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COMMENTS

TITLE TO PROPERTY: THE INCOME TAX REFUND CHECK AS AN ASSET OF THE WAGE EARNER'S BANKRUPTCY ESTATE.

Californian Michael Cedor may not feel that he is on the front line of a battlefield, but he is. Around him revolves a heated legal debate over the issue of whether an employee who files a petition in bankruptcy may retain any asset of value with which to begin his new life. At first glance the issue may seem to be a minor one, but the reader should look closer. When an employee contemplates his financial problems, usually with creditors close at his heels, and makes his decision to file for bankruptcy, he may naturally assume that any tangible thing which he possesses will be sold and the proceeds distributed among those creditors. Michael Cedor did some thinking, consulted an attorney, and started his new life with a little pocket money—his income tax refund.

In many employee bankruptcies, a tax refund check is the only asset of any value upon which creditors may levy. Properly filed and perfected security interests remove many goods from the trustee's reach, and thus it is understandable why the issue of who receives the bankrupt's income tax refund check is being so vigorously contested. The final outcome may well mean the difference in the small creditor receiving some payment in satisfaction of his claim or none at all.

As a general rule, if an item is found to be "property" within the meaning of section 70a(5) of the Bankruptcy Act,¹ title to it vests in

¹ § 70a(5) of the Bankruptcy Act, 11 U.S.C. § 110a(5) (1970) reads as follows:

(a) The trustee of the estate of a bankrupt . . . shall . . . be vested by operation of law with the title of the bankrupt as of the date of the filing of the petition initiating a proceeding under this title, except insofar as it is to property which is held to be exempt, to all of the following kinds of property wherever located . . . (5) property, including rights of action, which prior to the filing of the petition he could by any means have transferred or which might have been levied upon and sold under judicial process against him, or otherwise seized, impounded, or sequestered: *Provided*, That rights of action *ex delicto* for libel, slander, injuries to the person of the bankrupt or of a relative, whether or not resulting in death, seduction and criminal conversion shall not vest in the trustee unless by the law of the State such rights of action are subject to attachment, execution, garnishment, sequestration, or other judicial process: *And provided further*, That when any bankrupt, who is a natural person, shall have any insurance policy which has a cash surrender value payable to himself, his estate, or personal representatives,

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the trustee by operation of law on the date the bankruptcy petition is filed. Whether an income tax refund is such property is an issue that has generated a clear split between the Ninth and Second Circuits, a division which appears to be ultimately resolvable only by the Supreme Court.

In *In re Cedor*² the Ninth Circuit held that income tax refunds are not "property" as defined in section 70a(5). In that case, two employee bankrupts filed their bankruptcy petitions prior to the close of the calendar tax year. After the tax year ended, they filed for and received federal income tax refunds; and, as ordered by the referee in bankruptcy, each turned over to the trustee the apportioned amount of the refund check which represented withholdings from wages earned prior to the date that the petition in bankruptcy was filed. Cedor sought to recover 75% of the portion turned over to the trustee, claiming that the refunds were not "property" within the meaning of 70a(5) and thus did not pass to the trustee, and alternatively that if the title to the refund check *did* pass to the trustee, this constituted a "garnishment" of "disposable earnings" as defined in the Consumer Credit Protection Act³ and that 75% of the refund check consequently was exempt as earnings.

The amount withheld from a taxpayer's wages is determined by the information which he supplies on his W-4 form. To a certain degree, the wage earner can control the amount to be withheld by choosing the number of exemptions he claims. For example, a married worker with two children could ordinarily claim a maximum of four exemptions. The amount then withheld from his wages would represent the mandatory minimum, *i.e.*, he would maximize his take-home pay. On the other hand, such a worker might choose, voluntarily, to declare zero exemptions. This would cause a larger amount to be withheld from his paycheck. Actual tax liability in a given year is constant. Thus, by choosing the number of exemptions that he claims, the wage earner can utilize withholdings as a type of savings device. By choosing to declare less exemptions than those to which he is

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he may, within thirty days after the cash surrender value has been ascertained and stated to the trustee by the company issuing the same, pay or secure to the trustee the sum so ascertained and stated, and continue to hold, own, and carry such policy free from the claims of the creditors participating in the distribution of his estate under the bankruptcy proceedings, otherwise the policy shall pass to the trustee as assets. . . .

² 337 F. Supp. 1103 (N.D. Cal. 1972), *aff'd per curiam sub nom. In re James*, 470 F.2d 996 (9th Cir. 1972), *cert. denied sub nom. Walsh v. Cedor*, 411 U.S. 973 (1973).

³ The Consumer Credit Protection Act, 15 U.S.C. §§ 1671-77 (1970), is discussed in detail *infra*.

statutorily entitled, an excess of amount withheld over tax liability is created, and the wage earner assures himself of a refund. The *Cedor* court distinguished "forced" overpayment of taxes from voluntary overpayment. Since forced overpayment occurred when the mandatory minimum required by law to be withheld from wages created a surplus over actual tax liability, the portion of the tax refund check attributable to such forced withholding was not 70a(5) property, the court held, and thus did not pass to the trustee. That portion of the refund check which was generated through the decision of the bankrupt not to declare exemptions on his W-4 form to which he was entitled the court held to be 70a(5) "property" which passed to the trustee. Although such a portion as was traceable to optional withholding was "property" under 70a(5), 75% of that portion was exempt and did not pass to the trustee; the court held that to take that entire portion would constitute a "garnishment".

In *In re Kokoszka*⁴ the Second Circuit held that income tax refunds are 70a(5) "property". Kokoszka filed his bankruptcy petition *after* the close of the calendar tax year. The tax refund claim in *Kokoszka* was thus both determinable and enforceable, while in *Cedor* it was an inchoate, indeterminable claim because the calendar tax year had not yet closed. The Second Circuit held that Kokoszka's entire refund check was "property" within the meaning of 70a(5) and that the Consumer Credit Protection Act did not compel the trustee to return 75% of the refund to the bankrupt. The court expressly noted the Ninth Circuit's holding in *Cedor*, but refused to follow it.

A careful analysis of the historical genesis of the concept of "property" as it is embodied in the Bankruptcy Act and pertinent case law reveals two divergent lines of reasoning with respect to whether or not a given asset is "property" within the meaning of the Act.

One line of thinking, which may be called the "traditional" line, holds that the purpose of the Act is to secure *everything of value* which a bankrupt possesses at the cleavage point of bankruptcy—the filing of the petition. Having secured all property and interests in property, whether valuable or not, the Act then provides for an equitable distribution of these assets among the bankrupt's creditors. This goal having been accomplished, the bankrupt is granted his discharge and given a "fresh start".

The other line of reasoning, which may accurately be called "reasoning from equitable principles", argues that the primary purpose of the Bankruptcy Act is to grant the bankrupt a fresh start and

⁴ 479 F.2d 990 (2d Cir. 1973), *cert. granted sub nom. Kokoszka v. Belford*, 414 U.S. 1091 (1973).

free him from the entanglement of past indebtedness. If passing a given asset to the trustee as property interferes with the financial rebirth of the debtor, the asset cannot be classified as 70a property, for to so hold would vitiate the policy dictates of the Act.

An examination of historical background is relevant here. Present day theories of what is and is not "property" within the meaning of the Bankruptcy Act are in part a function of the Act's history and the place of the concept of "property" within it.

THE CONCEPT OF PROPERTY

The title to and rights in the bankrupt's property which pass to the trustee are covered by section 70 of the Bankruptcy Act. Subsection (a) of section 70 sets out the non-exempt property and property interests which vest in the trustee of the estate of the bankrupt by operation of law as of the date of the filing of the petition. The prior Bankruptcy Acts of 1800,⁵ 1841,⁶ and 1867⁷ had similar provisions, but none was as comprehensive⁸ in scope as that of the Act of 1898.⁹ The Chandler Act of 1938,¹⁰ however, extensively changed section 70. One author writes that "[s]ome of the changes were merely declaratory of or clarified existing law while others expanded the section to cover fields totally or partially untouched before by legislative enactment."¹¹ Clause (5) of section 70 is the most comprehensive in the section and appears broad enough to cover most of the property listed in other clauses.¹²

Past case law often advanced the argument that the section 70a enumeration of the kinds of property which pass to the trustee was not intended to be an exclusive list. The section should not be so narrowly construed, so the argument ran, as to deprive the trustee of any valuable interest belonging to the bankrupt. However valid this statement may have been at a prior time, it is today no longer correct.¹³ When unusual or unique interests arise that can not be found within the enumerating clauses of the section, the better view

⁵ Bankruptcy Act of 1800, ch. 19, §§ 2, 5, 11, 13, 50, 2 Stat. 21, 23, 24, 25, 34.

⁶ Bankruptcy Act of 1841, ch. 9, § 3, 5 Stat. 442-43.

⁷ Bankruptcy Act of 1867, ch. 176, §§ 14-16, 14 Stat. 522-24.

⁸ 40 TEXAS L. REV. 569, 569-70 (1962).

⁹ Bankruptcy Act of 1898, ch. 541, § 70, 30 Stat. 565 (amended by 52 Stat. 879 (1938), as amended, 11 U.S.C. § 110 (1970)).

¹⁰ Ch. 575, § 70, 52 Stat. 879 (1938).

¹¹ 40 TEXAS L. REV. 569, 570 (1962).

¹² 4A W. COLLIER, BANKRUPTCY ¶ 70.15, at 136 (14th ed. 1967) [hereinafter cited as COLLIER].

¹³ The statement is found in *In re Baudouine*, 96 F. 536 (S.D.N.Y. 1899), *rev'd on other grounds*, 101 F. 574 (2d Cir. 1900), and has been followed in other cases, notably *Board of Trade v. Weston*, 243 F. 332 (7th Cir. 1917). This dictum, as noted in the text, is no longer accurate. See 4A COLLIER ¶ 70.07 n.17. See also 42 TEXAS L. REV. 542 (1964).

seems to be that one ascertains whether the interest should be incorporated into section 70a by applying the principle of *ejusdem generis*.¹⁴ As will be demonstrated later, this question becomes obfuscated when the Supreme Court, as it has in recent bankruptcy decisions, applies equitable principles in clear contravention of the statutory language of the Bankruptcy Act.

Clause (5) contains but two specific restrictions¹⁵ (certain rights of action and life insurance policies) and establishes a two-fold test to be applied in determining what types of property pass by operation of law to the trustee: at the date of the filing of the bankruptcy petition, could the "property" in question have been (1) transferred by the bankrupt, or (2) levied upon and sold under judicial process against the bankrupt or otherwise seized, impounded, or sequestered.¹⁶ For an asset to meet this test and pass to the trustee, only one of the two conditions need be fulfilled; both are not required. Also, 70a(5) does not include property which is capable of being levied upon or transferred but which is *exempt* under state or federal law from execution or seizure.¹⁷

Prior to the Chandler Act of 1938, amending section 70a, the general rule was that a determinable and enforceable claim for an income tax refund passed to the trustee.¹⁸ Before the enactment of this amendment, however, there were some interests which passed to the trustee only upon the happening (or non-happening) of fortuitous circumstances, *viz.*, certain contingent and executory interests.¹⁹ A

¹⁴ See Comment, 12 N.Y.L.F. 311, 312 (1966). The author therein argues that principles of *sui generis* should be applied to ascertain whether a unique interest falls within the scope of section 70a. This is, of course, incorrect, since *sui generis* means that the interest would be the *only one* of the class, while under *ejusdem generis* it would meet the test if it were of a *similar* class.

¹⁵ See the text of § 70a(5) of the Bankruptcy Act, 11 U.S.C. § 110a(5) (1970), set out in note 1 *supra*.

¹⁶ C. NADLER, *THE LAW OF BANKRUPTCY* § 272 (2d ed. 1965).

¹⁷ An income tax refund may be exempt under state law. See, e.g., *In re Perry*, 225 F. Supp. 481 (N.D. Ohio 1963).

¹⁸ See, e.g., *Chandler v. Nathans*, 6 F.2d 725 (3d Cir. 1925).

¹⁹ As explained in the text above, prior to passage of the Chandler Act, contingent and executory interests were covered under § 70a(5) of the Act: To prevent the bankrupt from utilizing technical loopholes in the law in order to block passage of these interests, the Chandler Act added clause (7) and the first two paragraphs following, but not a part of, clause (8). See 4A COLLIER ¶ 70.03 at 36-37. Clauses (7), (8), and the paragraphs following clause (8) set forth the following:

(7) contingent remainders, executory devises and limitations, rights of entry for condition broken, rights or possibilities of reverter, and like interests in real property, which were nonassignable prior to bankruptcy and which, within six months thereafter, become assignable interests or estates or give rise to powers in the bankrupt to acquire assignable interests and estates; and (8) property held by an assignee for the benefit of creditors appointed under an assignment which constituted an act of

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leading bankruptcy treatise explains that the addition of clause (7) and the first two paragraphs following, but not a part of, clause (8)

reflect a desire to include within the bankrupt's estate certain contingent and executory interests and thus permit a realization on assets which formerly escaped bankruptcy for technical reasons unnecessarily favorable to the bankrupt. Prior to the 1938 Act, if a contingent interest was assignable under state law it passed to the trustee by virtue of § 70a(5). But where such interests were not assignable under state law, the bankrupt was enabled to divest himself of his debts through bankruptcy and yet possibly come into great wealth during the administration of his estate by virtue of the ripening of contingent or executory interests untouched by bankruptcy. . . . This was characterized as 'virtually a fraud upon the act.'²⁰

Further, there is near unanimity among those who have researched the legislative history of the Chandler Act that the intent of Congress in enacting it was to expand the coverage of section 70a in order to further an equitable distribution of the property of the bankrupt among his creditors.²¹ Even prior to the enactment of the amendment,

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bankruptcy, which property shall, for the purposes of this Act, be deemed to be held by the assignee as the agent of the bankrupt and shall be subject to the summary jurisdiction of the court.

All property, wherever located, except insofar as it is property which is held to be exempt, which vests in the bankrupt within six months after bankruptcy by bequest, devise or inheritance shall vest in the trustee and his successor or successors, if any, upon his or their appointment and qualification, as of the date when it vested in the bankrupt, and shall be free and discharged from any transfer made or suffered by the bankrupt after bankruptcy.

All property, wherever located, except insofar as it is property which is held to be exempt, in which the bankrupt has at the date of bankruptcy an estate or interest by the entirety and which within six months after bankruptcy becomes transferable in whole or in part solely by the bankrupt shall, to the extent it becomes so transferable, vest in the trustee and his successor or successors, if any, upon his or their appointment and qualification as of the date of bankruptcy.

Bankruptcy Act of 1898, § 70a(7), (8), and § 70a, 11 U.S.C. § 110a(7), (8), and § 110a (1970).

Reasoning by analogy, one can make a strong argument that since the Chandler Act was enacted to remove some technical loopholes and to increase the scope of the coverage of 70a, and that since determinable and enforceable refund claims had been held to pass to the trustee in prior case law, to permit the bankrupt to have the windfall created when he files his bankruptcy petition prior to the close of the calendar year would defeat clear congressional intent. Once again, the bankrupt would be able to take advantage of a technicality, and well-advised bankrupts would always file their petitions prior to December 31 if they were contemplating bankruptcy in the latter part of a year. The similarity between contingent interests and inchoate tax refund claims is obvious, and the analogy seems warranted.

²⁰ 4A COLLIER ¶ 70.03 at 37.

²¹ See, e.g., McLaughlin, *Amendment of the Bankruptcy Act*, 40 HARV. L. REV. 583, 604-05 (1927) for an analysis of what the drafters of the 1898 Bankruptcy Act meant the scope of § 70a to be.

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case law insisted that the various provisions of the Bankruptcy Act should be broadly construed when such construction was necessary to carry out congressional intent and where narrow construction would achieve the opposite result, permitting the bankrupt to stand on the technicalities of the language of the law.²²

The general rule, discussed above, which held that tax refunds were property under section 70a(5) which passed to the trustee was not changed by passage of the Chandler Act;²³ and the issue, considered relatively settled, was one which generated little litigation until the early 1960's.

Increasing Litigation Creates a Circuit Split

It must be pointed out here that these earlier cases concerned situations where the claim for an income tax refund was both determinable and enforceable, that is, the refund sought was for the year *prior* to the filing of the petition for bankruptcy. *Inchoate* tax refund claims, those claims which arose when the petition was filed during the calendar year for which a tax refund was sought, presented an entirely different question; the claim for refund here was not even determinable, since there would always be a question of just how much of a refund, if any, was owed. The courts were also confronted with the question of whether the refund claim was transferable, since the Federal Assignment of Claims Act²⁴ arguably prohibited assignment of claims against the government.

In *In re Goodson*,²⁵ a California district court held that when a bankruptcy petition was filed prior to the close of the calendar year, the tax refund should be prorated and that the trustee was entitled

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For an extensive analysis of the amendment provisions, see ANALYSIS OF H.R. 12889, 74th Cong., 2d Sess. 224 (1936), quoted in pertinent part in 4A COLLIER ¶ 70.03. The most revealing portion of this analysis reads, with respect to the reasons for including the provisions on contingent and executory interests:

To an extent this involves a departure from the strict theory of the date of cleavage, but *the bankrupt ought not to get the benefit of all legal complications at the expense of creditors*. The vesting of such property is usually independent of the bankrupt's economic efforts and has no relation to his normal budget, so the usual reasons assigned for leaving him his after acquired property do not apply.

ANALYSIS at 226, quoted in 4A COLLIER ¶ 70.03 at 38 (emphasis added).

²² *In re Cantelo Mfg. Co.*, 185 F. 276 (D. Me. 1911).

²³ See, e.g., *Fahs v. Martin*, 224 F.2d 387 (5th Cir. 1955).

²⁴ 31 U.S.C. § 203 (1970). The statute reads in pertinent part as follows:

All transfers and assignments made of any claim upon the United States, or any part or share thereof, or interest therein, whether absolute or conditional, and whatever may be the consideration therefor . . . shall be absolutely null and void, unless they are freely made and executed in the presence of at least two attesting witnesses, after the allowance of such claim, the ascertainment of the amount due, and the issuing of a warrant for the payment thereof.

²⁵ 203 F. Supp. 837 (S.D. Cal. 1962).

only to that part of the refund attributable to withholdings from the bankrupt's wages prior to the time he filed his petition. With respect to the argument that the Assignment of Claims Act prohibited assignment of the inchoate claim, the court stated that while such an assignment was not enforceable as against the government because of the statute, it nevertheless operated as an equitable assignment which would be enforceable by the assignee (the trustee) against the assignor (the bankrupt).²⁶

The Third Circuit, in *In re Sussman*,²⁷ indicated that the reasoning adopted by *Goodson* was to be strictly confined and limited to the facts of that case, that is, it applied only to refund claims that the bankrupt could have presented at the time the petition was filed. *Sussman*, in contrast, involved an inchoate claim, which was further limited by the Assignment of Claims Act.²⁸ The *Sussman* court held that the bankrupt had no vested or transferable property in his inchoate tax refund claim and thus nothing which could pass to the trustee under section 70a(5). The court pointed out that while they felt the conclusion, considering the existing case law and statutes, to be an "inevitable" one, they nonetheless called the result "unfortunate" and "a windfall to the bankrupt at the expense of the creditors."²⁹

The Fifth Circuit, in *Segal v. Rochelle*,³⁰ reached a result directly in conflict with that of *Sussman*. Noting that the case was similar, on its facts, to *Sussman*,³¹ the court nonetheless held ". . . that an inchoate right to receive a . . . refund is 'property', and that it is property which the bankrupt could 'by any means have transferred' within the meaning of [§ 70a(5)]."³² The court thereupon awarded the refund to the trustee.

The Circuit Split Resolved

To resolve the split between the Third and Fifth Circuits, the Supreme Court heard *Segal*³³ on certiorari.³⁴ In *Segal* the trustee had

²⁶ *Id.* at 847.

²⁷ 289 F.2d 76 (3d Cir. 1961). *Sussman* was met by several critical writings which excoriated the decision as being quite contrary to the legislative trend which had been to expand section 70a and thereby further the "theme of the Bankruptcy Act"—an equitable distribution of the bankrupt's assets among his creditors. See *Sampson v. Imperial Paper & Color Corp.*, 313 U.S. 215 (1941). See also 14 STAN. L. REV. 380 (1962).

²⁸ 289 F.2d 76, 77-78.

²⁹ *Id.* at 78. For a discussion of *Goodson* and *Sussman*, see *Calvery, Income Tax Refunds Due Wage Earners*, 39 REF. J. 8 (1965). For another case following the *Sussman* reasoning, see *Fournier v. Rosenblum*, 318 F.2d 525 (1st Cir. 1963).

³⁰ 336 F.2d 298 (5th Cir. 1964).

³¹ *Id.* at 299.

³² *Id.* at 303.

³³ 382 U.S. 375 (1966).

³⁴ *Segal v. Rochelle*, 380 U.S. 931 (1965).

filed claims for loss carryback tax refunds due Gerald and Sam Segal as individuals and on behalf of their partnership; the loss carryback refund was generated by losses incurred by the partners during the year in which the bankruptcy petition was filed. One writer has stated that:

The primary obstacle facing the Supreme Court was that under section 70a(5) of the Act the trustee acquired the property of the bankrupt as of the date of the filing of the petition; and, as a general rule, property subsequently acquired belongs to the bankrupt. Two previous decisions [*Sussman* and *Fournier*], which the Supreme Court later rejected in *Segal*, had held that such claims were not property which would pass to the trustee. Both [*Sussman* and *Fournier*] . . . had been in great part based on the reasoning that since the tax laws allowed a loss carryback refund to be made only when the tax year had ended, the claimed refund was too tenuous an interest to be classified as property under section 70a. . . .³⁵

In an article³⁶ which almost certainly influenced the Court in its holding in *Segal* and which the trustee respondent cited in his brief,³⁷ a referee in bankruptcy argued that Congress intended section 70a "to cover all assets and estate of a bankrupt *that can in any manner be made legally available for the payment of his debts.*"³⁸ Although not completely persuaded by respondent's arguments, the Court held that:

The main thrust of 70a(5) is to secure for creditors everything of value the bankrupt may possess in alienable or leviable form when he files his petition. To this end the term "property" has been construed most generously and an interest is not outside its reach because it is novel or contingent or because enjoyment must be postponed. . . . However, limitations on the term do grow out of other purposes of the Act; one purpose which is highly prominent . . . is to leave the bankrupt free after the date of his petition to accumulate new wealth in the future.³⁹

The guiding criterion under 70a(5), as indicated above, is transferability or leviability.⁴⁰ The Court in *Segal* found little difficulty in holding that the transferability test had been met:

³⁵ Comment, 12 N.Y.L.F. 311 (1966).

³⁶ Herzog, *Bankruptcy Law—Modern Trends*, 36 REF. J. 18 (1962).

³⁷ Brief for Respondent at 4, *Segal v. Rochelle*, 382 U.S. 375 (1966). The Respondent's brief also heavily relied on 14 STAN. L. REV. 380 (1962). See, e.g., Brief for Respondent at 5-6 and 14 STAN. L. REV. 380, 381.

³⁸ Herzog, *Bankruptcy Law—Modern Trends*, 36 REF. J. 18, 19 (1962) (emphasis added).

³⁹ 382 U.S. 375, 379 (1966).

⁴⁰ *Chicago Bd. of Trade v. Johnson*, 264 U.S. 1 (1924); *In re Coleman*, 87 F.2d 753 (2d Cir. 1937).

[It] decided that the restriction prohibiting assignment of claims against the government where the amount is not ascertained, as provided for by the Federal Assignment of Claims Act, was not applicable to tax refund claims for the reason that the Federal Assignment of Claims Act contemplates a voluntary transfer and not one by operation of law.⁴¹

Having held that income tax refund claims were transferable by operation of law and with the above-discussed policy considerations in mind, the Court said the test for determining whether the refund claim was property under 70a(5) was whether it was "sufficiently rooted in the pre-bankruptcy past and so little entangled with the bankrupts' ability to make an unencumbered fresh start that it should be regarded as 'property' under § 70a(5)."⁴² The Court, obviously disapproving the reasoning of *Sussman* and *Fournier*, concluded that it was.⁴³ This was one of the most liberal constructions and expansive definitions of 70a(5) property ever rendered by the Supreme Court.

MODIFICATION OF THE CONCEPT OF PROPERTY BY EQUITABLE PRINCIPLES

In the landmark case of *Lines v. Frederick*⁴⁴ the Supreme Court, in a brief per curiam opinion, affirmed a Ninth Circuit case⁴⁵ which had held that accrued but unpaid vacation pay was not property within the meaning of section 70a(5) and thus did not pass to the trustee. In a radical departure from the *Segal* rationale, the Court concluded:

The *most important consideration* limiting the breadth of the definition of "property" lies in the basic purpose of the Bankruptcy Act to give the debtor a "new opportunity in life and a clear field for future effort, unhampered by the pressure and discouragement of pre-existing debt."⁴⁶

No longer is the main thrust of the Act to secure everything of value that the bankrupt might possess in order to further an equitable distribution among the creditors; this was the *Segal* theory of the policy behind the Act. What in *Segal* was cited as another "highly prominent"⁴⁷ purpose has now become the *raison d'être*. The guiding criterion of transferability or leviability has now become secondary to equitable considerations.⁴⁸

⁴¹ C. NADLER, *THE LAW OF BANKRUPTCY* § 275a (2d ed. 1965); 382 U.S. 375, 382-84 (1966).

⁴² 382 U.S. 375, 380 (1966).

⁴³ *Id.*

⁴⁴ 400 U.S. 18 (1970).

⁴⁵ *Frederick v. Lines*, 425 F.2d 215 (9th Cir. 1970).

⁴⁶ 400 U.S. 18, 19 (1970), *citing* *Local Loan Co. v. Hunt*, 292 U.S. 234, 244-45 (1934) (emphasis added).

⁴⁷ 382 U.S. 375, 379 (1966).

⁴⁸ Several articles have pointed out this sudden predominance of equitable
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Ordinarily, whether the property in question could have been transferred, levied upon and sold, impounded, seized, or sequestered is a matter to be determined by the applicable state or federal law, usually the former.⁴⁹ When the federal courts have declined to follow local law, the reason has generally been that the state courts have defined "property" in such a manner as to prevent the passing of assets which ought to have been within the reach of 70a(5).⁵⁰ As is pointed out by the Ninth Circuit in *Lines*:

It is unnecessary for us to decide whether . . . Mr. Frederick . . . could have transferred his right to receive his vacation pay, or whether creditors could have reached those expectancies, because even if [it could have been done], we think that a transfer of those rights to the trustee impairs the bankrupt's abilities to make an unencumbered fresh start. An asset is not deemed "property" for the purpose of applying section 70a(5), if a transfer of that asset to the trustee interferes with the bankrupt's freedom after the date of his petition to accumulate new wealth.⁵¹

Under California law, accrued vacation pay would have been transferable⁵² or leviable, and the court, by contracting its definition of property, prevents these assets from passing. "Thus, the Court subverts its traditional policy of sweeping all assets of value into the bankruptcy estate to its concern for giving the debtor a 'fresh start' after bankruptcy."⁵³

The "fresh start" doctrine seems to have originated in *Wetmore v. Markoe*.⁵⁴ The *Lines* court cites another decision along the road carved out by the "fresh start" doctrine—*Local Loan Co. v. Hunt*⁵⁵—for the proposition that the various provisions of the Bankruptcy Act were adopted in light of the "fresh start" view and "are to be construed

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principles. The most prescient article is Aug, *Recent Trends in the Application of Equitable Principles of Bankruptcy*, 43 REF. J. 109 (1969), written before the Supreme Court decided *Lines*. See also Lee, *Leading Case Commentary*, 45 REF. J. 115 (1971) and Comment, 22 HASTINGS L.J. 846 (1971). Case Comment, 49 N.C.L. Rev. 738 (1971) is perhaps the best student work written in the area.

⁴⁹ *Segal* makes this clear. See 382 U.S. 375, 381 n.6 (1966).

⁵⁰ Case Comment, 49 N.C.L. Rev. 738, 740 (1971). The article cites *Chicago Bd. of Trade v. Johnson*, 264 U.S. 1 (1924) in which the Court stated at page 10: Congress derives its power to enact a bankruptcy law from the Federal Constitution, and the construction of it is a federal question. Of course, where the bankruptcy law deals with property rights which are regulated by the state law, the federal courts in bankruptcy will follow the state courts; but when the language of Congress indicates a policy requiring a broader construction of the statute than the state decisions would give it, federal courts cannot be precluded by them.

⁵¹ 425 F.2d 215, 217 (9th Cir. 1970).

⁵² Comment, 49 N.C.L. Rev. 738 n.3 (1971).

⁵³ *Id.* at 740.

⁵⁴ 196 U.S. 68 (1904).

⁵⁵ 292 U.S. 234 (1934).

when reasonably possible in harmony with it so as to effectuate the general purpose and policy of the [A]ct."⁵⁶ That this represents the predominant policy motivation behind the Act, however, is highly questionable.⁵⁷

One analysis⁵⁸ argues that the "equitable" matter confronting the Ninth Circuit in *Lines* may be divided into three categories: (1) the *hardship* to the debtor which results if, having ascertained that the "property" is transferable to the trustee, the court actually transfers it; (2) the *benefit* to the creditors which will result if the asset is transferred—a comparison of the transfer value of the asset versus costs of administration is one test; and (3) the *feasibility of bankruptcy administration* of an asset that may turn out to be burdensome. This is actually a mirror image of (2), that is, will the costs of administering the asset so consume it that little or nothing ultimately reaches the creditors.

The major equitable concern in *Lines* was category (1). The Court stated:

[T]he respondents here are wage earners whose sole source of income, before and after bankruptcy, is their weekly earnings. The function of their accrued vacation pay is to support the basic requirements of life for them and their families during brief vacation periods or in the event of layoff. . . . Where the minimal requirements for the economic survival of the debtor are at stake, legislatures have recognized that protection that might be unnecessary or unwise for other kinds of property may be required. See, e.g., Consumer Credit Protection Act. . . .⁵⁹

In contrast, at least one referee in bankruptcy has argued that the statutory language of the Bankruptcy Act made the conclusion that accrued vacation pay passed to the trustee "virtually inescapable".⁶⁰ The *Lines* Court avoided that result by construing "property" in such a way as to subordinate it to equitable "fresh start" policy grounds. In so doing, the Court eschewed the rather clear language of *Segal* which stated that the Bankruptcy Act was to be liberally construed and, *sotto voce*, reiterated its policy, announced in *Bank of Marin v. Eng-*

⁵⁶ 400 U.S. 18, 19 (1970), citing *Local Loan Co. v. Hunt*, 292 U.S. 234, 245 (1934).

⁵⁷ See *In re Leslie*, 119 F. 406, 410 (N.D.N.Y. 1903), where the deciding judge, who had been a member of the House Judiciary Committee during the passage of the Bankruptcy Act of 1898, points out that:

The main purpose of the bankrupt law is to prevent preferences, and secure a fair and an equitable division of the bankrupt estate among the creditors, not to grant discharges. This end accomplished, the bankrupt is granted a discharge from all his debts. The attainment of the first is not to be sacrificed to the accomplishment of the last.

Quoted in 49 N.C.L. Rev. 738, at 745 n.42 (1971).

⁵⁸ Comment, 22 HASTINGS L.J. 846, 854 (1971).

⁵⁹ 400 U.S. 18, 20 (1970).

⁶⁰ Lee, *Leading Case Commentary*, 45 REF. J. 115, 116 (1971).

land,⁶¹ that bankruptcy jurisdiction was governed by equitable principles.⁶²

In a forward looking article written soon after *Lines* was decided, one writer stated that with the *Lines* decision:

[T]he Court has opened "a clear field for future effort" on the part of advocates for broadening the doctrine that in addition to the exemption exclusion, the "purpose" of the Bankruptcy Act to preserve for the debtor and his family the "minimal requirements for economic survival" or the "basic requirements of life" places a limitation on the kinds of property of the debtor which pass to the trustee where the exemption exclusions appear to be inadequate.⁶³

Equitable Principles Rise to Preeminence

The above statement was quite correct, and *Cedor* was to be decided upon precisely the ground it mentioned. Whether a court proceeds from an equitable base or from the statutory language of the Bankruptcy Act is determinative of the outcome of the newer tax refund cases.

Consider, for example, the contrasting responses of the Ninth and Second Circuits to the arguments raised in *Cedor* and *Kokoszka* respectively:

In re Cedor

The Property Argument. The bankrupt contended that the reasoning of *Lines* dictated that the tax refunds be held not to be "property" within the meaning of 70a(5). In *Lines*, he argued, there was accrued but unpaid vacation pay which the bankrupt was unable to reach prior to taking his vacation or terminating his employment, and here

⁶¹ 385 U.S. 99 (1966).

⁶² *Perry v. Commerce Loan Co.*, 383 U.S. 392 (1966) is another example of a case in which the Court seems to have ignored the clear statutory language of the Act in favor of an equitable result.

The statutory language ignored was § 14c(5) of the Bankruptcy Act, 11 U.S.C. § 32c(5) (1970) which provided:

(c) The court shall grant the discharge unless satisfied that the bankrupt has . . . (5) in a proceeding under this title commenced within six years prior to the date of the filing of the petition in bankruptcy had been granted a discharge, or had a composition or an arrangement by way of composition or a wage earner's plan by way of composition confirmed under this title. . . .

Perry sought to receive an extension of time to pay his debts in a Chapter XIII action. Within the preceding six years, however, he had filed a straight bankruptcy petition and had received a discharge. The referee dismissed *Perry's* motion, saying it was barred by § 14c(5). The decision was affirmed by the district court and the Court of Appeals for the Sixth Circuit. 340 F.2d 588 (6th Cir. 1965). The Supreme Court reversed, holding that § 14c(5) did not control extension of debt payment plans, because such plans were created *after* the Bankruptcy Act had been passed.

⁶³ *Lee, Leading Case Commentary*, 45 REF. J. 115, 118-19 (1971).

(in *Cedor*) the bankrupt was likewise unable to reach the fund of withheld wages prior to the filing of his federal income tax return.⁶⁴ If, as the Court in *Lines* recognized, wages are "a specialized type of property presenting distinct problems in our economic system,"⁶⁵ surely the forced overpayment of tax on wages represents a specialized type of property, too. The *Cedor* court was most receptive to this reasoning, finding that:

The collection by the Internal Revenue Service without the consent or control of the bankrupt, and the belated refund, render these funds quite similar in a practical sense, to the accrued but unpaid wages which constituted vacation pay. If *Lines* stands for anything, it is that the practical realities are controlling in this determination.⁶⁶

Like accrued vacation pay, the tax refund, although uncertain as to amount

. . . by reason of past experience, is anticipated by the wage earner as an annual event. To deprive the wage earner of that planned-on annually reoccurring payment, cannot be said to be less severe than the deprivation of two weeks of paid vacation. . . .⁶⁷

The court holds that where the tax refund is generated by an excess of the mandatory minimum amount required by law to be withheld over the amount of the bankrupt's actual tax liability at the end of the year, the excess withholding is not 70a(5) property.⁶⁸ The court so phrases its decision in order to prevent *optional* withholding amounts, controlled by the decision of the bankrupt, from being unable to pass to the trustee; such optional withholding amounts are held to be "property" and pass.⁶⁹

The court in *Cedor* considers the "practicalities" to be controlling: in other words, this is another in the sequence of decisions⁷⁰ based upon equitable considerations rather than the statutory dictates of the Act.

⁶⁴ 337 F. Supp. 1103, 1105 (N.D. Cal. 1972), *aff'd per curiam sub nom. In re James*, 470 F.2d 996 (9th Cir. 1972), *cert. denied sub nom. Walsh v. Cedor*, 411 U.S. 973 (1973).

⁶⁵ 400 U.S. 18, 20 (1970), *citing Sniadach v. Family Fin. Corp.*, 395 U.S. 337, 340 (1969).

⁶⁶ 337 F. Supp. 1103, 1105 (N.D. Cal. 1972), *aff'd per curiam sub nom. In re James*, 470 F.2d 996 (9th Cir. 1972), *cert. denied sub nom. Walsh v. Cedor*, 411 U.S. 973 (1973).

⁶⁷ *Id.*

⁶⁸ *Id.*

⁶⁹ *Id.* at 1106.

⁷⁰ The major cases in the sequence of equitable decisions have been mentioned several times in the text. They are: *Pepper v. Littin*, 308 U.S. 295 (1939); *Perry v. Commerce Loan Co.*, 383 U.S. 392 (1966); *Bank of Marin v. England*, 385 U.S. 99 (1966). See Aug, *Recent Trends in the Application of Equitable Principles of Bankruptcy*, 43 REF. J. 109 (1969) for a discussion of the sequence.

If construed in terms of the Act's statutory language, it is not clear how one part of a tax refund can be held not to be property while another part (if attributable to optional withholding) is held to be property which passes.

The Garnishment Argument. Given that amounts attributable to optional withholding are property and pass to the trustee, the bankrupt then argued that the portion of the refund attributable to such optional withholding is exempt, because if the trustee takes title to the whole part of the refund check representing optional withholding, it is a garnishment⁷¹ and is controlled by the Consumer Credit Protection Act⁷² [hereinafter cited as CCPA].

Under relevant provisions of the CCPA, only 25% of the "disposable earnings" of a wage earner may be garnished.⁷³ Calling the theory that the income tax refund check is traceable to wages and that an order to turn the check over to the trustee constitutes a garnishment "somewhat strained",⁷⁴ the court nonetheless accepts it, pointing out that there was no reason "why the amount of the refund should be held to have lost its character as 'earnings' by reason of its somewhat circuitous route to the wage earner's hands."⁷⁵ Since "garnishment" is "any legal or equitable procedure through which the earnings of any individual are required to be withheld for the payment of any debt"⁷⁶ and since the taking of title to the check by the trustee is a legal or equitable procedure, the court finds that a garnishment exists.⁷⁷

⁷¹ *Id.*

⁷² 15 U.S.C. §§ 1671-77 (1970) at § 1672(c) [hereinafter cited as CCPA].

⁷³ 15 U.S.C. § 1672 (1970) provides:

For the purposes of this subchapter:

(a) The term "earnings" means compensation paid or payable for personal services, whether denominated as wages, salary, commission, bonus, or otherwise, and includes periodic payments pursuant to a pension or retirement program.

(b) The term "disposable earnings" means that part of the earnings of any individual remaining after the deduction from those earnings of any amounts required by law to be withheld.

(c) The term "garnishment" means any legal or equitable procedure through which the earnings of any individual are required to be withheld for the payment of any debt.

15 U.S.C. § 1673(a) (1970) reads in part:

. . . [t]he maximum part of the aggregate disposable earnings of an individual for any workweek which is subjected to garnishment may not exceed

(1) 25 per centum of his disposable earnings for that week. . . .

⁷⁴ 337 F. Supp. 1103, 1107 (N.D. Cal. 1972), *aff'd per curiam sub nom. In re James*, 470 F.2d 996 (9th Cir. 1972), *cert. denied sub nom. Walsh v. Cedor*, 411 U.S. 973 (1973).

⁷⁵ *Id.*

⁷⁶ See 15 U.S.C. § 1672(c) (1970), the text of which is set out in note 73 *supra*.

⁷⁷ 337 F. Supp. 1103, 1107 (N.D. Cal. 1972), *aff'd per curiam sub nom. In re James*, 470 F.2d 996 (9th Cir. 1972), *cert. denied sub nom. Walsh v. Cedor*, 411 U.S. 973 (1973).

There are two counterarguments to this assertion. One author points out that the cleavage date in bankruptcy is the point of the filing of the petition and

[w]hen tax refunds are in the custody of the sovereign on the date of bankruptcy they are obviously not subject to levy ("garnishment") and therefore do not pass to the trustee under the leviability test. Nor do they pass to the trustee by operation of law merely by virtue of the fact that the debtor has instituted the "legal or equitable" procedure known as bankruptcy. . . . [T]he court in *Segal* held that refunds pass to the trustee only if under the state law the refunds are voluntarily alienable by the Bankrupt on the date of bankruptcy. . . . [It is hard to understand] how an order of the referee in bankruptcy, requiring the bankrupt to turn over his tax refund where the title to the refund has already vested in the trustee under the transferability test, can be construed as a garnishment.⁷⁸

The other argument is even more persuasive and has been advanced in both case law⁷⁹ and commentary.⁸⁰ "Disposable earnings", it reasons, are those earnings for a pay period to which the employee is entitled after all statutory deductions.⁸¹ Since disposable earnings are all wages *except* the amount representing withholding monies, it follows that withholding amounts cannot be classified as disposable earnings,⁸² and it is withholding monies that constitute the tax refund. The withholding monies, so it is argued, thus lose their status as "wages" and become instead a potential claim for a tax refund and logically cannot resume their character as wages.⁸³ Thus, withholdings do not fall under the coverage of the CCPA. Moreover, from the language of the CCPA, one can argue that the restrictions in it were "tailored to protect the individual's disposable earnings *in the particular pay period*," since the statute refers not to earnings generally, but "only to 'aggregate disposable earnings of an individual for any workweek' or multiple thereof."⁸⁴ Congressional intent in enacting the CCPA was "to make sure that wage earners were able to receive

⁷⁸ Lee, *Leading Case Commentary*, 47 REF. J. 239, 244 (1973).

⁷⁹ *In re Kingswood*, 343 F. Supp. 498, 502 (C.D. Cal. 1972), *rev'd in favor of Cedor*, 470 F.2d 996 (9th Cir. 1972), *petition for cert. filed sub nom. Michelman v. Kingswood*, 42 U.S.L.W. 3101 (U.S. Aug. 13, 1973) (No. 289); *In re March*, [1970-1973 Transfer Binder] BANKR. L. REP. ¶ 64,748 (D.R.I. 1973).

⁸⁰ Lee, *Leading Case Commentary*, 47 REF. J. 239, 245 (1973).

⁸¹ See 15 U.S.C. § 1672(c) (1970), the text of which is set out in note 73 *supra*.

⁸² Lee, *Leading Case Commentary*, 47 REF. J. 239, 245 (1973).

⁸³ *In re March*, [1970-1973 Transfer Binder] BANKR. L. REP. ¶ 64,748 (D.R.I. 1973).

⁸⁴ Lee, *Leading Case Commentary*, 47 REF. J. 239, 244-45 (1973) (emphasis added). See also *Hodgson v. Cleveland Municipal Court*, 326 F. Supp. 419 (N.D. Ohio 1971).

at least 75% of their take home pay in any one pay period so that they would have enough cash to meet basic needs."⁸⁵ Subchapter II of the CCPA—"Restrictions on Garnishment"⁸⁶—restricts certain methods a creditor may use to reach a debtor's wages, and "only by a play on words can such legislation be termed an Exemption Statute."⁸⁷

Cedor is clearly an equitable decision, and is reconcilable to the main trend of case authority only on these grounds. Given the statutory language of the Bankruptcy Act, the clear legislative intent, and the *Segal* doctrine, the decision appears to be an aberration, or as one writer put it, "an errant sibling of *Lines v. Frederick*."⁸⁸

In re Kokoszka

The Property Argument. The decision in *Kokoszka*, that court points out, is controlled by *Segal* and *Lines*.⁸⁹ Whether an item is "property" or not must be defined in terms of the purposes of the Bankruptcy Act,⁹⁰ and "property" must be "given a generous construction in order to give creditors everything of value, including items where the enjoyment of value is postponed. . . ."⁹¹ *Lines*, says the *Kokoszka* court, *limits* the concept of property where the bankrupt is a wage earner and where "the minimal requirements for the economic survival of the debtor are at stake."⁹²

The court further indicates that the test of whether an item is property is the same as the *Segal* test: is it "sufficiently rooted in the pre-bankruptcy past and so little entangled with the bankrupt's ability to make a fresh start that it should be regarded as 'property' under § 70a(5)"⁹³ This test announced in *Segal* might be fairly regarded as the precursor of the equitable loophole created in *Lines*, but in *Segal* the test was clearly subordinate to the policy behind the Bankruptcy Act—to secure for creditors everything of value a bankrupt might possess at the moment of bankruptcy.

The Second Circuit views *Lines* as a "very narrow exception to

⁸⁵ *In re Kokoszka*, 479 F.2d 990, 996-97 (2d Cir. 1973), *cert. granted sub nom.* *Kokoszka v. Belford*, 414 U.S. 1091 (1973).

⁸⁶ 15 U.S.C. §§ 1671-77 (1970).

⁸⁷ *In re Kingswood*, 343 F. Supp. 498, 501 (C.D. Cal. 1972), *rev'd in favor of Cedor*, 470 F.2d 996 (9th Cir. 1972), *petition for cert. filed sub nom. Michelman v. Kingswood*, 42 U.S.L.W. 3101 (U.S. Aug. 13, 1973) (No. 289). The appendix attached to the case, written by the referee in bankruptcy in the action below, is very informative of the purposes behind enactment of the CCPA.

⁸⁸ Lee, *Leading Case Commentary*, 47 REF. J. 239, 240 (1973).

⁸⁹ 479 F.2d 990, 993-94 (2d Cir. 1973), *cert. granted sub nom.* *Kokoszka v. Belford*, 414 U.S. 1091 (1973).

⁹⁰ *Id.* at 994 (emphasis added).

⁹¹ *Id.*, citing *Segal v. Rochelle*, 382 U.S. 375, 379 (1966).

⁹² *Id.*, citing *Lines v. Frederick*, 400 U.S. 18, 20 (1970).

⁹³ *Id.*

the general proposition that everything of value passes to the trustee. . . ."⁹⁴ Only when the item to be regarded as property is "essential to basic week to week support in the future" does it not pass to the trustee⁹⁵ (given, of course, that it is alienable or leviable under state law at the moment the bankruptcy petition is filed). The court then says:

Because a tax refund is not the weekly or other periodic income required by a wage earner for his basic support, to deprive him of it will not hinder his ability to make a *fresh* start unhampered by the pressure of preexisting debt.⁹⁶

The court counters the argument that a tax refund represents overwithheld wages and that wages are a specialized type of property which does not pass to the trustee by replying that to classify property as "wages" does not render it sacrosanct nor ". . . give it special protection, for to do so would exempt from the bankruptcy estate most of the property owned by many bankrupts, such as savings accounts. . . ."⁹⁷

The *Kokoszka* court notes that the argument that an income tax refund was an expected annual event and that taking it away would deny a fresh start was an argument which convinced the *Cedor* court. In response to this, the Second Circuit likens a tax refund to a Christmas Club account⁹⁸ and says that an expectation of a special source of income after bankruptcy does not have anything to do with whether or not an asset is "property" and further finds that the retention of a tax refund would not be giving the bankrupt a "fresh start," but a "head start" over those who received no tax refund.⁹⁹

The bankrupt also argued that the tax refund should not be held to be property because the refund, as it is usually small, will not reach the creditors, but will instead be consumed in administration expenses.¹⁰⁰ The court concedes that this argument has merit, but insists that the proper solution is not to declare that tax refunds are not property and do not pass, but rather for the debtor to move the

⁹⁴ *Id.*

⁹⁵ *Id.* at 994-95.

⁹⁶ *Id.* at 995.

⁹⁷ *Id.*

⁹⁸ The Christmas Club analogy was first used in *In re Stanley*, [1970-1973 Transfer Binder] BANKR. L. REP. ¶ 64,160 (E.D. Va. 1971).

⁹⁹ 479 F.2d 990, 995 (2d Cir. 1973), *cert. granted sub nom. Kokoszka v. Belford*, 414 U.S. 1091 (1973). The argument that the retention of the property would not be giving a "fresh start" but a "head start" over others was first made by Mr. Justice Harlan in his dissent to *Lines*. See 400 U.S. 18, 22 (1970).

¹⁰⁰ 479 F.2d 990, 995 (2d Cir. 1973), *cert. granted sub nom. Kokoszka v. Belford*, 414 U.S. 1091 (1973).

bankruptcy court for an order of abandonment,¹⁰¹ which may be granted at the sound discretion of the referee.

The Garnishment Argument. The court in *Kokoszka* holds that tax refunds are not "earnings" and thus are not regulated by the CCPA; the intent of Congress in passing CCPA,¹⁰² as noted above, was to insure that wage earners received at least 75% of their take home pay in order to meet basic needs. It is quite correct that Congress intended that "earnings" mean "periodic payments of compensation and [do] not pertain to every asset that is traceable in some way to some compensation."¹⁰³ This is a corollary of the argument above that "disposable earnings" do not include withholdings, that tax refund checks represent withholding, and therefore that a refund check is not composed of disposable earnings and thus is not controlled by the CCPA.

CONCLUSION

This article has tried to trace the development of the concept of "property", with a particular focus on the intended scope of that term as it was embodied in the Bankruptcy Act of 1898 and subsequent amendments. New, valuable, and unusual property interests have arisen, and the courts have been faced with the problem of deciding whether or not these interests fall within the scope of section 70a or, more particularly, section 70a(5) of the Act. The test enumerated by clause (5) is two-fold: (1) could the property have been transferred by the bankrupt as of the date he filed his petition or (2) is the property reachable under judicial process? Although this is the language included in the statute, one way courts have avoided classifying an interest as property has been to hold that Congress never intended the Act to reach such interests.

To argue that Congress never intended to reach the interest is to argue policy, and, as indicated above, from the legislative history of the Act it is clear that the *primary* policy behind enactment of the statute was to insure that every asset which the bankrupt possessed on the date he filed his petition is equitably distributed among his creditors. The policy of giving the bankrupt a *fresh start* was originally quite secondary in the minds of Congress. At this comparatively early stage of historical development, an asset, if leviable or transferable, passed to the trustee unless it was prevented from doing

¹⁰¹ *Id.* at 996. An order of abandonment may be made pursuant to section 67c(5) of the Act, 11 U.S.C. § 107(c)(5) (1970).

¹⁰² *Id.* at 997.

¹⁰³ *Id.* See also 29 C.F.R. § 870.10(b) (1973).

so by applicable state law. A few present-day state laws are so worded that an income tax refund is not transferable.¹⁰⁴

In *Segal v. Rochelle*,¹⁰⁵ the Supreme Court followed the mandate of the language of the Bankruptcy Act, holding that an inchoate loss carryback tax refund claim passed to the trustee, the Federal Assignment of Claims Act notwithstanding. This represents the outer limit of the Court's definition of property; the *Segal* opinion focused upon the policy behind enactment of the Bankruptcy Act and the requirements dictated by its language.

The remaining question is, then, what effect the Supreme Court's decision in *Lines v. Frederick*¹⁰⁶ has had upon this expansive definition of property? Some courts view *Lines* as carving out a very narrow exception to the general rule and hold that *Segal* stands for that general rule.¹⁰⁷ These courts continue to announce that the "general trend has been toward making the term 'property' within the Bankruptcy Act broader and inclusive of a larger range of interests."¹⁰⁸

Considerable commentary has been devoted to the point that there is a continuing series of bankruptcy decisions based on equitable rather than statutory principles stretching all the way back to the seminal case of *Pepper v. Litton*.¹⁰⁹ The Supreme Court has periodically reaffirmed the theory that equitable principles predominate in bankruptcy cases in such decisions as *Bank of Marin v. England*¹¹⁰ and *Perry v. Commerce Loan Co.*¹¹¹ Some commentators argue that *Lines* is another of these equitable decisions and that the recent trend of the Supreme Court has been to base its decisions upon equitable principles.¹¹²

It is this writer's opinion that *Kokoszka* and *Cedor* each represent one line of this conflicting reasoning; *Cedor* is the progeny of the equitable decisions, while *Kokoszka* follows the traditional, statutorily-based line of cases. Competing policy considerations are thus at stake—the dictates of the Act and the intent behind it versus the increased concern of the Court for a minimal standard of economic

¹⁰⁴ See, e.g., *In re Perry*, 225 F. Supp. 481 (N.D. Ohio 1963).

¹⁰⁵ 382 U.S. 375 (1966).

¹⁰⁶ 400 U.S. 18 (1970).

¹⁰⁷ *In re Kokoszka*, 479 F.2d 990, 994 (2d Cir. 1973), cert. granted sub nom. *Kokoszka v. Belford*, 414 U.S. 1091 (1973); *In re Jones*, 337 F. Supp. 620, 624 (D. Minn. 1971), leave to appeal denied, (8th Cir. May 14, 1971), cert. denied, 404 U.S. 1040 (1972).

¹⁰⁸ 337 F. Supp. 620 (D. Minn. 1971).

¹⁰⁹ 308 U.S. 295 (1939).

¹¹⁰ 385 U.S. 99 (1966).

¹¹¹ 383 U.S. 392 (1966). See note 58 supra.

¹¹² See, e.g., Aug, *Recent Trends in the Application of Equitable Principles of Bankruptcy*, 43 REF. J. 109 (1969).

well-being for U.S. citizens. Thus the lines are drawn, and the Supreme Court will decide the issue in the summer of 1974.

ADDENDUM

The United States Supreme Court, on June 19, 1974,¹¹³ announced in *Kokoszka v. Belford*¹¹⁴ that an income tax refund is "property" which passes to the trustee under section 70a(5) and thus resolved the debate with which this Comment has been concerned. The Court noted the dual (and often conflicting) concerns of the Bankruptcy Act:

It is the twofold purpose of the Bankruptcy Act to convert the estate of the bankrupt into cash and distribute it among creditors and then to give the bankrupt a fresh start with such exemptions and rights as the statute left untouched.¹¹⁵

Segal and *Lines* are briefly reviewed by the Court, which views the opposite holdings of the two cases from a functional viewpoint: "In each case, the Court found the crucial analytical key *not in an abstract articulation of the statute's purpose but in an analysis of the nature of the asset involved* in light of those principles."¹¹⁶

Chief Justice Burger, writing for a unanimous Court, noted that income tax refunds, like the vacation pay in *Lines*, are derived from wages.¹¹⁷ The difference between the two is that vacation pay was "designed to function as a *wage substitute* . . . to 'support the basic requirements of life for [the debtors] and their families. . . .'"¹¹⁸ Citing with approval the Second Circuit's finding that a tax refund was *not* a wage substitute upon which the wage earner depended for his basic support,¹¹⁹ the Court held that unlike depriving the bankrupt of his accrued vacation pay, depriving him of his income tax refund will not hamper his ability to make a fresh start.¹²⁰ Thus, the fact that vacation pay is designed to function as a wage substitute, while a tax refund is not, was a "crucial" distinction.¹²¹ The Court thereupon reiterated the *Segal* test¹²² and held "that the income tax refund is

¹¹³ At the date the foregoing article was completed, the decision analyzed herein had not been rendered, although *certiorari* had been granted. Any discussion of the final status of the income tax refund as an asset of the wage earner's bankruptcy estate would be incomplete without a brief *addendum* on the outcome of the case.

¹¹⁴ 42 U.S.L.W. 4952 (U.S. June 19, 1974).

¹¹⁵ *Id.* at 4953, citing *Burlingham v. Crouse*, 228 U.S. 459, 473 (1913).

¹¹⁶ 42 U.S.L.W. 4952, 4953 (U.S. June 19, 1974) (emphasis added).

¹¹⁷ *Id.* at 4954.

¹¹⁸ *Id.*, citing *Lines v. Frederick*, 400 U.S. 18, 20 (1970) (emphasis added).

¹¹⁹ 479 F.2d 990, 994 (2d Cir. 1973).

¹²⁰ 42 U.S.L.W. 4952, 4954 (U.S. June 19, 1974).

¹²¹ *Id.*

¹²² *Segal v. Rochelle*, 382 U.S. 375, 380 (1966).

'sufficiently rooted in the [*sic*] bankruptcy past' to be defined as 'property' under § 70a(5)."¹²³

The Court further found that while tax refunds have their source in wages, they were not "disposable earnings" within the meaning of the CCPA¹²⁴ and thus were not subject to the wage garnishment restrictions¹²⁵ of that Act. The legislative history of the CCPA, the Court concluded, "fully support[s]"¹²⁶ the view

. . . that Congress, in an effort to avoid the necessity of bankruptcy, sought to regulate garnishment in its usual sense as a levy on periodic payments of compensation needed to support the wage earner and his family on a week-to-week, month-to-month basis.¹²⁷

"Periodic payments of compensation" do not include tax refunds, nor do they include "every asset that is traceable in some way to such compensation."¹²⁸

However sound this decision may be as a construction of applicable principles of the Bankruptcy Act, one clear indication emerges. The two conflicting lines of decisions—those based upon the statutory language of the Act and those based upon equitable principles—still remain. This decision does little to resolve the conflict. Indeed, such language as quoted above, *i.e.*, that the Court finds "the crucial analytical key not in an abstract formulation of the statute's purpose but in an analysis of the nature of the asset involved in light of those principles,"¹²⁹ seems but an indication that future determinations of whether or not new and unusual assets are 70a(5) "property" will be made on an *ad hoc* basis only. One would have hoped for clearer principles to emerge from this conflict.

Michael B. Colgan

¹²³ 42 U.S.L.W. 4952, 4954 (U.S. June 19, 1974).

¹²⁴ *Id.* at 4955.

¹²⁵ The applicable wage garnishment restrictions of the CCPA are discussed in the text accompanying notes 72-73 *supra*.

¹²⁶ 42 U.S.L.W. 4952, 4955 (U.S. June 19, 1974).

¹²⁷ *Id.*

¹²⁸ *Id.*

¹²⁹ *Id.* at 4953.