In the

Supreme Court of the United States

CRAIG PHELPS, receiver in Bankruptcy,

Petitioner,

v.

UNITED STATES OF AMERICA,

Respondent.

No. 74-121

Washington, D. C.
April 16, 1975

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v.	:	No. 74-121
UNITED STATES OF AMERICA, Respondent.	:	

Washington, D. C.

Wednesday, April 16, 1975

The above-entitled matter came on for argument at 2:11 p.m.

BEFORE:

WARREN E. BURGER, Chief Justice of the United States
WILLIAM J. BRENNAN, JR., Associate Justice
POTTER STEWART, Associate Justice
BYRON R. WHITE, Associate Justice
THURGOOD MARSHALL, Associate Justice
HARRY A. BLACKMUN, Associate Justice
LEWIS F. POWELL, JR., Associate Justice
WILLIAM H. REHNQUIST, Associate Justice

APPEARANCES:

DENNIS E. QUAID, Esq., Suite 865, One North LaSalle Street, Chicago, Illinois 60602, for the petitioner.

KEITH A. JONES, Esq., Assistant to the Solicitor General, Department of Justice, Washington, D. C. 20530, for the respondent.

C O N T E N T S

P R O C E E D I N G S

MR. CHIEF JUSTICE BURGER: We will hear argument next in No. 74-121, Phelps against United States.

Mr. Quaid, I think you may now proceed whenever you are ready.

ORAL ARGUMENT OF DENNIS E. QUAID ON BEHALF OF THE PETITIONER

MR. QUAID: Mr. Chief Justice, and may it please the Court: This case comes before the Court to review the judgment of the United States Court of Appeals for the Seventh Circuit reversing the district court's order affirming the bankruptcy court's finding that it had summary jurisdiction over the controversy before it and adjudicating that controversy in favor of the receiver in bankruptcy over the United States and its claim to a tax lien.

The case arose in the year 1971 when the Internal Revenue Service made four assessments of taxes against Chicagoland Ideal Cleaners Company, the first in March and the last in June of 1971. Thereafter the directors of the taxpayer made a general assignment for the benefit of creditors on June 28 of 1971. Two months later the Internal Revenue Service filed, or recorded, its Notice of Tax Lien with the Recorder of Deeds for Cook County, and on the same day served a notice of tax levy upon the assignee for the benefit of creditors. Sometime thereafter an involuntary petition for

bankruptcy was filed against Chicagoland Ideel Cleaners, the company was adjudicated, a receiver appointed, and the petition which initiated this proceeding filed.

The petitioner feels that the essential question presented in this case is the one of jurisdiction, the summary jurisdiction of the bankruptcy court to proceed to the merits of the controversy before it.

We feel that there are three independent and alternative bases of summary jurisdiction for the bankruptcy court in this case. The first is section 2a(21) of the Bankruptcy Act, and the second is section 70a(8) also of the Bankruptcy Act. Although slightly different, we believe that they stand for the same principle, that the bankruptcy court enjoys and can exercise summary jurisdiction over an assignee for the benefit of creditors and properly in his hands the bankruptcy court, being of course a court which proceeds in rem, we believe that having summary jurisdiction over the assignee and the property in the possession of the assignee, the bankruptcy court can go on to adjudicate property rights and interests in the property which it has gained summary jurisdiction over.

QUESTION: The property we are talking about is money in a bank account?

MR. QUAID: Well, the property initially started out as tangible property, being the fixtures and equipment of the bankrupt, the Chicagoland Ideel Cleaners. The assignee

liquidated by sale, pursuant to a power of sale contained within the assignment, that equipment and fixtures, he reduced it to cash. And when the levy was served it was cash, but before then, and during the time when the assessments existed, it did consist of tangible personal property and was capable of physical seizure at that time.

QUESTION: It does make some difference, doesn't it, as to whether the property is a pure intangible or whether, as you say, it's personal property subject to reduction to possession or seizure?

MR. QUAID: Well, the courts have recognized a difference, whether it's tangible or intangible property, personal property. And we feel that if the Government had acted to assert its rights more promptly when it was tangible personal property, this would have been an entirely different case.

However, notwithstanding that fact, even when it was intangible property, we feel that the Government really never acted promptly to perfect its rights and reduce what there was to its possession. Even if it's intangible property, cash in a bank account, they still can compel the turnover of that money to them if they went forward with their rights.

QUESTION: Can they actually not merely levy on a bank account but force the bank to turn over the money to them physically in the face of an adverse claim by the person

who says, "I don't owe the Government"?

MR. QUAID: Well, I believe the Government is making that claim in this case that once they serve their levy, they seem to feel that they have ownership, not only possession, but actually ownership of these funds and the power to require anyone to turn it over to them under pain of penalty.

QUESTION: It's perfectly clear that once it's served, the bank is not supposed to let it out of its possession or to pay the money to anybody else, as a matter of Federal law, isn't it?

MR. QUAID: True. Yes.

QUESTION: So it's effectively sterilized.

MR. QUAID: Well, it's frozen until there is a determination, if there is any contest of ownership or rights in the property.

QUESTION: That is, upon the service of the Notice of Levy.

MR. QUAID: Yes, sir.

QUESTION: In that respect it's something like a jeopardy assessment in a tax case, isn't it?

MR. QUAID: Well, I think it performs a different function, although it does ask to preserve whatever rights the Government would have in it and protect those rights.

QUESTION: It preserves not only the right, but it preserves the resource to satisfy the claim --

MR. QUAID: Well, that's correct.

QUESTION: -- which is the function of the jeopardy assessment, in part at least, isn't it?

MR. QUAID: Yes, it is.

QUESTION: Aren't we really talking about the place where the merits of the controversy should be determined, whether by the referee on the one hand or a plenary proceeding in court on the other? Isn't this the argument?

MR. QUAID: Yes. The question is one of jurisdiction, who should decide it, the referee or another court, the district court, in a plenary proceeding, although the merits of the controversy in a question of the summary jurisdiction of a bankruptcy court, at least in part, enter into, the merits enter into the determination of the summary jurisdiction, as I think is adequately revealed in the briefs on the part of both parties.

But what we are dealing with is a case where you have an assignee for the benefit of creditors who is holding the funds. The Bankruptcy Act makes special provision and special rights of the bankruptcy representatives to that assignee. In section 2a(21), summary jurisdiction, or at least jurisdiction, is given over that representative which this Court has held to be summary in nature in order to provide a prompt and expeditious remedy for the bankruptcy trustee to reach whatever property or assets are in the hand of the

assignee. And also section 70a goes on to give summary jurisdiction by creating a theory or a fiction that the assignee is a mere agent or bailee for the purpose of the exercise of summary jurisdiction to enable the bankruptcy representative to reach the property.

The third basis, and the one which is the heart of this case, is whether there is constructive possession by the bankruptcy court supporting its summary jurisdiction. And again we have to go back to the special relationship which has been created in the Bankruptcy Act which gives the bankruptcy representative these powers to compel a turnover on the part of an assignee for the benefit of creditors of whatever property or assets he has in his hand to reduce the delay and the cost of the bankruptcy proceedings and to simplify and ease their administration for the benefit of all creditors.

Now, the United States claims that they obtained constructive possession due to the service of their Notice of Levy upon the assignee for the benefit of creditors. I would contend that constructive possession in this case, due to the nature of the relationship provided by the Bankruptcy Act over the assignee went to the bankruptcy court upon the filing of the bankruptcy petition, and that the Government would have to show its actual possession of the funds in question or the property before the liquidation in order to defeat this one basis of the court's summary jurisdiction. The levy does not

give to the United States actual possession of the funds. There are some cases saying that it's a seizure of a property interest. The case of the United States v. Eiland says that it was in a transfer of ownership of the asset. In that case it was a pure debt, it shows an action, and there is no tangible property involved.

But in this case we feel that these cases are not well founded and that the case in fact cited in the Government's brief of In Re Brewster-Raymond Corporation correctly sets forth the better rule that the service of the levy, even upon what the Government claims was their Federal tax lien, perfects the property interest of the Government in the property.

QUESTION: What if you had in the possession of the assignee for the benefit of creditors while he was conducting a mercantile operation property on consignment from a third party which under State law, the third party's right would prevail over the assignee. Now, would you say that the bankruptcy court would have summary jurisdiction to adjudicate title to that kind of property?

MR. QUAID: I would say that it would, but that is a different situation because here what we have is a tax lien which under section 67 is postponed to the costs of administration and priority wage claims. In the situation that you suggest, you have a different situation where there is no postponement provision, no subordination of the lien

to any of the priorities of section 64 of the Bankruptcy Act.

QUESTION: Any property that's physically in the possession of the assignee, even though he doesn't assert any ownership claim to it, becomes subject to the summary jurisdiction of the bankruptcy court?

MR. QUAID: I would believe so, yes.

QUESTION: That is property of the bankrupt, formerly of the bankrupt --

MR. QUAID: Yes.

QUESTION: -- assigned to the assignee.

MR. QUAID: Of course, on a consignment situation, you would not have a question of a lien, but you would have a question of title residing in the consignor.

QUESTION: Generally that would be the property of the bankrupt still, would it not, if he were only a consignor, rather than assignee?

MR. QUAID: Well, I would say that --

QUESTION: Assignor, I mean. If he were a consignor rather than assignor, he would still have the property, wouldn't he?

MR. QUAID: I don't believe he would have title to the property, he would only have the right to sell it subject to the authority of the consignor. The consignee would not have title to it.

QUESTION: No. The consignor would.

MR. QUAID: Yes.

QUESTION: Right.

QUESTION: Then, you read section 70a of the Act, at subsection (8), which appears on page 5a of your brief where it says "property held by an assignee for the benefit of creditors," you read "assignee for the benefit of creditors" very broadly as not modifying property at all, so that any property held by an assignee for the benefit of creditors regardless of whom the property belongs to becomes subject to the summary jurisdiction of the bankruptcy court?

MR. QUAID: I believe that it would become subject to the summary jurisdiction of the bankruptcy court, but I think that in that case the rights of the third party would probably prevail and be superior to that of the bankruptcy representative.

QUESTION: But that would be decided by the bankruptcy court.

MR. QUAID: Yes.

QUESTION: Well, supposing I am the assignee for the benefit of creditors of Joe Doakes who becomes a bankrupt and I have a chair in my house that never belonged to Joe Doakes, it's nonetheless held by me. Is that subject to the summary jurisdiction of the bankruptcy court?

MR. QUAID: I think the question is who is the proper party, or proper court to decide these questions.

And I think that if the bankruptcy representative, the claim of any party to title or lien to property, either in the possession of assignee for the benefit of creditors of someone who is now bankrupt, if that had to be a plenary proceeding on every such claim, then a very heavy burden would be cast upon the administration of bankruptcy estates.

QUESTION: So possession by the assignee confers the same sort of summary jurisdiction in the bankruptcy court as possession by the bankrupt does?

MR. QUAID: It's a different situation because the Bankruptcy Act creates special provision for the assignee for the benefit of creditors. But if we become involved with the tax lien and the levy at this point where the levy upon the property in the hands of the bankrupt would give to the United States greater rights than it does upon,a levy upon the assignee for the benefit of creditors.

QUESTION: The United States claims that once it serves its levy, the assignee isn't holding it any longer for the general benefit of creditors.

MR. QUAID: Well, they claim that and that is the point that we dispute.

QUESTION: I suppose you would concede that if the assignee for the benefit of creditors took possession of a piece of property that had been mortgaged by the bankrupt to his creditor in which the bankrupt claims some equity and the

mortgagee then repossessed the property, took it from the assignee for the benefit of creditors and held it under a claim of right under his right to foreclose, that the bankruptcy court would have no summary jurisdiction over that property and over the claim of the secured creditor.

MR. QUAID: In that case the property would be in the actual possession of the mortgagee.

QUESTION: I know, but it was, had been and was in the possession of the assignee.

MR. QUAID: Yes, but it no longer is.

QUESTION: And the United States claims that the lien, the levy achieves that very same purpose.

MR. QUAID: Well, that is the point that we contest.

QUESTION: That's the issue.

MR. QUAID: Yes, it is.

We feel that the levy does not transfer ownership to the Government, but it merely perfects their right, their property interest in the property now in the hands of the assignee for the benefit of creditors.

As I mentioned in the case In Re Brewster-Raymond where there is a tax lien upon the bankrupt prior to bankruptcy and a levy upon a debtor of the bankrupt, the court held that the property was still subject to the administration of the bankruptcy court and the bankruptcy estate. We feel that this is the better decision in that it gives effect to

bringing together the decision-making powers in the bankruptcy court who is the court that is going to administer the assets of the bankrupt in these proceedings and a court who is familiar with these problems and will also serve to protect the costs of administration and the priority wage claim that Congress is seeking to protect.

Now, the Government is claiming in this case a alid tax lien upon the property or rights to property of Chicagoland Ideel Cleaners. We do not believe that they did have a valid tax lien since the lien attaches to property or a right to property belonging to the taxpayer with the assignment by Chicagoland Ideel Cleaners to the assignee for the benefit of creditors. There was a trust created for the benefit of all creditors. The assignor no longer had any property interest in the property and that there was a transformation of the assets of the property at that time which deprived the tax lien of any property or right to property belonging to the taxpayer upon which it could attach. We believe that this principle has been recognized in the case of United States v. Bess where they held that a tax lien existing upon a taxpayer did not attach to the proceeds of his life insurance policy after his death, did not attach to the full face value of that policy but rather only to the cash surrender value, which was a fund which was being accumulated and held to him and which he could have reached.

In this case, after the assignment, the only interest remaining in Chicagoland Ideel Cleaners was the possibility that there be an excess in the value of the property which he had assigned over his total indebtedness. And in this case where the Government's tax lien is in the sum of $141,000 and is only one claim against the estate and the proceeds of the sale of the bankrupt property amounted to just over $31,000, there was obviously no reverter interest which could have come back to the taxpayer, the assignor, Chicagoland Ideel Cleaners.

QUESTION: Let me see if I understand you then. It's your position that this subordinates the tax collector to the general creditors.

MR. QUAID: It subordinates him to the costs of the bankruptcy administration and priority wage claims.

QUESTION: But not other creditors.

MR. QUAID: No, not other creditors. It could not have that effect because that would be tax levy to the priorities established in the Bankruptcy Act in section 64.

QUESTION: I wanted to get that straight because, as I understood your argument, I thought you went farther than that.

MR. QUAID: No. The United States will be protected in this proceeding since even if they had no lien, they would have a fourth priority preference under section 64 of the

Bankruptcy Act to payment. The priorities ahead of them are costs of administration, priority wage claims, and certain costs of creditors in defeating plans of arrangement and wage-earner plans. And as far as the third priority is concerned, there are no such claims. So the United States will, except to the extent that they are subject to costs of administration and priority wage claims, both of which exist, they will not be subordinated to the claims of general unsecured creditors or put into the same category as those creditors.

QUESTION: Even if the referee were to decide against them as to the perfection of their lien.

MR. QUAID: Yes. They still enjoy the priority under section 64 whether they have a lien or not. Of course, if they do have a lien, then if they are subordinated under section 67, they end up in the same priority slot.

Turning to section 67, Congress has expressed its concern over the fact that tax claims are eating up and diminishing the assets of bankruptcy estates at the current time and for the last several years. Consequently they have established a provision subordinating tax liens, although no other liens, to the first two priorities of section 64, being costs of administration and priority wage claims. This Court has held that when the tax lien, in the words of the statute, is not accompanied by possession, that that possession is being defined as actual possession. In the case of Goggin v.

Division of Labor Law Enforcement of California, they stated that the purpose of this provision was to give a public warning to all parties whose rights may be affected by the tax lien which is unknown to third parties and is characterized as a secret lien, that if the United States takes actual and physical possession of the assets, third parties, and in particular general unsecured creditors who may extend further credit to such a company will be warned or forewarned and can take measures to protect themselves and salvage what they can from the relationship.

However, the United States did not do this. They served the Notice of Levy and took no further steps. Instead they waited after the assignment for the assignee to perform the liquidation of the tangible equipment and fixtures which were in the hands of the assignee. Therefore, we feel that the assets -- I'm sorry, that the tax lien is subordinated and postponed to the first two priorities, being costs of administration and priority wage claims.

We feel that this Court should be guided by the policy of the Bankruptcy Act or the policy expressed by Congress in the Bankruptcy Act that tax claims should be subordinated and that there should be something else for other parties in the bankruptcy administration, or bankruptcy estate, at least to provide the bare minimum, being the costs of administration and the priority wage claims earned by

wage earners within three months preceding the initiation of the bankruptcy.

We feel that the Bankruptcy Act is the one statute which deals with all these problems, not only with the administration of an insolvent corporation's assets, but also with the treatment of the tax liens or other claims for taxes of the Internal Revenue Service.

We also feel that this is not an action to restrain the collection of taxes since we are dealing here with the Government's lien and levy, not taxes, and that the Government's claim that this is not appropriate for a summary proceeding is not applicable since the case of New Hampshire Fire Insurance Company v. Scanlon recognized as an expressed statutory exception to that rule the summary jurisdiction of the bankruptcy court.

After the argument of counsel for the United States I will have a short time for rebuttal.

MR. CHIEF JUSTICE BURGER: Very well.

Mr. Jones.

ORAL ARGUMENT OF KEITH A. JONES ON BEHALF OF RESPONDENT

MR. JONES: Mr. Chief Justice, and may it please the Court: The United States did not oppose the grant of certiorari in this case, but it was hoped that the case would serve as a suitable vehicle for the resolution of a question of substantial importance to the Federal Government's powers of

internal revenue collection.

That question is whether the Government's interest in tangible property that is levied upon -- and tangible property such as bank accounts -- is terminated or impaired by the taxpayer's subsequent bankruptcy.

Unfortunately for purposes of clarity and exposition, that is not the only question that has been raised in this case. Petitioner has raised at least two major subsidiary issues that do not relate to the Government's general power to levy or its power to rely upon the effectiveness of its tax levies, but rather relate only to the factual peculiarities of this particular case.

Since this is so, I would like at the outset of my arguments to focus the Court's attention on what we feel to be the more important issue in this case, that is, the question of the Government's right to rely upon its tax levies, notwithstanding the taxpayer's subsequent bankruptcy. And I will at the end of my argument address the subsidiary questions that petitioner has additionally raised.

I think that the case can be initially understood more clearly if it is taken in the form of a hypothetical example that is somewhat less complicated than the actual facts of this case. I would posit as that example a common situation where the Government levies upon a bank at which the taxpayer has a bank account in order to seize the account of the

taxpayer.

Under the Internal Revenue Code and the accompanying regulations, as our brief discusses at some length, the service of such a Notice of Levy upon the bank imposes upon the bank an affirmative duty that is enforceable by personal liability to turn over the entire amount of the account to the United States. And there is no doubt that this form of levy is generally effective for internal revenue purposes. I say there is no doubt about it because this method of seizing intangible property, the method of serving a notice to the person who holds the intangible rights, has been used by the Government and approved by this Court at least since the Civil War, and I would refer the Court to the cases of Miller v. United States at 11 Wallace 268 which we did not cite in our brief but is cited by the Court of Appeals, and also to the more recent case of Sims v. United States at 359 U.S. 108.

As to this much of the case, I take it that there is no dispute between the parties. The petitioner does not contend that as a general matter such a levy would be invalid. Where we part company with the petitioner is over the consequence to be derived from the taxpayer's subsequent bankruptcy after the levy. In our view, in the hypothetical example I am using, the bank's duty to pay over the monies to the Federal Government is not affected by the intervention of the subsequent bankruptcy proceeding. Such proceeding should not terminate or impair in

any way the Government's rights to reduce that account to its actual possession and those rights should not be subject -- the rights and obligations established by the levy should not be affected by the subsequent bankruptcy proceeding.

Now, in taking this position we do not rely upon any special preference for the Government or upon any special exigencies in favor of Federal tax collection, although of course we feel that that should be taken into account. But our reliance here is upon a long-established and sound rule of bankruptcy practice that this Court has applied on many occasions in the past. That rule is that a bankruptcy court lacks summary jurisdiction over property held by a third party as custodian, agent, or bailee for a third person who is an adverse party to the bankrupt. The property so held is not subject to administration in bankruptcy unless the adverse claimant so consents to that administration.

Now, compilation of --

QUESTION: Unless the property is taken away from him in a plenary suit.

MR. JONES: That's right.

QUESTION: What you mean is it's not subject to a summary proceeding.

MR. JONES: In a summary proceeding property would be turned over without regard to the validity of the adverse claimant's claim, and then he would have to rely upon his

rights as a creditor in the bankruptcy proceeding.

QUESTION: He can file a petition for reclamation, can't he?

MR. JONES: I suppose so. I am advised by co-counsel that he could. But in a plenary proceeding the question turns exclusively upon the rights of the adverse claimant. If he has rights in the property, then it belongs to him and isn't subject to administration in bankruptcy at all. So that the distinction between a summary proceeding and a plenary proceeding is not merely a matter of the elaborateness of the procedures, but it affects the substantive rights as well.

QUESTION: I didn't quite get that last, Mr. Jones. Why do you say it affects the substantive rights as well?

MR.JONES: Well, in this case, for example, in a plenary proceeding, the only issue before the court would be whether the Government's levy was valid and whether the taxpayer owed a tax. If so, then the monies would be paid over to the Government in full.

In a summary proceeding, I take it that petitioner's position is that the question is whether those properties had been the properties of the taxpayer. If so, they are turned over to the bankruptcy court, and then the United States only has an interest as a creditor in whatever is left after the payment of expenses in bankruptcy.

QUESTION: That's the consequence of once going into

the jurisdiction of the bankruptcy court for any kind of property.

MR. JONES: That's right.

Well, as I say, the general rule upon which we rely here is that property held by a third person on behalf of an adverse claimant is not subject to the summary jurisdiction of the bankruptcy court. And a compilation of the cases applying this rule is set forth at Volume 2, paragraph 23.06(1) of Collier's treatise on bankruptcy, and I stress that paragraph because, although we adverted to a number of related paragraphs in Collier's we did not include that one in our brief. I will repeat, it's paragraph 23.06(1).

I will discuss just two of those cases here for purposes of example. In Taubel v. Fox, 264 U.S. 426, a sheriff had pursuant to a judgment levy seized the property of a debtor, and while the sheriff was still holding the property the debtor was adjudicated a bankrupt, and the bankruptcy court sought to require the sheriff to pay over the property to the receiver in bankruptcy. This Court concluded that since the property was being held by the sheriff on behalf of an adverse claim, that is, the judgment creditor, it was not subject to summary turnover. Instead, the sheriff was free to release the property to the judgment creditor.

In this connection, I would like to refer to page 23 of our brief, footnote 10, where we misdescribe

Taubel v. Fox to our own disadvantage. We stated in that footnote that in that case, Taubel v. Fox, this Court merely held that property, and so forth, and we should have said this Court merely stated that property in the hands of a non-adverse third person, who was not holding it as agent for any adverse claimant, was subject to turnover. In fact, the Court in Taubel went on to hold, since the sheriff in that case was holding for an adverse claimant, then the property was not subject to summary turnover.

The other case of this Court that I would mention was First National Bank v. Title and Trust Company at 198 U.S. 280, and in that case the third party in possession was a warehouseman who was holding the property for a third person who was an adverse claimant to the bankrupt to whom the bankrupt had assigned the warehouse receipt. Once again the Court held that the property in the warehouseman's hands was not subject to summary turnover.

We believe that this general rule enunciated and applied in cases governs this case as well. Property held for the United States pursuant to a levy, like property held by other third persons for other adverse claimants is beyond the reach of the bankruptcy court's summary turnover orders. In the hypothetical example I have propounded, a bank upon which the Government has served a valid notice of levy holds the taxpayer's account for the Government as the Government's

agent. The Government, as an adverse claimant, is entitled to receive the monies in that account. The monies in the account, like the property seized by the sheriff in Taubel v. Fox, should be payable to the Government as an adverse claimant and not to the receiver in bankruptcy for distribution in accordance with the priority rules of bankruptcy.

QUESTION: How about the provision in subsection (8) of section 70a of the Act that equates the possession of the assignor to the possession of the bankrupt. You don't have that in your hypothetical example.

MR. JONES: That's true. That's why I used the hypothetical because I wanted the Court's attention first to be focused upon the general case of the Government's levy, and I intended at a later point to address the special considerations that arise when the person upon whom the levy has been served is a general assignee, and I hope to get to that point in a moment.

Now, the petitioner here, as we understand it, does not challenge the general rule upon which we rely, it does not challenge the rule that a third person in custody for an adverse claimant is not subject to summary turnover. His argument on this aspect of the case is simply that taxing authorities, unlike all other similarly situated adverse claimants, are unable to avail themselves of the benefits of this general rule. He bases this argument exclusively upon

section 67c(3) of the Bankruptcy Act.

But as we read that statute, it has absolutely nothing to do with the issue in this case. The petitioner's argument has confused the question of inclusion of property into the bankrupt estate with that of distributing property out of the bankrupt estate. This case is one of inclusion, that is, the issue is whether the property that has been levied upon is to be included in the bankrupt estate by virtue of the bankruptcy court's summary turnover orders. Section 67c(3) does not address that question at all. It is addressed to the separate, distinct question of distribution of what priorities various claimants have to the property that is being distributed out of the estate. Nothing in section 67c(3) was intended to treat the Government any less favorably than other adverse claimants in constructive possession. As we have seen, such claimants are entitled to reduce their property to actual possession without any interference from the bankruptcy court.

Well, these are the basic legal considerations as to the general issue which we feel is involved here. I think I should also call this Court's attention, however, to certain practical considerations. It is of great importance that the United States in its capacity as a collector of taxes be able to rely upon its notice of levy. If the Internal Revenue Service cannot so rely, then it will be forced to resort to more summary collection procedures or to enforce more immediate

compliance with its notices of levy. And this would entail the use of hasty collection devices that inevitably would cause disruption, would be burdensome and annoying to taxpayers and to third parties with whom they deal. We see no social objective that would be achieved by forcing the Government to scramble in this way for actual possession, although the legitimate concerns of bankruptcy administration and internal revenue collection can be served by giving to the United States the same rights as are presently held by all other similarly situated adverse claimants.

In short, both for practical reasons of internal revenue collection and as a matter of established bankruptcy procedure, the Government's levy should be honored whether or not the taxpayer subsequently becomes bankrupt. The United States is entitled to rely upon its valid prebankruptcy levy as placing the property levied upon beyond the reach of the bankruptcy court.

Now, this completes my presentation of the Government's position on what we believe to be the central issue in this case, the issue that the Court presumably took the case to decide, that, as is evident, there are other subsidiary issues in this case. I now turn to the consideration of those issues.

As Mr. Justice Rehnquist has noted, the petitioner contends that this case is governed by a special rule in favor of general assignees. He contends that regardless of the

effect that a notice of levy might have in other circumstances, that property held by a general assignee must be turned over to the receiver in bankruptcy whether or not there has been a levy, and he relies both upon section 70a(8) of the Bankruptcy Act and also upon section 2a(21) of that Act.

But although those provisions do state that the bankruptcy court has jurisdiction to require assignees for the benefit of creditors to deliver the property in their possession to the receiver in bankruptcy, they have never been construed as granting the bankruptcy court summary power to reach property held by the assignee in a manner adverse to the bankrupt and to the general creditors. The bankruptcy court's summary jurisdiction under those provisions extends only to the property that the assignee was holding for the exclusive benefit of general creditors at the time of bankruptcy.

For example, in Galbraith v. Velelli at 256 U.S. 46, this Court was presented with the contention by a receiver in bankruptcy that property held by an assignee adversely to the bankrupt was subject to summary turnover. In that case, the assignee had incurred certain expenses of administration prior to bankruptcy, and he claimed that he was entitled to take the property, or take the property in the value of the amount of his expenses, and hold those for himself as an adverse claimant. And this Court upheld the assignee's contention. The Court held that as to property with respect to which the assignee had

himself an adverse claim, that property was not subject to turnover to the receiver in bankruptcy, that it was outside the bankruptcy court's summary jurisdiction.

QUESTION: That wasn't modified by the Chandler Act amendments?

MR. JONES: Section 2a(21) was enacted after the decision in Galbraith v. Valelli, but it was generally considered as being merely a codification of prior law and Collier in his treatise, as we indicated in our brief, so treats that enactment. And I don't think that anyone has construed it as being a general requirement that the assignee turn over all the property in his possession willy-nilly without regard to any adverse claim. And I believe that after the passage of the Chandler Act, lower courts, not this Court, but lower courts have had the opportunity to apply Galbraith v. Valelli to situations such as the one involved here, and they have done so to bar the summary turnover of property held by the assignee for his ownself or as custodian or agent for a third person from summary turnover to the receiver in bankruptcy.

QUESTION: Here the levy was made before bankruptcy?

MR. JONES: That's correct.

QUESTION: But the levy was made after assignment.

MR. JONES: That's also correct.

QUESTION: So the assignee for the benefit of

creditors who took possession of the property before bankruptcy and sold it, then was subjected to a levy.

MR. JONES: That is right.

QUESTION: And then came backruptcy, and any rights under the Bankruptcy Act that the assignee may have had or any rights of the trustee or the estate against the assignee only arose with the filing of the bankruptcy petition.

MR. JONES: Well, any rights that they had in bankruptcy arose at that time, that's correct. Of course, they were creditors prior to the --

QUESTION: And you are asserting any rights of the United States arose before bankruptcy.

MR. JONES: Let me distinguish between various kinds of rights. Of course, the Government had a right to payment of its taxes long before --

QUESTION: The levy arose before bankruptcy.

MR. JONES: The levy was served upon the assignee before bankruptcy.

One of the petitioner's arguments in this case, a second subsidiary kind of argument, is that the assignee wasn't holding any properties subject to levy. He claims that the proceeds in the assignee's hands weren't subject to levy under the Internal Revenue Code. We believe that contention is plainly wrong. The assignee -- let me backtrack.

The taxpayer was holding the property subject to the

Government's lien. When the taxpayer assigned the property to the assignee, the assignee took the property subject to the lien. Petitioner concedes that much.

QUESTION: May I interrupt at that point? What had happened up to that time had been the notice of a deficiency assessment, as I understood it.

MR. JONES: There was an assessment of taxes due, right.

QUESTION: Did that create a lien?

MR. JONES: It did.

QUESTION: Not a lien which gave any notice to other creditors, though, did it?

MR. JONES: No, and that lien until perfected would not have been valid as against, for example, a bona fide purchaser. It only became perfected when the Notice of Lien, not the Notice of Levy, but the Notice of Lien was properly filed.

QUESTION: That was filed with the assignee.

MR. JONES: No, that was done -- the Notice of Levy was served upon the assignee. The Notice of Lien was filed in the appropriate State office, but they were both filed after the assignee took possession of the property.

QUESTION: And the Notice of Levy was filed, as I understand it, after he sold the chattel --

MR. JONES: After he had reduced the property to

proceeds, to cash.

QUESTION: For the benefit of the creditors who under Illinois law are the beneficiaries of the trust, isn't that right?

MR. JONES: That's right. Of course, our argument is that Federal law supervenes.

QUESTION: Also the Federal law talks about property or rights to property of the taxpayer.

MR. JONES: Yes. You are talking about section 6331.

QUESTION: Which is the whole basis of this lawsuit.

MR. JONES: Yes, it is. But one aspect of that provision that the petitioner has consistently overlooked in this case is the fact that the Government's levy does not reach only property of the taxpayer.

I seem to be searching in vain for the statutory language. It's section 6331(a) which is set forth at page 12a of the petition for writ of certiorari, provides that "If any person liable to pay any tax neglects or refuses to pay the same within 10 days after notice and demand, it shall be lawful for the Secretary or his delegate to collect such tax by levy upon all property and rights to property belonging to such person or on which there is a lien provided in this chapter for the payment of such tax."

And it is our contention that the Government's lien in this case reattached to the proceeds in substitution.

QUESTION: That's really the question, isn't it?

MR. JONES: That's one of the three questions. I regard that as a subsidiary --

QUESTION: It's not the big question that you hoped --

MR. JONES: That's correct.

QUESTION: That you did not oppose certiorari in because you hoped the Court would decide. But that is a more particularized question in this case.

MR. JONES: That is true.

Now, in our brief we cited Justice Story's opinion in Sheppard v. Taylor as an example of this Court's application of the Federal common law rule that a lien does attach to proceeds in substitution. That is also the rule under Illinois law, as we cited a number of Illinois cases in our brief that stand for the proposition that when an assignee under Illinois law takes property subject to a lien and sells that property, the lien reattaches to the proceeds. The same rule under both Federal common law and Illinois common law.

Petitioner's sole reliance for alleged contrary authority is upon United States v. Bess. But in that case, that case holds at the very most that the Government's lien will not reattach to proceeds that were not fully realizable in the taxpayer's hands. In that case the Government had a lien on a taxpayer's insurance policy, and after the death of the taxpayer, the monies, the face amount of the policy was

paid to the beneficiary and the Government claimed the face amount. This Court held that as to the proceeds that would have been realizable in the taxpayer's hands, that is the cash surrender value, the Government's lien reattached. As to the proceeds that were not realizable in the hands of the taxpayer, that is, the additional insurance proceeds above and beyond the cash surrender value, the lien would not reattach.

Now, petitioner tries to fit himself within this narrow exception to the general rule that the lien reattaches to proceeds in substitution. I frankly don't see how he is able to do that. The taxpayer in this case could just as easily as did the general assignee convert the property into cash. The taxpayer could have sold off the property, liquidated its receivables, and received cash in exactly the same manner as the general assignee. There is no reason whatsoever in this case why the Government's lien should not reattach to those proceeds in substitution. And since we believe the lien clearly did so reattach to those proceeds, there was property subject to a lien on which there was a lien, which under section 6331 of the Code was subject to levy, and it is clear that the Government's levy served notice upon the assignee that not only all property of the taxpayer, but also all property on which there was a Federal tax lien was thereby seized on behalf of the United States in

payment of taxes and demand was made upon the assignee for the payment of those amounts to the United States.

If there are no further questions, I ask the Court to affirm the judgment below.

Thank you.

MR. CHIEF JUSTICE BURGER: You have something further, Mr. Quaid?

REBUTTAL ARGUMENT OF DENNIS E. QUAID ON BEHALF OF PETITIONER

MR. QUAID: Just vriefly, Mr. Chief Justice.

The assignee was not holding for adverse claimants as in the cases cited by counsel for the Government. He was holding for the benefit of general creditors, he was not holding for a particular creditor as was the sheriff in the Taubel v. Fox case cited by the Government. He was holding as a State-appointed receiver or representative of creditors.

QUESTION: What would you say if there had never been a bankruptcy?

MR. QUAID: Well, then, it would have been an entirely different situation.

QUESTION: I know, but who would have -- would the levy have been good?

MR. QUAID: Well, I think it would have become a moot question because the United States would have had a first priority under section 3466 of the revised statute.

QUESTION: That may be so when the assignee finally distributed and paid his expenses out of it. The question here is whether he would have had to turn the proceeds over to the Government.

MR. QUAID: I think he may have in that situation due to the fact that bankruptcy did not subsequently occur, and also the situation --

QUESTION: Except for the Bankruptcy Act, you would say the assignee was subject to the levy and would have had to turn the proceeds over.

MR. QUAID: I think the important factor in this case is the Bankruptcy Act and the policy that Congress has set forth in the Bankruptcy Act.

QUESTION: Yet that case, the case of Galbraith v. Valelli does seem to say that where the assignee holds adversely to the interest of the general creditors, there is no summary jurisdiction in the bankruptcy court.

MR. QUAID: There he was holding in his own personal sense adversely.

QUESTION: But here the Government says as a matter of tax law, the levy had proceeded to such a stage that he was holding for the benefit of the Government.

MR. QUAID: We feel that tax law is wrong and inappropriate in a bankruptcy situation, whether it's a Federal statute more comprehensive and which considers the rights of

all parties which are involved.

QUESTION: Yes, but the date of the -- the minute before bankruptcy you say the Government's levy was good and that he would have had to turn it over if bankruptcy hadn't ensued. The minute before bankruptcy that was the situation, that the assignee was not holding for the benefit of the creditors solely, he was holding for the benefit of the United States to the extent of their tax levy.

MR. JONES: But the bankruptcy did come and did change the rights of the respective parties.

I thank you gentlemen for your attention.

MR. CHIEF JUSTICE BURGER: Thank you, gentlemen. The case is submitted.

(Whereupon, at 3:07 p.m., the argument in the above-entitled matter was concluded.)