankruptcy Act which these bills amend provide rules for the distribution of estates of bankrupt individuals or corporations. Since bankrupts are also taxpayers, the Federal Government, as well as the State and local governments, are usually creditors.

In bankruptcy there are three general types of claims: (1) secured claims; (2) claims of general creditors with priority of payment; and (3) claims of general creditors without priority of payment.

The secured creditors are paid first from the specific property of the bankrupt which is held as security for their claims. After the payment to the secured creditors, the remaining funds of the bankrupt's estate are distributed first to the creditors given priority of payment by the Bankruptcy Act, in the order of priority specified in that act, and then the remaining assets are distributed pro rata to the nonpriority general creditors.

Federal tax liabilities are established by statute as secured liens if the tax liabilities have been assessed. However, the Internal Revenue Code provides that assessed tax claims which have been granted secured lien status are not valid against mortgagees, pledgees, purchasers, or judgment creditors until notice of lien has been filed. Therefore, as against interests of these types, the unfiled Federal tax lien is treated as a junior lien. Recently, the Supreme Court decided that the trustee in bankruptcy is, by virtue of the Bankruptcy Act, a judgment creditor within the meaning of that term as used in the Internal Revenue Code.[1] Therefore, unless notice of the Federal tax lien has been filed, the lien is not valid against the trustee in bankruptcy, who represents all the general creditors. Accordingly, the tax liabilities secured by such a lien become general claims although they are accorded a priority of payment by the Bankruptcy Act. This destroys any practical significance of the secured status of unfiled tax liens. The amendment suggested by this committee provides that the Government be granted a 1-year period within which its unfiled liens will be considered superior to the general creditors represented by the trustee in bankruptcy, but only if notices of these liens are subsequently filed. Your committee believes that this limited period of time is necessary so that the Government will have at least a minimal time after tax liabilities are assessed to determine whether or not its lien must be filed. In addition, this amendment treats tax liens for this limited period essentially no better than unfiled mortgages or judgments which, in many States, may be recorded after bankruptcy and still obtain secured status.

With respect to the priority status granted Federal tax claims, this committee agrees with the Committee on the Judiciary that the present rule granting priority of payment to all outstanding tax claims should be limited to those tax claims which are not more than 3 years old. However, this committee believes that the "date of assessment" should be the commencement date for the running of the 3-year period. The bills would begin this period with the date the tax becomes "legally due and owing." The tax law does not contain the "legally due and owing" concept and therefore the development of its meaning, with respect to taxes, would have to await judicial interpretation. Other problems discussed in the body of this report also would arise if the words "legally due and owing" were used for this purpose. The "date of assessment" is already a very well established tax law concept. This is both the earliest time at which the amount of the tax is definitely ascertained, and the earliest time when the Internal Revenue Service may begin collection procedures. It is most appropriate to measure the time a tax liability is outstanding

[1] *United States* v. *Speers*, 382 U.S. 266, 86 S. Ct. 411 (1965), aff'g, *In re Kurtz Roofing Co.*, 335 F. 2d 361 (6th Cir., 1964).

from the first day it may be collected. While perhaps the courts would interpret the term "legally due and owing" as meaning the "date of assessment" a question of this importance should not be left in doubt. Accordingly, this committee believes that the term "date of assessment" should be substituted for the expression "legally due and owing."

Another major provision proposed by these bills involves the dischargeability of a bankrupt's taxes. Again, this committee agrees with the view of the Committee on the Judiciary that the present nondischargeability rule should be modified, but it does not agree that the full discharge of taxes 3 years old which would be provided by the bills is the proper solution. This committee suggests instead that the collection of prebankruptcy Federal tax liabilities be limited in any year to 10 percent of taxable income after taxes. In this way a bankrupt's old taxes would not constitute an oppressive financial burden or jeopardize his chances of financial rehabilitation. Nevertheless this would discourage voluntary bankruptcies on the part of those with substantial earning capacities.

Finally, this committee recommends an amendment to provide that a bankruptcy court may upon its own determination (or upon the request of a creditor), when considering a voluntary petition in bankruptcy, require the debtor to enter into a wage earner's plan for payment of part or all of his debts by setting aside a portion of his salary for this purpose. This is considered desirable as a means of slowing down the increasing volume of voluntary bankruptcies where consumers have accumulated large debts by the purchase of expensive items on credit plans and avoided payment of these liabilities by filing voluntary bankruptcy petitions.

II. SECURED STATUS OF FEDERAL TAX LIENS (SECS. 5 AND 6 OF H.R. 136 AND S. 1912)

Present law.—The Bankruptcy Act provides that before any distribution is made to general creditors, the secured creditors (those who rely upon specific security) are entitled to have their claims satisfied from the property of the bankrupt which is held as security for their claims. Secured claims include mortgages, pledges, judgments, and tax liens on real or personal property, whether or not recorded. After the payment to the secured claimants, the remaining funds of the bankrupt's estate are distributed first to the general creditors given priority of payment by the Bankruptcy Act, in the order of that priority, and then to the remaining general creditors.

Federal tax liabilities are by statute established as secured claims if the tax liabilities have been assessed and the taxpayer has received notice and demand of the taxes owed (secs. 6321 and 6322 of the code). Although it is not necessary for a notice of a tax lien to be filed for the tax liabilities to be accorded secured status, the Internal Revenue Code provides that the tax lien is not valid as against mortgagees, pledgees, purchasers, or judgment creditors until notice of the lien has been filed (sec. 6323 of the code). Therefore, as against interests of these types, recorded before the tax lien is filed, the Federal tax lien is treated as a junior lien. In a recent Supreme Court case, *United States* v. *Speers* (cited above), the Court held that the Bankruptcy Act conferred upon the trustee in bankruptcy the status of a judgment

creditor (as of the date the petition is filed) within the meaning of that term as used in the Internal Revenue Code. As indicated above, one of the types of interest against which an unfiled tax lien is not valid is a judgment creditor and since the trustee represents all the general creditors in a bankruptcy proceeding, the Government's unfiled tax lien for assessed taxes is effectively reduced to the status of an unsecured claim. However, these tax claims are entitled to be paid as priority claims, ahead of nonpriority general creditors.

Bills' proposal.—While these bills were pending in this committee, the Supreme Court rendered the decision discussed above. The decision interprets present law as providing the rule set forth in section 6 of these bills. Prior to the Supreme Court's decision, the courts of appeals for three judicial circuits had interpreted the statute in a contrary manner.

In general, prior to the *Speers* decision by the Supreme Court, 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). Therefore, assessed tax claims were paid as secured claims prior to any distribution to the general creditors (with certain limited exceptions).

Reasons for the amendment.—Your committee understands that the principal motivation of the proponents of the bills was to deny a secured status to unrecorded tax liens since they in effect represent "secret" liens. General creditors, unaware of these liens, often extend potential future bankrupt persons credit which they might not extend if they were aware of the tax liens. It is considered unfair to the general creditor to expose him to this extra risk. Your committee understands and is in accord with much of this reasoning. This is evident by the fact that it is recommending a 3-year limit on the priority status of tax claims. This is also evident by the fact that it is recommending only a 1-year secured status for unfiled tax liens. However, your committee believes that this desire to protect general creditors must be balanced against other considerations.

First, it believes that a limited period of secured status should be granted assessed tax claims because of the very large administrative problem the Internal Revenue Service must face in this regard. There were, for example, approximately 2.4 million new delinquent Federal tax accounts in the fiscal year ending June 30, 1965. However, only 222,000 notices of lien were filed in the same period, and many of these related to delinquent accounts which had arisen in previous years. This illustrates how the Service, at the present time, manages to dispose expeditiously of delinquent accounts without the necessity of filing tax liens. Moreover, under the present procedures, four-fifths of the 2.4 million new delinquencies are collected in the first year after assessment, reducing appreciably the magnitude of the administrative problem by the end of the first year. Therefore, the 1-year period of secured status is needed for unfiled tax liens primarily as a means of aiding the Internal Revenue Service in the proper disposition of delinquent accounts before any filing of tax liens becomes necessary. Under the present procedures, the Internal Revenue Service usually sends out a series of three delinquency letters which requires a period of about 4 months to process. Accordingly, until this period has elapsed the Service has not had any personal contact with the delinquent taxpayer. Thus, in fact, there usually is no oc-

casion for the Government to begin investigating a delinquent taxpayer's credit standing before a period of close to 6 months has elapsed after the assessment is made.

The ordinary creditor has an opportunity to investigate the financial situation of a potential debtor before credit is extended. In contrast, the United States is not in a position to investigate the financial circumstances of a taxpayer until after the delinquency occurs, and because of the very large number of delinquencies involved, its collection officers are unable to give any personal attention to the matter until, as indicated above, the elapse of a period of something like 6 months after the assessment is made.

The administrative burden falling on the Internal Revenue Service, if a limited secured status is not given tax liens, is a fundamental reason your committee believes provision for such a status is required. However, your committee believes it is also in the interest of taxpayers, and the economy generally, not to adopt a procedure which encourages the Internal Revenue Service into a hasty procedure of filing tax liens. As a matter of practice, it has been found that the filing of a tax lien usually results in the termination of the extension of credit, and, as a result, quite often precipitates bankruptcy. As a result, in the past the Service has refrained from filing tax liens in those cases where it was thought the tax delinquents might be able to rehabilitate their credit standing and ultimately pay not only their delinquent tax liability, but their other outstanding liabilities as well. Your committee has been informed, however, that because of the Supreme Court decision in the *Speers* case the Internal Revenue Service is reconsidering its lien-filing policy and this reconsideration is likely to lead to the earlier filing of liens in many cases.

Your committee, while believing that it is not in the national interest for the law to compel the adoption of a policy of quick lien filing by the Internal Revenue Service so as to foreclose to delinquent taxpayers any appreciable chance of rehabilitation, nevertheless, recognizes that this consideration must be balanced against the undesirability of having "secret" tax liens outstanding for any appreciable period of time. Your committee has concluded that the 1-year period provided in this amendment presents a reasonable balance between these two conflicting considerations. Such a minimal period gives the Service an opportunity to test the credit standing of the tax delinquent and dispose of the delinquency in the great bulk of the cases. At the same time your committee does not believe that it is too much to expect other creditors to take into account that there may be tax assessments made within the preceding one year outstanding against a person to whom they are contemplating an extension of credit.

In any event, it should be obvious to the close observer that a provision for a 1-year secured status for tax liens will not hurt general creditors since, under the bills as referred to this committee, the same tax claims would have a priority status over these same general creditors not only for the 1 year, but also for 2 additional years. Your committee's amendments do not change this. Actually, the interests which would benefit most from denying assessed taxes this 1-year secured status are those interests which are junior to tax liens outside of bankruptcy and which do not in any way rely upon the filing of public notice. Examples of the interests which would obtain this windfall benefit are those mortgages which in some States can be perfected after the petition in bankruptcy has been filed, judgments

perfected after such a petition is filed, and various junior State tax liens assessed before the bankruptcy petition has been filed, whether perfected before or after bankruptcy. This committee does not believe that Congress intends to provide junior lienors with windfall benefits at the expense of Federal tax claims. Nonpriority general creditors would still have a junior status because the fourth category priority presently accorded all tax claims is, under these bills, continued for a 3-year period.

In addition, administrative expenses and certain wages also have higher priorities than secured tax liens where the circular priority provision—elsewhere in these bills and not changed by your committee—becomes applicable. Thus, these expenses and wages are presently payable before secured tax liens in the case of personal property not already in possession. As a result, these expenses will have a status above assessed tax claims whether or not the assessed tax claims constitute secured claims. Therefore, as in the case of the nonpriority general creditors, whose status in any event is below the assessed tax claims, the status of these administrative expenses and wage claims in any event is above these assessed tax claims.

In reality, your committee's amendment, even for this 1-year period, treats assessed taxes no better than the treatment now given unfiled mortgages and judgments in many States for even longer periods of time. Therefore, consistent with the treatment accorded these interests, for the assessed tax claim to have a secured status in the case of bankruptcy, notice of the tax lien must be filed within 1 year after the assessment or within 1 month after the bankruptcy occurs.

General explanation of amendment.—For the reasons given above it is recommended that H.R. 136 and S. 1912 be amended to provide that unrecorded tax liens will be valid against a trustee in bankruptcy for a period of 1 year after the date of assessment but only if notice of the lien is filed by the Internal Revenue Service within that year or, if later, within 1 month from the date of bankruptcy. Thereafter, as under the bills, unrecorded tax liens would not have a secured status as against the trustee in bankruptcy. H.R. 136 and S. 1912 also provide that every statutory lien which is not perfected or enforceable at the date of bankruptcy against a bona fide purchaser is to be invalid. An amendment is recommended to this provision which would provide that statutory liens for tax liabilities assessed within 1 year of bankruptcy are to be treated as filed immediately before the date of the bankruptcy (and treated as enforceable against one acquiring the rights of a bona fide purchaser as of that date). However, this treatment will be accorded only if notice of the lien is filed within the year after assessment or within 1 month after bankruptcy. Amendments to achieve similar results are also made elsewhere in the bill.

This committee's amendment also provides that compromise agreements which have been entered into under the provisions of the Internal Revenue Code (sec. 7122) or similar provisions of State law are in to be given secured status in certain cases. The tax liabilities covered by a compromise agreement are to be treated as secured claims against the trustee in bankruptcy only if notice of the compromise is publicly filed before bankruptcy in the same manner as notices of tax liens (sec. 6323). That is, notice of compromises must be filed in the same place as notices of tax liens, if that office will accept the notice of compromise. Otherwise, the notice of com-

promise is to be filed in the office of the clerk of the U.S. district court for the judicial district in which the property is located.

It is the opinion of your committee that publicly filed compromises should be given essentially the same treatment in bankruptcy as filed tax liens since they do not constitute "secret" liens. Moreover, not to give them this status would discourage the use of the compromise procedure by the Internal Revenue Service, a procedure which has proved to be highly useful to hard-pressed taxpayers.

III. PRIORITY OF TAX CLAIMS (SEC. 3 OF H.R. 3438 AND S. 976)

Present law.—The Bankruptcy Act presently provides that certain types of unsecured creditors are granted a priority status in the distribution of the bankrupt's estate. Thus, these priority claimants are paid before any distribution is made to the other general creditors but after the secured claimants have been satisfied. First priority is given to administrative expenses of the bankrupt's estate, including attorney's and trustee's fees; second priority is granted to certain prebankruptcy wages in a limited amount; third priority is given to costs of refusing a discharge; fourth priority is accorded to Federal, State, and local tax claims; and the fifth priority is granted to debts owed to persons entitled to priority under Federal law and to certain rents. Assets remaining after distributions to the priority categories specified above are distributed to the remaining creditors on a pro rata basis.

Bills' proposal.—H.R. 3438 and S. 976 would amend the priority provisions of the Bankruptcy Act so that taxes which became "legally due and owing" more than 3 years preceding bankruptcy, with certain exceptions, would no longer be entitled to priority of payment and would be paid pro rata with the claims of nonpriority general creditors. Generally, the exceptions provided to this 3-year rule relate to taxes (1) where the bankrupt failed to file a return, (2) where the bankrupt filed a false or fraudulent return, and (3) which were not reported on a return and as to which there had been no assessment pending exhaustion of administrative and judicial remedies. An additional exception is provided for withholding ("trust fund") taxes.

Reasons for the amendment.—This committee agrees with the Committee on the Judiciary that as a matter of policy there is no compelling reason which requires the granting of priority of payment to tax claims for an indefinite period. Also, the committee believes that the 3-year priority period provided in the bills represents an adequate balance of the interests of the general creditors against the claims of the Government for tax liabilities.

While there is no disagreement with the concept of a 3-year limitation of priority, the bills provide that the 3-year priority period is to commence running from the day the tax is "legally due and owing." Unfortunately the concept of "legally due and owing" has no established meaning in Federal tax law and also is not likely to be interpreted as providing a concise and consistent date which will be applicable to the many and varied taxes and factual situations which will arise. Some proponents of these bills have suggested that "legally due and owing" probably will be interpreted in all cases as the date the tax is assessed, while others believe that a new concept, other than "date of assessment," may be developed by the courts after one of these bills is passed. Therefore, such a concept might well vary in

some as-yet-undetermined manner with the type of tax involved as well as with the specific factual situation.

If the term "legally due and owing" should be interpreted as meaning the due date for the tax return, although the exceptions already provided by the bill (listed above) represent answers to many of the problems which would otherwise be presented, nevertheless, they still leave problems when the exception terminates—for example, when the administrative or judicial remedies have been exhausted. At that time under present law, a period of up to 30 days frequently must elapse before an assessment can be made. Nevertheless, if the assessment date is not the benchmark used for the beginning of the 3-year period it would appear that a bankruptcy petition could be filed before the administrative remedies have been exhausted or in any event in the 30-day period before the assessemnt can be made. As a result, the Government might never have an opportunity to file a lien on the assets involved since the effect of the exception would terminate the instant the remedies were exhausted. This committee does not believe that this is what the Congress intends.

The "date of assessment" is already a very well established tax law concept. This is both the earliest time at which the amount of the tax is definitely ascertained, and the earliest time when the Internal Revenue Service may begin collection procedures. It is most appropriate to measure the time a tax liability is outstanding from the first day it may be collected. While perhaps the courts would interpret the term "legally due and owing" as meaning the "date of assessment" a question of this importance should not be left in doubt. Accordingly, this committee believes that the term "date of assessment" should be substituted for the expression "legally due and owing."

General explanation of amendment.—For the reasons given above this committee recommends that the 3-year priority provision provided in the bills be adopted with one amendment. The amendment would substitute the "date of assessment" as the commencement date for the running of the 3-year priority of payment period, rather than the present language of the bills which refers to the time from which the tax becomes "legally due and owing." The "date of assessment" is an established concept in the Federal tax law as well as in the laws of most of the States, and since the determination of this date is a tax problem rather than a general bankruptcy question, this committee recommends that the "date of assessment," be adopted as the commencement date for the running of the 3-year priority period.

IV. DISCHARGE OF TAXES (SEC. 2 OF H.R. 3438 AND S. 976)

Present law.—Under present law when a bankrupt receives a discharge in bankruptcy, he is discharged from all provable debts, with certain limited exceptions. Among the exceptions to discharge are tax liabilities (including penalties and interest), alimony or child support, liabilities for certain willful torts, and debts which were created by fraud. The bankrupt is entitled to retain his property which is exempt from the claims of his creditors under State or Federal law. However, this exempt property is subject to unpaid Federal tax claims.

Bills' proposal.—H.R. 3438 and S. 976 would amend the Bankruptcy Act to provide that (subject to the same exceptions included in the priority of payment provision) the tax liabilities of the bankrupt which were "legally due and owing" for a period of 3 years or more prior to bankruptcy would be discharged. This discharge would be effective with respect to assessed as well as unassessed tax liabilities and to filed as well as unfiled tax liens.

Reason for amendment.—This committee agrees with the Committee on the Judiciary that present law, by denying any discharge of taxes, presents a substantial deterrent to one fundamental policy of the Bankruptcy Act—effective rehabilitation of the bankrupt. However, this committee believes that the desirability of rehabilitating a bankrupt by discharge of his taxes must be balanced against the adverse effects which would be created by a discharge provision.

A discharge provision which relieves the bankrupt of his tax liabilities could materially harm taxpayer morale in this country and thereby adversely affect the self-assessment revenue system. Of particular concern would be those cases where, shortly after bankruptcy and discharge, an individual earns large sums of income but would be under no responsibility to pay any of his remaining prebankruptcy tax liabilities. To provide such an individual with this type of tax forgiveness while most citizens are paying their fair share of our Nation's revenue needs, is in the view of this committee, both inequitable and likely to undermine the morale of our tax system. Additionally, in view of the substantial increase in voluntary bankruptcies which has been occurring in recent years, it does not seem prudent to provide potential bankrupts with the additional incentive of avoiding unpaid tax liabilities.

Therefore, this committee recommends an amendment which continues the bankrupt's previously incurred tax liabilities but substantially limits the extent to which they may be collected in any year. In this manner it is believed that the integrity of the tax system will be maintained, yet the burden on the bankrupt will be reduced so that his old tax liabilities will not be a deterrent to financial rehabilitation.

Explanation of amendment.—It is recommended that, in lieu of the provisions of H.R. 3438 and S. 976 which discharge taxes "legally due and owing" for a 3-year period preceding bankruptcy, the collection of prebankruptcy taxes provable in bankruptcy (whether or not assessed 3 years before bankruptcy) be severely limited. It should be noted that to the extent that this amendment affects tax liabilities less than 3 years old, it is a more liberal provision than that provided in the bills.

The amendment suggested by this committee provides that the Federal Government will be entitled to require the bankrupt to make an annual payment of not more than 10 percent of his taxable income less his Federal income taxes (unless the bankruptcy court believes it necessary to increase the percentage) until the prebankruptcy liabilities have been remitted. The same type of provision will apply with respect to State and local taxes, except that the annual payment to the State or local government will be limited to 5 percent of the taxable income less the Federal income tax (unless the bankruptcy court believes it necessary to increase the percentage). Also, the amendment provides a similar provision with respect to estates.

Your committee's recommended amendment leaves to State law the determination of the method by which the States and their subdivisions will actually collect the prebankruptcy taxes due them.

In those situations where more than one State or the subdivisions of more than one State are involved, each State and its subdivisions are to take a pro rata share of the 5 percent allowed to State or local governments on the basis of the relative amounts of its claims compared to the total claims of the debtor owed to all State or local governments. The allocation between a State government and its own subdivisions is to be resolved by State law. Also, any increase of the minimum percentages awarded by a bankruptcy court is to be allocated in the same manner as the allocation of the 5 percent.

This additional annual payment for Federal taxes is to be treated as if it were a new tax liability for purposes of determining interest, additions to tax, date of payment, and the collection procedures of the Internal Revenue Code. However, the provable prebankruptcy liabilities will cease to incur interest when the bankruptcy petition is filed and the liens securing such liabilities will be discharged upon termination of the bankruptcy proceedings. The same exceptions provided in the bills would continue to apply. If subsequent to the filing of his return, an individual making an additional payment has his taxable income or tax adjusted, the amount of the additional payment will also be adjusted, except that the effects of carrybacks are not to be considered.

V. PERMISSIVE WAGE EARNER PLANS (SEC. 32 OF THE BANKRUPTCY ACT)

Reasons for amendment.—Problems have arisen under the present bankruptcy laws where consumers who have accumulated large debts by the purchase of expensive luxury items on credit plans, avoid the payment of these liabilities by filing voluntary petitions in bankruptcy. Cases of this type appear to be growing rapidly. The losses attributable to these bankrupts increase the merchant's costs and tend to raise prices paid by other customers for the products they buy. The number of consumer bankruptcies is growing by ever-increasing numbers and can be slowed only by requiring these debtors to face up to their financial responsibilities. During the past year, approximately 180,000 voluntary bankruptcy petitions were filed.

General explanation of amendment.—For the reasons given above, your committee recommends an amendment to provide that during the time that a bankruptcy court is considering a voluntary petition in bankruptcy filed by an individual who is earning wages or a salary, the court, upon its own determination or upon the request of a creditor, may require the debtor to enter into a wage earner's plan under chapter XIII of the Bankruptcy Act. Under such a plan, the debtor obligates himself to pay part or all of his debts by setting aside a certain portion of his salary for this purpose. It should be emphasized that this provision relies upon the discretion of the bankruptcy courts, and it is expected that before exercising the discretion authorized by this provision the court will consider all the facts involved. A material fact, of course, would be the credit and sales practices of the creditors involved.

VI. COMMENTS ON OTHER PROVISIONS OF THE BILL

Your committee agrees with the Judiciary Committee's resolution of the circular priority problem in section 5 of H.R. 136 and S. 1912. No amendment was recommended because this committee believes the language relating to "prior indefeasible liens" refers only to liens which are prior in time to tax liens. While your committee is concerned that the circular priority provision relates only to tax liens, rather than to all statutory liens, it recognizes that the bulk of statutory liens causing a circularity problem are tax liens. If this provision is abused by the creation of numerous other statutory liens which result in discrimination against Federal tax liens, however, this provision should be reexamined.

Your committee also agrees with the amendment in the bills which, in effect, moves the provision relating to the statutory authority of bankruptcy courts to hear and determine tax disputes from the section of the Bankruptcy Act relating to the priority of unsecured tax claims to the provision of the act relating to the jurisdiction of bankruptcy courts. This committee understands that this amendment makes 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.

VII. VIEWS OF TREASURY DEPARTMENT

THE SECRETARY OF THE TREASURY,
Washington, January 25, 1966.

Hon. RUSSELL B. LONG,
Chairman, Senate Committee on Finance,
U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: I am writing concerning several bankruptcy bills, H.R. 3438 (S. 976) and H.R. 136 (S. 1912), which are pending in your committee and which, I understand, must be reported out by February 1.

As you know, the Treasury Department is deeply concerned with the effect that the adoption of these bills would have, first, on tax collection procedures and, second, on the present long-established administrative procedures for settling tax disputes.

I am writing particularly since it is not completely clear that the adverse effects of the bills on the orderly settlement of tax disputes has been adequately presented to the Congress. A few members of the tax bar did write to express their concern about this aspect of the bills in the hearings which were held by your committee on August 5, 1965. But unfortunately, the effect of these bills on the present handling of tax disputes, which effect was probably unintended, has not been widely recognized. The Treasury Department strongly feels that under these bills the great body of taxpayers will be substantially disadvantaged in the settlement of their tax disputes with the Internal Revenue Service (which will be unable to avoid taking precipitous action to prevent the loss of valuable rights in the event of taxpayers' bankruptcy). The broad damage to many taxpayers that would flow from the proposed bills cannot be, in my judgment, justified by the limited advantages which may result for a few creditors.

I understand that the staff of the Joint Committee on Internal Revenue Taxation has worked, together with some of our staff, on possible modifications of the bills, so that they provide that (1) a Federal tax lien, whether or not filed, would be valid for 1 year against a trustee in bankruptcy; (2) unsecured tax claims would not lose their present priority position against general creditors until 3 years after assessment; and (3) taxes would not be discharged in bankruptcy but their collection after bankruptcy would be limited to a percentage of aftertax earnings.

The Commissioner has informed me that a failure to allow validity to an unfiled tax lien for at least 1 year would require more frequent and hasty filings of such liens. This would unnecessarily destroy the businesses of many taxpayers who might otherwise financially rehabilitate themselves. This would be especially true of small- and medium-sized taxpayers. Moreover, unless unsecured tax claims maintain their priority position for at least 3 years after assessment, it is clear that present administrative procedures for settling tax disputes cannot be continued. Finally, it is his view that to provide for discharge rather than limited collection would invite abuses by taxpayers who could utilize bankruptcy as a means of avoiding their tax obligations.

In view of the vital importance of maintaining adequate collection of taxes, we believe that curtailment of the Government's collection powers should be carried out, if at all, only with the greatest of caution. In the interest of reaching an accommodation with respect to the concerns of other claimants in bankruptcy we would be willing to go along with the modifications suggested by the staff. However, if there is to be curtailment, I would strongly urge that it not go beyond these staff suggestions.

Because of their previous interest in these matters, I am sending copies of this letter to Senators Williams and Curtis.

Sincerely yours,

HENRY H. FOWLER.

VIII. TEXT OF AMENDMENTS RECOMMENDED BY THE COMMITTEE ON FINANCE

AMENDMENTS RECOMMENDED TO H.R. 136 AND S. 1912

On page 2, strike out lines 3 through 7 (sec. 2 of the bill) and renumber sections 3 through 6 as sections 2 through 5, respectively.

On page 3, line 23, strike out *"Provided,"* and insert the following:

> *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 having been filed immediately prior to the date of bankruptcy and such lien shall be considered as being enforceable at the date of bankruptcy against one acquiring 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: *Provided further:*

On page 6, line 8, strike out the closing quotation marks and after line 8 insert the following:

> (6) For the purposes of this Act, in any case in which a notice of a statutory lien for taxes covered by a compromise entered into under the provisions of section 7122 of the Internal Revenue Code of 1954 or similar provisions of the law of any State or subdivision thereof has been perfected but notice thereof has not been filed, or in any case in which such lien has been released, a statutory lien for such taxes, valid against the trustee in bankruptcy and a subsequent bona fide purchaser, shall be considered as having existed on the date on which notice of such compromise is filed in the office in which a notice of such lien was or would have been filed, or if such office does not accept such notices of compromise for recording, on the date on which a notice of such compromise is filed in the office of clerk of the United States district court for the judicial district in which the property subject to the lien is situated. The clerks of the United States district courts are authorized and directed to record all such notices of compromise filed with them under this paragraph.

On page 6, line 9, before "Subsection" insert "(a)".

On page 6, line 15, strike out "The" and insert "Except as against a statutory lien for taxes assessed within one year prior to the date of bankruptcy notice of which is filed within one year after the date of assessment of the taxes to which the lien relates or within one month after the date of bankruptcy, the".

On page 7, after line 12, insert the following new subsection:

> (b) Section 6323 of the Internal Revenue Code of 1954 (relating to validity of liens against mortgagees, pledgees, purchasers, and judgment creditors) is amended by adding at the end thereof the following new subsection:
>
> "(f) TRUSTEES IN BANKRUPTCY.—For purposes of applying subsection (a) with respect to a trustee in bankruptcy, in the case of any tax imposed by this title which is assessed within one year before the date of bankruptcy, if notice of the lien imposed by section 6321 with respect to such tax is filed by the Secretary or his delegate after the date of bankruptcy but within one year after the date of assessment or within one month after the date of bankruptcy, such notice shall be treated as having been filed immediately before the date of bankruptcy."

On page 7, after line 12, insert the following new section:

> SEC. 6. (a) The Bankruptcy Act is amended by inserting after section 32 (11 U.S.C. 55) a new section as follows:
>
> "SEC. 33. Mandatory Filing Under Chapter XIII.—During the pendency of a proceeding in bankruptcy, the court may, upon application of any creditor or upon its own motion, whenever it determines it to be feasible and desirable, and for the best interests of the creditors, order any voluntary bankrupt who is receiving salary or wages to file a petition under section 621 of this Act."

(b) Paragraph (3) of section 606 of the Bankruptcy Act (11 U.S.C. 1006(3)) is amended to read as follows:

"(3) 'debtor' shall mean a wage earner who filed a petition under this chapter, or any person filing a petition under this chapter pursuant to an order entered by a court under section 33 of this Act;".

Amend the title so as to read:

An Act to amend the Bankruptcy Act to clarify the status of statutory liens, and for other purposes.

AMENDMENTS RECOMMENDED TO H.R. 3438 AND S. 976

On page 2, beginning with line 7 (line 6 of S. 976) strike out all through line 10, on page 3 (section 2 of the bill) and insert the following:

SEC. 2. (a) Section 17 of such Act, as amended (11 U.S.C. 35), is amended—

(1) by striking out clause (1) of subdivision a and inserting in lieu thereof the following:

"(1) are due as a tax (including, whether provable or allowable, any interest, additional amount, addition to tax, or assessable penalty), penalty, or forfeiture to the United States or any State or subdivision thereof;" and

(2) by adding at the end thereof the following new subdivision:

"b. (1) Except as provided in paragraph (2) of this subdivision, in the case of a bankrupt who is an individual, any debt for a tax (including any interest, additional amount, addition to tax, or assessable penalty), or for any other penalty or any forfeiture arising under the tax laws of the United States or any State or subdivision thereof, which is allowable in a proceeding under this Act and which is unpaid upon the termination of such proceeding shall be collectible (A) in the case of a tax imposed by the United States, only in the amounts and in the manner prescribed in the Internal Revenue Code of 1954, and (B) in the case of a tax imposed by a State or a subdivision thereof, only in the manner prescribed by the applicable State law and only in an amount each year during the lifetime of the bankrupt not in excess of an amount equal to 5 percent of the difference between the taxable income of such individual (as determined for purposes of section 6873(b) of the Internal Revenue Code of 1954) and the tax imposed by chapters 1 and 2 of such Code for the preceding taxable year (as so determined), or not in excess of such larger amount as the court may order under this Act, and only in an amount after the death of the bankrupt not in excess of 5 percent of the difference between the taxable estate of the bankrupt (as determined under the Internal Revenue Code of 1954) and the tax imposed by chapter 11 of such Code on the estate of the bankrupt. If taxes imposed by two or more States or their subdivisions are collectible under the preceding sentence, the taxes imposed by each State and its subdivisions shall be collectible pro rata with the taxes of each other State and its subdivisions. This sub-

division 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 set apart to him under this Act, against any property abandoned by the trustee, or against any property owned by the bankrupt on the date of bankruptcy which is not administered in bankruptcy for any reason.

"(2) This subdivision b. shall not be applicable to any tax (including any interest, additional amount, addition to tax, or assessable penalty), or to any other penalty or any forfeiture arising under the tax laws of the United States or any State or subdivision thereof, (A) with respect to which the bankrupt made a false or fraudulent return with the intent to evade, (B) which the bankrupt willfully attempted in any manner to defeat or evade, (C) which was assessed in any case in which the bankrupt failed to file a return required by law, (D) which was assessed in any case to which section 6501(e) of the Internal Revenue Code of 1954 (relating to material omissions from returns), or similar provisions of the law of any State or subdivision thereof, was applicable, or (E) which the bankrupt was required to collect and withhold from others."

(b) Section 6873 of the Internal Revenue Code of 1954 (relating to unpaid claims in bankruptcy and receiverships) is amended by redesignating subsection (b) as subsection (c) and by inserting after subsection (a) the following new subsection:

"(b) INDIVIDUAL BANKRUPTS.—

"(1) LIMITATION.—If an individual is adjudicated a bankrupt in any liquidating proceeding under the Bankruptcy Act, any portion of a claim for taxes allowed in such proceeding which is unpaid after the termination of such proceeding shall be paid by the taxpayer without notice and demand in annual amounts as provided in this subsection.

"(2) AMOUNT OF ANNUAL PAYMENTS.—The amount of each annual payment which the taxpayer is required to pay under this subsection shall not exceed—

"(A) an amount equal to 10 percent of the difference between the taxpayer's taxable income (as determined under chapter 1) for the preceding taxable year, and the taxes imposed on the taxpayer under chapters 1 and 2 for such preceding taxable year, or

"(B) if larger, the amount specified by an order of the court which adjudicated the proceeding under the Bankruptcy Act.

For purposes of subparagraph (A), the taxpayer's taxable income for the preceding taxable year, and the tax imposed by chapter 1 for such year, shall be determined without regard to any loss or credit which may be carried back to such year.

"(3) TREATMENT AS NEW TAX.—For purposes of this subtitle, the amount of each annual payment required

to be paid under this subsection shall, under regulations prescribed by the Secretary or his delegate—

"(A) be treated as a tax imposed by chapter 1 with respect to the taxable income of the taxpayer for the preceding taxable year, and

"(B) be paid in such manner as the Secretary or his delegate shall prescribe by regulations.

"(4) RELEASE OF LIABILITY FOR PREBANKRUPTCY TAXES.—For purposes of this title (other than this subsection and section 2210), an individual who is adjudicated a bankrupt in any liquidating proceeding under the Bankruptcy Act shall be released from liability for payment of all taxes (including interest, additional amounts, additions to tax, and assessable penalties) imposed by this title which are allowed in such proceeding and which are unpaid after the termination of such proceeding.

"(5) EXCEPTIONS.—This subsection shall not apply—

"(A) to any amount collected from the exemption of the taxpayer allowed by law and set apart to him under the Bankruptcy Act, from any of the taxpayer's property abandoned by his trustee in bankruptcy, or from any of the taxpayer's property which was owned by him on the date of bankruptcy and which was not administered in bankruptcy for any reason;

"(B) to any tax with respect to which the taxpayer made a false or fraudulent return with the intent to evade;

"(C) to any tax which the taxpayer willfully attempted in any manner to defeat or evade;

"(D) to any tax assessed in any case in which the taxpayer failed to file a return required by law;

"(E) to any tax assessed in any case to which section 6501 (e) was applicable; and

"(F) to any tax which the taxpayer was required to collect and withhold from others."

(c)(1) Subchapter C of chapter 11 of the Internal Revenue Code of 1954 (relating to estate tax) is amended by inserting at the end thereof the following new section:

"Sec. 2210. Liability of estate for unpaid bankruptcy claims

"If the decedent was adjudicated a bankrupt in any liquidating proceeding under the Bankruptcy Act and any portion of a claim described in section 6873(b)(1) is unpaid at the date of his death, the executor of the decedent's estate shall pay to the United States an amount equal to 10 percent of the difference between the value of the taxable estate of the decedent and the amount of any tax imposed by this chapter, or to the amount of the unpaid claim, whichever is lesser, in satisfaction of such claim. For purposes of subtitle F, such amount shall be treated as an additional tax imposed by this title."

(2) The table of sections for subchapter C of chapter 11 of the Internal Revenue Code of 1954 is amended by adding at the end thereof

"Sec. 2210. Liability of estate for unpaid bankruptcy claims."

On page 3, line 14, beginning with "taxes" strike out all through "bankruptcy" in line 17 and insert the following: "taxes (including any interest, additional amount, addition to tax, or assessable penalty allowable under subdivision j of section 57 of this Act) due to the United States or to any State or subdivision thereof which are assessed on or after the date of bankruptcy, or which were assessed within three years prior to the date of bankruptcy and with respect to which no notice of a lien has been filed prior to such date;".

IX. HOUSE BILLS, WITH CHANGES RECOMMENDED BY COMMITTEE ON FINANCE

[Omit the part struck through and insert the part printed in italic]

H.R. 136

AN ACT To amend sections 1, 17a, 64a(5), 67(b), 67c, and 70c of the Bankruptcy Act, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That section 1 (11 U.S.C. 1) of the Bankruptcy Act approved July 1, 1898, as amended, is amended by inserting after paragraph 29 the following new paragraph:

"(29a) 'Statutory lien' shall mean a lien arising solely by force of statute upon specified circumstances or conditions, but shall not include any lien provided by or dependent upon an agreement to give security, whether or not such lien is also provided by or is also dependent upon statute and whether or not the agreement or lien is made fully effective by statute."

~~SEC. 2. Clause (1) of subsection a of section 17 of said Act 11 U.S.C. 35) is amended to read as follows:~~

~~"(1) are due as a tax, penalty, or forfeiture to the United States, or any State, county, district, or municipality;"~~

SEC. 3 *2*. Clause (5) of subsection a of section 64 of said Act (11 U.S.C. 104(a)) is amended to read as follows:

"(5) debts other than for taxes owing to any person, including the United States, who by the laws of the United States is entitled to priority, and rent owing to a landlord who is entitled to priority by applicable State law or who is entitled to priority by paragraph (2) of subdivision c of section 67 of this Act: *Provided, however,* That such priority for rent to a landlord shall be restricted to the rent which is legally due and owing for the actual use and occupancy of the premises affected, and which accrued within three months before the date of bankruptcy."

SEC. 4 *3*. Subsection B of section 67 of said Act (11 U.S.C. 107(b)), is amended to read as follows:

"b. The provisions of section 60 of this Act to the contrary notwithstanding and except as otherwise provided in subdivision c of this section, statutory liens in favor of employees, contractors, mechanics, or any other class of persons, and statutory liens for taxes and debts owing to the United States or to any State or any subdivision thereof, created or recognized by the laws of the United States or any State, may be valid against the trustee, even though arising or perfected while the debtor is insolvent and within four months prior to the filing of the petition initiating a proceeding under this Act by or against him."

SEC. 5 *4*. Subsection c of section 67 of said Act (11 U.S.C. 107(c)), is amended to read as follows:

"c. (1) The following liens shall be invalid against the trustee:

"(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, 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 having been filed immediately prior to the date of bankruptcy and such lien shall be considered as being enforceable at the date of bankruptcy against one acquiring 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: Provided further,* That where a statutory lien is not invalid at the date of 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.

"(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 rent secured by liens hereby invalidated or preserved shall be respectively allowable with priority and restricted as are debts therefor entitled to priority under clauses (2), (4), and (5) of subdivision a of section 64 of this Act, even though not otherwise granted priority.

"(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 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 that 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.

"(4) Where a penalty not allowable under subdivision j of section 57 is secured by a lien, the portion of the lien securing such penalty shall not be eligible for preservation under this subdivision c.

"(5) This subdivision c shall not apply to liens enforced by sale before the filing of the petition, nor to liens against property set aside to the bankrupt as exempt, nor to liens against property abandoned by the trustee or unadministered in bankruptcy for any reason and shall not apply in proceedings under section 77 of this Act, nor in proceedings under chapter X of this Act unless an order has been entered directing that bankruptcy be proceeded with.

"*(6) For the purposes of this Act, in any case in which a notice of a statutory lien for taxes covered by a compromise entered into under the provisions of section 7122 of the Internal Revenue Code of 1954 or similar provisions of the law of any State or subdivision thereof has been perfected but notice thereof has not been filed, or in any case in which such lien has been released, a statutory lien for such taxes, valid against the trustee in bankruptcy and a subsequent bona fide purchaser, shall be considered as having existed on the date on which notice of such compromise is filed in the office in which a notice of such lien was or would have been filed, or if such office does not accept such notices of compromise for recording, on the date on which a notice of such compromise is filed in the office of clerk of the United States district court for the judicial district in which the property subject to the lien is situated. The*

clerks of the United States district courts are authorized and directed to record all such notices of compromise filed with them under this paragraph."

SEC. 6 *5.* (a) Subsection c of section 70 of said Act (11 U.S.C. 110(c)) is amended to read as follows:

"c. The trustee may have the benefit of all defenses available to the bankrupt as against third persons, including statutes of limitation, 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~~ *Except as against a statutory lien for taxes assessed within one year prior to the date of bankruptcy notice of which is filed within one year after the date of assessment of the taxes to which the lien relates or within one month after the date of bankruptcy, 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."

(b) *Section 6323 of the Internal Revenue Code of 1954 (relating to validity of liens against mortgagees, pledgees, purchasers, and judgment creditors) is amended by adding at the end thereof the following new subsection:*

"(f) TRUSTEES IN BANKRUPTCY.—For purposes of applying subsection (a) with respect to a trustee in bankruptcy, in the case of any tax imposed by this title which is assessed within one year before the date of bankruptcy, if notice of the lien imposed by section 6321 with respect to such tax is filed by the Secretary or his delegate after the date of bankruptcy but within one year after the date of assessment or within one month after the date of bankruptcy, such notice shall be treated as having been filed immediately before the date of bankruptcy."

SEC. 6. (a) The Bankruptcy Act is amended by inserting after section 32 (11 U.S.C. 55) a new section as follows:

"SEC. 33. MANDATORY FILING UNDER CHAPTER XIII.—During the pendency of a proceeding in bankruptcy, the court may, upon application of any creditor or upon its own motion, whenever it determines it to be feasible and desirable, and for the best interests of the creditors, order any voluntary bankrupt who is receiving salary or wages to file a petition under section 631 of this Act."

(b) *Paragraph (3) of section 606 of the Bankruptcy Act (11 U.S.C. 1006 (3)) is amended to read as follows:*

> *"(3) 'debtor' shall mean a wage earner who filed a petition under this chapter, or any person filing a petition under this chapter pursuant to an order entered by a court under section 33 of this Act;".*

Amend the title so as to read: "An Act to amend the Bankruptcy Act to clarify the status of statutory liens, and for other purposes."

[Omit the part struck through and insert the part printed in italic]

H.R. 3438

AN ACT To amend the Bankruptcy Act with respect to limiting the priority and nondischargeability of taxes in bankruptcy

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That subdivision (a) of section 2 of the Bankruptcy Act, as amended (11 U.S.C. 11), is amended by inserting after paragraph (2) the following new paragraph:

"(2A) Hear and determine, or cause to be heard and determined, 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, and in respect to any tax, whether or not paid, when any such question has been contested and

adjudicated by a judicial or administrative tribunal of competent jurisdiction and the time for appeal or review has not expired, to authorize the receiver or the trustee to prosecute such appeal or review;".

~~SEC. 2. Clause (1) of subdivision a of section 17 of such Act, as amended (11 U.S.C. 35), is amended to read as follows:~~

~~"(1) are taxes 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: *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 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 has collected or withheld from others as required by the laws of the United States or any State or political subdivision thereof, but has 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: *And provided further,* That a discharge in bankruptcy shall not release or affect any tax lien."~~

SEC. 2. (a) Section 17 of such Act, as amended (11 U.S.C. 35), is amended—

(1) by striking out clause (1) of subdivision a and inserting in lieu thereof the following:

"(1) are due as a tax (including, whether provable or allowable, any interest, additional amount, addition to tax, or assessable penalty), penalty, or forfeiture to the United States or any State or subdivision thereof;"

and

(2) by adding at the end thereof the following new subdivision:

"b. (1) Except as provided in paragraph (2) of this subdivision, in the case of a bankrupt who is an individual, any debt for a tax (including any interest, additional amount, addition to tax, or assessable penalty), or for any other penalty or any forfeiture arising under the tax laws of the United States or any State or subdivision thereof, which is allowable in a proceeding under this Act and which is unpaid upon the termination of such proceeding shall be collectible (A) in the case of a tax imposed by the United States, only in the amounts and in the manner prescribed in the Internal Revenue Code of 1954, and (B) in the case of a tax imposed by a State or a subdivision thereof, only in the manner prescribed by the applicable State law and only in an amount each year during the lifetime of the bankrupt not in excess of an amount equal to 6 percent of the difference between the taxable income of such individual (as determined for purposes of section 6873 (b) of the Internal Revenue Code of 1954) and the tax imposed by chapters 1 and 2 of such Code for the preceding taxable year (as so determined), or not in excess of such larger amount as the court may order under this Act, and only in an amount after the death of the bankrupt not in excess of 6 percent of the difference between the taxable estate of the bankrupt (as determined under the Internal Revenue Code of 1954) and the tax imposed by chapter 11 of such Code on the estate of the bankrupt. If taxes imposed by two or more States or their subdivisions are collectible under the preceding sentence, the taxes imposed by each State and its subdivisions shall be collectible prorata with the taxes of each other State and its subdivisions. This subdivision 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 set apart to him under this Act, against any property abandoned by the trustee, or against any property owned by the bankrupt on the date of bankruptcy which is not administered in bankruptcy for any reason.

"(2) This subdivision b shall not be applicable to any tax (including any interest, additional amount, addition to tax, or assessable penalty), or to any other penalty or any forfeiture arising under the tax laws of the United States or any State or subdivision thereof, (A) with respect to which the bankrupt made a false or fraudulent return with the intent to evade, (B) which the bankrupt willfully attempted in any manner to defeat or evade, (C) which was assessed in any case in which the bankrupt failed to file a return required by law, (D) which was assessed in any case to which section 6501(e) of the Internal Revenue Code of 1954 (relating to material omissions from returns), or similar provisions

of the law of any State or subdivision thereof was applicable, or (E) which the bankrupt was required to collect and withhold from others."

(b) Section 6873 of the Internal Revenue Code of 1954 (relating to unpaid claims in bankruptcy and receiverships) is amended by redesignating subsection (b) as subsection (c) and by inserting after subsection (a) the following new subsection:

"(b) INDIVIDUAL BANKRUPTS.—

"(1) LIMITATION.—If an individual is adjudicated a bankrupt in any liquidating proceeding under the Bankruptcy Act, any portion of a claim for taxes allowed in such proceeding which is unpaid after the termination of such proceeding shall be paid by the taxpayer without notice and demand in annual amounts as provided in this subsection.

"(2) AMOUNT OF ANNUAL PAYMENTS.—The amount of each annual payment which the taxpayer is required to pay under this subsection shall not exceed—

"(A) an amount equal to 10 percent of the difference between the taxpayer's taxable income (as determined under chapter 1) for the preceding taxable year, and the taxes imposed on the taxpayer under chapters 1 and 2 for such preceding taxable year, or

"(B) if larger, the amount specified by an order of the court which adjudicated the proceeding under the Bankruptcy Act.

For purposes of subparagraph (A), the taxpayer's taxable income for the preceding taxable year, and the tax imposed by chapter 1 for such year, shall be determined without regard to any loss or credit which may be carried back to such year.

"(3) TREATMENT AS NEW TAX.—For purposes of this subtitle, the amount of each annual payment required to be paid under this subsection shall, under regulations prescribed by the Secretary or his delegate—

"(A) be treated as a tax imposed by chapter 1 with respect to the taxable income of the taxpayer for the preceding taxable year, and

"(B) be paid in such manner as the Secretary or his delegate shall prescribe by regulations.

"(4) RELEASE OF LIABILITY FOR PREBANKRUPTCY TAXES.—For purposes of this title (other than this subsection and section 2210), an individual who is adjudicated a bankrupt in any liquidating proceeding under the Bankruptcy Act shall be released from liability for payment of all taxes (including interest, additional amounts, additions to tax, and assessable penalties) imposed by this title which are allowed in such proceeding and which are unpaid after the termination of such proceeding.

"(5) EXCEPTIONS.—This subsection shall not apply—

"(A) to any amount collected from the exemption of the taxpayer allowed by law and set apart to him under the Bankruptcy Act, from any of the taxpayer's property abandoned by his trustee in bankruptcy, or from any of the taxpayer's property which was owned by him on the date of bankruptcy and which was not administered in bankruptcy for any reason;

"(B) to any tax with respect to which the taxpayer made a false or fraudulent return with the intent to evade;

"(C) to any tax which the taxpayer willfully attempted in any manner to defeat or evade;

"(D) to any tax assessed in any case in which the taxpayer failed to file a return required by law;

"(E) to any tax assessed in any case to which section 6501 (e) was applicable; and

"(F) to any tax which the taxpayer was required to collect and withhold from others."

(c) (1) Subchapter C of chapter 11 of the Internal Revenue Code of 1954 (relating to estate tax) is amended by inserting at the end thereof the following new section:

"Sec. 2210. Liability of estate for unpaid bankruptcy claims.

"If the decedent was adjudicated a bankrupt in any liquidating proceeding under the Bankruptcy Act and any portion of a claim described in section 6873(b)(1) is unpaid at the date of his death, the executor of the decedent's estate shall pay to the United States an amount equal to 10 percent of the difference between the value of the taxable estate of the decedent and the amount of any tax imposed by this chapter, or to the amount of the unpaid claim, whichever is lesser, in satisfaction of such claim. For purposes of subtitle F, such amount shall be treated as an additional tax imposed by this title."

(2) *The table of sections for subchapter C of chapter 11 of the Internal Revenue Code of 1954 is amended by adding at the end thereof*

"Sec. 2210. Liability of estate for unpaid bankruptcy claims."

SEC. 3. Clause (4) of subdivision a of section 64 of such Act, as amended (11 U.S.C. 104), is amended to read as follows:

"(4) ~~taxes which became legally due and owing by the bankrupt to the United States or to any State or any subdivision thereof which are not released by a discharge in bankruptcy~~: *taxes (including any interest, additional amount, addition to tax, or assessable penalty allowable under subdivision of section 57 of this Act) due to the United States or to any State or subdivision thereof which are assessed on or after the date of bankruptcy, or which were assessed within three years prior to the date of bankruptcy and with respect to which no notice of a lien has been filed prior to such date: Provided, however,* That no priority over general unsecured claims shall pertain to taxes not included in the foregoing priority: *And provided further,* That no order shall be made for the payment of a tax assessed against any property of the bankrupt in excess of the value of the interest of the bankrupt estate therein as determined by the court;".

SEC. 4. If any provision of this Act, or any amendment made by it, or the application thereof to any person or circumstance is held invalid, such invalidity shall not affect other provisions of this Act, or other amendments made by it, or applications thereof which can be given effect without the invalid provision or application.

SEC. 5. (a) Nothing in this Act, or in the amendments made by it, shall operate to release or extinguish any penalty, forfeiture, or liability incurred under the Bankruptcy Act before the effective date of this Act.

(b) The amendments made by this Act shall govern proceedings so far as applicable in cases pending when it takes effect.

SEC. 6. This Act shall take effect on the ninetieth day after the day of its enactment.

X. CHANGES IN EXISTING LAW

The changes in existing law made by the bills H.R. 136 and S. 1912, as reported, are shown in Senate Report No. 277 accompanying S. 1912, which is identical with H.R. 136, and the changes in existing law made by the bills H.R. 3438 and S. 976, as reported, are shown in Senate Report No. 114 accompanying S. 976, which is identical with H.R. 3438.

XI. MINORITY VIEWS

I. *Validation of the secret tax lien.*—The purpose of one of the amendments proposed by the majority in its report is that unrecorded tax liens be given a secured status and that they prevail over the trustee in bankruptcy for a period of 1 year after "date of tax assessment." This proposal would turn the bill (H.R. 136) against its sponsors and pervert its purpose. It would contradict the holding of the Supreme Court in *United States* v. *Speers*, decided December 13, 1965. In the *Speers* case the Court laid down a uniform rule holding that a secret lien such as the tax collector had could not be put above the trustee, this amendment would completely reverse the Court's holding.

This proposal, adopted by the majority of the Senate Finance Committee, would treat the Government unlike other creditors, and, contrary to the general policy against secret liens, would give the Government the advantage of a lien which it has not recorded as of the date of bankruptcy.

But the amendment proposed by the committee, perhaps inadvertently, does more than give preferred status for secret liens for 12 months. By allowing the 1-year period the Government will file liens just before the year runs out and the trustee will never have the priority that the Court gave him over the tax collector. Furthermore,

the 1-year rule would not limit the tax collector to one years taxes. The tax that might be assessed within that 1 year may cover taxes for 1, 2, 3, 5, or more years.

Treasury has contended that they need 1 year to weed out what they call delinquent taxpayers as distinguished from those who are potential bankrupts. The same logic could also be properly applied to general creditors but the Bankruptcy Act denies it.

The Court said that some experience from the operation of the rule announced by the Court in the *Speers* case might be useful, saying that:

> Should experience indicate that inclusion of the Treasury within section 6323 is advisable the fact will not be lost upon the Congress.

Perhaps experience is advisable but now we find the committee at the urging of Treasury attempting to reverse that rule with only 60 days having elapsed since the rule was announced by the Court. How much experience could be gained in 60 days?

It seems necessary to remind the majority of the fundamentals which have been part of the Bankruptcy Act for more than 50 years. First, the filing of a petition in bankruptcy brings all of the property of the bankrupt, wherever located, into the custody of the court, and no creditor can thereafter obtain any lien against the property by judgment, levy, or other process. The trustee in bankruptcy represents all creditors. His title relates back to the date of the filing of the petition in bankruptcy. In order to save the bankrupt estate the trouble and expense of requiring the trustee to obtain judgment, execution and a return unsatisfied, Congress, in 1910, invested the trustee with all the rights, remedies, and powers of a creditor holding a lien by judicial proceedings as to all property coming into the custody of the bankruptcy court by virtue of the filing of a petition.

The trustee was accorded by the same congressional enactment the status of a creditor who had exhausted his remedy at law by obtaining a judgment and execution return unsatisfied. This statute, familiarly known as the strong-arm clause of the Bankruptcy Act, has worked well and was reenacted by the Chandler Act in 1938 after a thorough reexamination of the Bankruptcy Act.

If the proposed amendment, which will discriminate against the trustee in bankruptcy, is enacted we shall then have the anomaly where a judgment creditor may obtain a lien effective as against a competing, unfiled Federal tax lien, no matter how old if only the judgment lien precedes bankruptcy, but the trustee who is a representative of all the creditors and endowed by Congress with the attributes of a judgment lienor is to be denied that status as to the Federal tax lien unless the tax lien has been a secret lien for more than twelve months.

It is indefensible as a matter of sound public policy to withhold from the trustee in bankruptcy any of the protections than non-bankruptcy law affords judgment creditors. The general creditors deserve and are entitled to at least as much and as prompt protection against secret tax liens as any other variety of secret liens. If Congress should approve a secret lien for a year following tax assessment, more damage would be done to bankruptcy administration and to the interests of unsecured creditors generally than would be gained by enactment of the other provisions of H.R. 136. It would be regret-

table if the effort to rationalize the treatment of statutory liens in bankruptcy goes aground because the bill does not relieve the Treasury Department of a burden to record its tax liens which Congress placed upon it over 50 years ago.

II. *Amortization of tax indebtedness.*—Another amendment recommended by the majority of the Senate Finance Committee consists of a quasi-discharge approach in H.R. 3438. This proposal would authorize the Internal Revenue Service to require the bankrupt to make an annual payment of 10 percent of its taxable income, less his Federal income taxes after bankruptcy, until such time as the outstanding tax claim was fully remitted. Furthermore the amendment would allow 5 percent to be taken for State and local taxes. Taken together such percentages could result in even moderate income earners paying nearly 50 percent of their income in taxes. In addition, the proposal would authorize the bankruptcy court to require annual payments in excess of 10 percent should it believe it appropriate. Of course, this proposal represents some concession to humanitarianism in tax collection policy. However, it restricts and complicates administration of the relief it is designed to afford so much that it cannot be regarded worthy of serious consideration. A primary purpose of this bill, by limiting the nondischargeability of taxes, is to provide a means for the effective rehabilitation of the bankrupt. This purpose would be seriously frustrated by the acceptance of the proposed amendment. The contention by the Treasury Department that this bill would compel the Government to refuse leniency to hardpressed taxpayers and even force taxpayers into bankruptcy who otherwise might have had a chance to rehabilitate themselves, is unpersuasive.

It may also be argued that the present unlimited tax priority often puts pressure on general creditors to guarantee credit and precipitate bankruptcy in order to stop the accumulation of tax claims which otherwise may exhaust all of the debtor's assets. H.R. 3438 recognizes the principle that trade creditors and taxing authorities would both benefit more in the long run if they work together rather than in competition for the assets of the estate.

III. *The compulsory chapter XIII provision.*—The tacking on to S. 1912 of Senator Gore's proposal to authorize compulsory transfer of a voluntary bankruptcy to chapter XIII seems well calculated to break the back of whatever measure gets saddled with it. It is not germane to either proposal and is controversial in the extreme. It does not indicate what sanctions are to be imposed on the recalcitrant bankrupt. We surmise that if enacted in its present form, voluntary bankrupts will choose to come in as involuntary bankrupts by committing the sixth act of bankruptcy. In any event, the merits of Senator Gore's proposal deserve to be explored disentangled from the perplexities of S. 1912.

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