

**BANKRUPTCY—UNDER THE TURNOVER PROVISION OF SECTION 542(A) OF THE BANKRUPTCY REFORM ACT, THE BANKRUPTCY COURT CAN ORDER THE INTERNAL REVENUE SERVICE TO TURN OVER PROPERTY THAT WAS SEIZED PRIOR TO DEBTOR'S FILING FOR REORGANIZATION. *United States v. Whiting Pools, Inc.* (1983)**

Whiting Pools, Inc. (Whiting), filed a petition for reorganization<sup>1</sup> under Chapter 11 of the Bankruptcy Reform Act of 1978.<sup>2</sup> The day prior to the reorganization filing, the Internal Revenue Service (IRS) had seized Whiting's tangible personal property<sup>3</sup> pursuant to the levy and distraint provision of the Internal Revenue Code of 1954.<sup>4</sup> The provision allows IRS seizure of property and property rights<sup>5</sup> subject to a tax lien.<sup>6</sup> Whiting owed

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1. *United States v. Whiting Pools, Inc.*, 103 S. Ct. 2309, 2310 (1983). Whiting Pools, Inc. was in the business of selling, installing, and servicing swimming pool equipment and supplies. *Id.* It also retailed pool equipment and supplies from its place of business. *In re Whiting Pools, Inc.*, 10 B.R. 755, 756 (1981). The IRS made a tax assessment against Whiting Pools, Inc. for unpaid unemployment taxes owing for the third and fourth quarters of 1979 and the second and third quarters of 1980. *In re Whiting Pools, Inc.*, 15 B.R. 270, 271 (D.C.N.Y. 1981). Despite the IRS' demand for payment, the unpaid balance of such assessment was approximately \$92,000. *Id.* Whiting also had ongoing litigation with Marine Midlands at the time of the Bankruptcy Court filing in which Marine Midlands held a security interest of either \$6,000 or \$12,500 depending upon the outcome of the litigation. *In re Whiting Pools, Inc.*, 10 B.R. at 756.

2. 11 U.S.C. §§ 1101, *et seq.* (Supp. V 1981). Section 1101(1) defines a debtor in possession as the person who is serving as trustee in the case. *Id.* Section 1102(a)(1) provides: "As soon as practicable after the order for relief under this chapter, the court shall appoint a committee of creditors holding unsecured claims." *Id.* § 1102(a)(1). Section 1106 provides that a trustee shall file financial statements and reports which will be used in the investigation of the debtor's acts, conduct, assets, liabilities, and financial condition. *Id.* § 1106. Section 1107 provides that a debtor in possession shall have all the rights of a trustee. *Id.* § 1107.

3. *United States v. Whiting Pools, Inc.*, 103 S. Ct. at 2311. On January 14, 1981, the U.S. acting through the IRS seized all of the debtor's property at its place of business. Whiting's tangible property included equipment, vehicles, inventory, office equipment, and supplies. *In re Whiting Pools, Inc.*, 10 B.R. at 756.

4. 26 U.S.C. § 6331 (1976). Section 6331 provides:

(a) Authority of Secretary - 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 to collect such tax (and such further sum as shall be sufficient to cover the expenses of the levy) 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 . . . .

(b) The term "levy" as used in this title includes the power of distraint and seizure by any means. . . . In any case in which the Secretary may levy upon property or rights to property, he may seize and sell such property or rights to property (whether real or personal, tangible or intangible).

*Id.*

5. *Id.*

6. 26 U.S.C. § 6321 (1976).

approximately \$92,000 in Federal Insurance Contribution Act taxes and federal taxes withheld from its employees, and as a consequence of non-payment, a tax lien had attached to all of its property.<sup>7</sup> After filing for reorganization, Whiting was continued as debtor in possession<sup>8</sup> performing the same functions as a trustee in a reorganization.<sup>9</sup>

Intending to proceed with a tax sale of the seized property,<sup>10</sup> the IRS<sup>11</sup> moved in Bankruptcy Court for a declaration that the automatic stay provision of the Bankruptcy Code, section 362(a),<sup>12</sup> is inapplicable to the IRS or, in the alternative, for a relief from the stay.<sup>13</sup> Intending to use the property

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7. *United States v. Whiting Pools, Inc.*, 103 S. Ct. at 2311. The estimated worth of the seized property in the hands of Whiting as a going concern was \$162,876. *Id.* Testimony taken before the bankruptcy judge indicated that sale of the property by the IRS would net a maximum of \$30,000 to \$35,000, with a more probable recovery in the neighborhood of \$20,000. *United States v. Whiting Pools, Inc.*, 674 F.2d 144, 146 (2d Cir. 1982).

8. *United States v. Whiting Pools, Inc.*, 103 S. Ct. at 2311.

9. 11 U.S.C. § 1107(a) (Supp. V 1981). Section 1107(a) provides:

Subject to any limitations on a trustee under this chapter, and to such limitations or conditions as the court prescribes, a debtor in possession shall have all the rights, other than the right to compensation under section 330 of this title, and powers, and shall perform all the functions and duties, except the duties specified in sections 1106(a)(2), (3), and (4) of this title, of a trustee serving in a case under this chapter.

*Id.*

10. 26 U.S.C. § 6335 (1976). Section 6335 provides that "[a]s soon as practicable after seizure of property, notice in writing shall be given by the Secretary . . . to the owner of the property . . . and shall also give notice of the sale of such property." *Id.*

11. The IRS was represented by the United States Counsel.

12. 11 U.S.C. § 362(a) (Supp. V 1981). Section 362(a) provides:

Except as provided in subsection (b) of this section, a petition filed under section 301, 302 or 303 of this title operates as a stay, applicable to all entities, of—

(1) the commencement or continuation, including the issuance or employment of process, of a judicial, administrative, or other proceeding against the debtor that was or could have been commenced before the commencement of the case under this title, or to recover a claim against the debtor that arose before the commencement of the case under this title;

(2) the enforcement, against the debtor or against property of the estate, of a judgment obtained before the commencement of the case under this title;

(3) any act to obtain possession of property of the estate or of property from the estate;

(4) any act to create, perfect, or enforce any lien against property of the estate;

(5) any act to create, perfect, or enforce against property of the debtor any lien to the extent that such lien secures a claim that arose before the commencement of the case under this title;

(6) any act to collect, assess, or recover a claim against the debtor that arose before the commencement of the case under this title;

(7) the setoff of any debt owing to the debtor that arose before the commencement of the case under this title against any claim against the debtor; and

(8) the commencement or continuation of a proceeding before the United States Tax Court concerning the debtor.

*Id.*

13. *United States v. Whiting Pools, Inc.*, 103 S. Ct. at 2311. The function of the automatic

in his reorganized business, Whiting counterclaimed pursuant to Section 542(a) of the Bankruptcy Code<sup>14</sup> which would require the IRS to turn the seized property over to the bankruptcy estate.<sup>15</sup>

The Bankruptcy Court held that the IRS was bound by the automatic stay provision because the seized property was essential to Whiting's reorganization effort.<sup>16</sup> The court directed the IRS to turn the property over to Whiting conditioned upon Whiting providing the IRS with specified protection for its interest.<sup>17</sup> The court found its authority under section 543(b)(1)<sup>18</sup> of the Bankruptcy Code rather than under section 542(a)<sup>19</sup> as claimed by Whiting. Section 543(b)(1) provides that a custodian shall turn over seized property to the trustee in a bankruptcy,<sup>20</sup> while section 542(a) requires an entity, other than a custodian, to turn over seized property.<sup>21</sup> A custodian is defined by section 101(10)(c) of the Bankruptcy Code as a trustee, receiver, or agent.<sup>22</sup>

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stay is to give the debtor a respite from his creditors by freezing all debt collection proceedings.  
11 U.S.C. § 362(a) (Supp. V 1981).

14. 11 U.S.C. § 542(a) (Supp. V 1981). Section 542(a) provides:

Except as provided in subsection (c) or (d) of this section, an entity, other than a custodian, in possession, custody, or control, during the case, of property that the trustee may use, sell, or lease under section 363 of this title, or that the debtor may exempt under section 522 of this title, shall deliver to the trustee, and account for, such property or the value of such property, unless such property is of inconsequential value or benefit to the estate.

*Id.*

15. *United States v. Whiting Pools, Inc.*, 103 S. Ct. at 2311.

16. *In re Whiting Pools, Inc.* 10 B.R. at 757. "... [T]he seized property is absolutely necessary to an effective reorganization of the debtor. The Service has seized virtually everything this debtor owns. If the stay is lifted and the sale occurs, the debtor will cease to exist."

*Id.*

17. *Id.* at 761. The Bankruptcy Court conditioned the release of the property to the debtor in possession as follows:

1. That the debtor in possession pay the IRS as adequate protection under 11 U.S.C. § 361 the sum of \$20,000 before the turnover occurs, and

2. That the debtor shall pay to the IRS the sum of \$1,000 a month until the tax is paid, and

3. That during this period of time, the IRS shall retain its lien upon the property seized, and

4. That if the debtor fails to make the payments required when the IRS turns over the property, that stay shall be lifted.

*Id.*

18. 11 U.S.C. § 543(b)(1) (Supp. V 1981). Section 543(b)(1) provides: "A custodian shall deliver to the trustee any property of the debtor transferred to such custodian, or proceeds of such property, that is in such custodian's possession, custody, or control on the date that such custodian acquires knowledge of the commencement of the case. . . ." *Id.*

19. 11 U.S.C. § 542(a) (Supp. V 1981).

20. 11 U.S.C. § 543(b)(1) (Supp. V 1981). See *supra* note 18 for text of section 543(b)(1).

21. 11 U.S.C. § 542(a) (Supp. V 1981). See *supra* note 14 for text of section 542(a).

22. 11 U.S.C. § 101(10)(c) (Supp. V 1981). Section 101(10)(c) reads as follows: "... [C]ustodian means—trustee, receiver, or agent under applicable law, or under a contract, that

The Bankruptcy Court held that the IRS has "custody of the debtor's property incident to the enforcement of its lien,"<sup>23</sup> and therefore, the IRS must be considered a custodian within the meaning of section 101(10)(c) of the Bankruptcy Code.<sup>24</sup> The court found that section 543(b)(1) requires a "custodian" to turn over property to the trustee in a bankruptcy case,<sup>25</sup> as opposed to the "entity" language of section 542(a).<sup>26</sup> Thus, the Bankruptcy Court held that the IRS can be ordered to turn over property under section 543(b)(1).<sup>27</sup>

On appeal, the United States District Court of the District of New York held that a turnover order against the IRS was not authorized by either section 542(a) or section 543(b)(1), and reversed the Bankruptcy Court's decision.<sup>28</sup> The United States Court of Appeals, Second Circuit, reversed the district court, holding that a turnover order could issue against the IRS under section 542(a).<sup>29</sup> The case was remanded for reconsideration of the adequacy of the Bankruptcy Court's protective conditions for the IRS' interest in Whiting's property.<sup>30</sup> The United States Supreme Court granted certiorari to resolve the conflict of ruling by the Court of Appeals, Second Circuit, with that of the Fourth Circuit in *Cross Electric Co. v. United States*.<sup>31</sup> The Supreme Court in *Whiting held*, affirmed.<sup>32</sup> Under the turnover provision of section 542(a) of the Bankruptcy Reform Act, the Bankruptcy Court can order the Internal Revenue Service to turn over property that was seized prior to debtor's filing for reorganization. *United States v. Whiting Pools, Inc.*, 103 S. Ct. 2309 (1983).

The Bankruptcy Reform Act of 1978 was enacted to modernize the bankruptcy laws which had not been significantly changed since 1938.<sup>33</sup> Vast changes had occurred in the law of debtor-creditor relations, including the

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is appointed or authorized to take charge of property, or for the purpose of general administration of such property for the benefit of the debtor's creditors. . . ." *Id.*

23. *In re Whiting Pools, Inc.*, 10 B.R. at 760.

24. *Id.*; 11 U.S.C. § 101(10)(c) (Supp. V 1981).

25. 11 U.S.C. § 543(b)(1) (Supp. V 1981).

26. 11 U.S.C. § 542(a) (Supp. V 1981).

27. *In re Whiting Pools, Inc.*, 10 B.R. at 761.

28. *In re Whiting Pools, Inc.*, 15 B.R. at 273.

29. *United States v. Whiting Pools, Inc.*, 674 F.2d 144, 156 (2nd Cir. 1982).

30. *Id.* at 160. See *supra* note 17 for the conditions.

31. 664 F.2d 1218 (4th Cir. 1981). The Fourth Circuit Court in *Cross Electric Co. v. United States* held that an account receivable levied upon by the IRS prior to the filing of petition for reorganization was not property of the debtor's estate. *Id.* at 1221. The trustee in *Cross* had given no indication that he would attempt to redeem the account receivable, and the court found it would not have been reasonable for him to do so. *Id.* The court held that the IRS' levy operated as if it were a transfer to the government of the indebtedness. *Id.* at 1219-20.

32. *United States v. Whiting Pools, Inc.*, 103 S. Ct. at 2317.

33. S. REP. No. 989, 95th Cong., 2d Sess. 2, reprinted in 1978 U.S. CODE CONG. & AD. NEWS 5787, 5788.

adoption of the Uniform Commercial Code and the spread of consumer credit.<sup>34</sup> A steady growth in the number of bankruptcies for both consumer and the more complicated business reorganization cases had created great stresses and strains in the bankruptcy system.<sup>35</sup>

In *Whiting*, the Supreme Court found that Congress intended that the Chapter 11 reorganization provisions of the Bankruptcy Reform Act of 1978<sup>36</sup> assist bankrupt businesses so that they could continue to provide jobs, satisfy creditor's claims, and produce a return for their owners.<sup>37</sup> The legislative history of the Act indicates that Congress believed a business reorganization to be more economically efficient than a liquidation because it permits restructuring of a business's finances so that jobs and assets are preserved.<sup>38</sup>

According to the Court, the congressional presumption was that the assets of the debtor would be more valuable if used in a rehabilitated business than if "sold for scrap."<sup>39</sup> Therefore, the Court held that all of the debtor's property essential to running the business must be included in the reorganization estate, even property in which a creditor has a secured interest.<sup>40</sup> The Court determined that Congress' choice of methods in protecting the creditor suggested its intent to include a broad range of property in the estate.<sup>41</sup> The Bankruptcy Court may give adequate protection to a secured creditor's property interest by imposing limits or conditions upon the trustee's power to sell, use, or lease the property.<sup>42</sup> The Supreme Court found that the secured creditor should not look to the non-bankruptcy remedy of possession for protection, but rather to the appropriate bankruptcy provision<sup>43</sup> to safeguard its interests.<sup>44</sup>

The expressed legislative purpose of the reorganization is to formulate

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34. *Id.*

35. *Id.* at 2-3, 1978 U.S. CODE CONG. & AD. NEWS at 5788-89.

36. 11 U.S.C. § 1101 *et seq.* (Supp. V 1981).

37. *United States v. Whiting Pools, Inc.*, 103 S. Ct. at 2312; H.R. REP. NO. 595, 95th Cong., 2d Sess. at 220, *reprinted in* 1978 U.S. CODE CONG. & AD. NEWS 5963, 6179.

38. H.R. REP. NO. 595, 95th Cong., 2d Sess. at 220, *reprinted in* 1978 U.S. CODE CONG. & AD. NEWS at 6179.

39. *United States v. Whiting Pools, Inc.*, 103 S. Ct. at 2312; H.R. REP. NO. 595, 95th Cong., 2d Sess. at 220, *reprinted in* 1978 U.S. CODE CONG. & AD. NEWS at 6179.

40. *United States v. Whiting Pools, Inc.*, 103 S. Ct. at 2313.

41. *Id.*

42. *Id.*; 11 U.S.C. § 363(e) (Supp. V 1976). Section 363(e) provides:

Notwithstanding any other provision of this section, at any time, on request of an entity that has an interest in property used, sold, or leased, or proposed to be used, sold or leased, by the trustee, the court shall prohibit or condition such use, sale, or lease as is necessary to provide adequate protection of such interest. In any hearing under this section, the trustee has the burden of proof on the issue of adequate protection.

*Id.*

43. 11 U.S.C. § 363(e) (Supp. V 1976).

44. *United States v. Whiting Pools, Inc.*, 103 S. Ct. at 2313.



and have confirmed a plan of reorganization for the debtor.<sup>45</sup> Congress intended that the plan specify how much and in what form (e.g., cash, property, or securities) the creditors will be paid, whether the remaining shareholders will retain their interest in the company, and determine any organizational changes that will be made (e.g., continuing without several unprofitable divisions).<sup>46</sup> Chapter 11 does not require that a trustee handle every reorganization, and thus, in some cases, the debtor remains in possession to manage the property of the estate and continue the operation of the business.<sup>47</sup>

"The filing of a bankruptcy petition . . . automatically stays the enforcement of any lien against the debtor's property or to recover any claim owed by the debtor"<sup>48</sup> under section 362 of the Bankruptcy Code.<sup>49</sup> As one of the primary debtor protections, the automatic stay gives the debtor a breathing spell from its creditors, stops all collection efforts, harassment, and foreclosure actions, and permits the debtor to attempt a repayment or reorganization plan, or simply to be relieved of the financial pressures that drove it into bankruptcy.<sup>50</sup> At the same time, the automatic stay, by its nature, seriously affects the rights of all of the debtor's creditors, secured or unsecured.<sup>51</sup> As a result, certain restrictions can be imposed upon the debtor if the stay is continued.<sup>52</sup> In the form of either cash payments or a replacement lien, adequate protection should be arranged for the secured creditor if the collateral is declining in value or is being depleted during the stay.<sup>53</sup> Moreover, any creditor may request relief from such stay.<sup>54</sup>

The commencement of a bankruptcy case creates the estate for reorganization.<sup>55</sup> Property of the estate, as defined in section 541(a)(1) is comprised of "all legal or equitable interests of the debtor in property as of the commencement of the case," wherever the property may be located.<sup>56</sup> Thus, the

45. H.R. REP. NO. 595, 95th Cong., 2d Sess. at 221, 1978 U.S. CODE CONG. & AD. NEWS at 6180; 11 U.S.C. §§ 1101 *et seq.* (Supp. V 1976).

46. *Id.*

47. *Id.* at 104, 1978 U.S. CODE CONG. & AD. NEWS at 6065; 11 U.S.C. § 1107(a) (Supp. V 1976).

48. S. REP. NO. 989, 95th Cong., 2d Sess. at 4, *reprinted in* 1978 U.S. CODE CONG. & AD. NEWS at 5790; 11 U.S.C. § 362 (Supp. V 1976).

49. 11 U.S.C. § 362(a) (Supp. V 1976). *See supra* note 12 for text of section 362(a).

50. H.R. REP. NO. 595, 95th Cong., 2d Sess. at 54-55, *reprinted in* 1978 U.S. CODE CONG. & AD. NEWS at 5840-41.

51. S. REP. NO. 989, 95th Cong., 2d Sess. at 4, *reprinted in* 1978 U.S. CODE CONG. & AD. NEWS at 5790.

52. *Id.*

53. *Id.*

54. *Id.* at 4-5, 1978 U.S. CODE CONG. & AD. NEWS at 5790-91.

55. *Id.* at 82, 1978 U.S. CODE CONG. & AD. NEWS at 5868; H.R. REP. NO. 595, 95th Cong., 2d Sess. at 367, *reprinted in* 1978 U.S. CODE CONG. & AD. NEWS at 6323.

56. 11 U.S.C. § 541(a) (Supp. V 1976). Section 541(a) provides:

The commencement of a case under section 301, 302, or 303 of this title creates an

property of the estate need not be in the debtor's possession. Legislative history explains that the policy of the Bankruptcy Reform Act of 1978 was "to include all of the property of the debtor in the bankruptcy case and to allow the trustee more easily to recover property that may have been transferred by the debtor."<sup>57</sup> Congress presumed that as a result of this policy, the amounts that would be returned to all creditors would be greater.<sup>58</sup>

Section 363 empowers the trustee to use, sell, or lease any property of the estate subject to conditions necessary to provide adequate protection for the creditor's interest in the property.<sup>59</sup> Congress believed that this provision would most often be used in reorganization cases.<sup>60</sup> In order for a debtor to successfully reorganize, it is important that the business continue uninterrupted.<sup>61</sup> Any break in operations could result in a loss of customers which might not be regained.<sup>62</sup> If the trustee or debtor in possession had to seek a court order authorizing each use, sale, or lease of soft collateral (e.g.,

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estate. Such estate is comprised of all the following property, wherever located:

(1) Except as provided in subsections (b) and (c)(2) of this section, all legal or equitable interests of the debtor in property as of the commencement of the case.

(2) All interests of the debtor and the debtor's spouse in community property as of the commencement of the case that is—

(A) under the sole, equal, or joint management and control of the debtor; or

(B) liable for an allowable claim against the debtor, or for both an allowable claim against the debtor and an allowable claim against the debtor's spouse, to the extent that such interest is so liable.

(3) Any interest in property that the trustee recovers under section 543, 550, 553 or 723 of this title.

(4) Any interest in property preserved for the benefit of or ordered transferred to the estate under section 510(c) or 551 of this title.

(5) An interest in property that would have been property of the estate if such interest had been an interest of the debtor on the date of the filing of the petition, and that the debtor acquires or becomes entitled to acquire within 180 days after such date—

(A) by bequest, devise, or inheritance;

(B) as a result of a property settlement agreement with the debtor's spouse, or of an interlocutory or final divorce decree; or

(C) as a beneficiary of a life insurance policy or of a death benefit plan.

(6) Proceeds, product, offspring, rents, and profits of or from property of the estate, except such as are earnings from services performed by an individual debtor after the commencement of the case.

(7) Any interest in property that the estate acquires after the commencement of the case.

*Id.*

57. S. REP. NO. 989, 95th Cong., 2d Sess. at 5, reprinted in 1978 U.S. CODE CONG. & AD. NEWS at 5791.

58. *Id.*

59. 11 U.S.C. § 363 (Supp. V 1976).

60. H.R. REP. NO. 595, 95th Cong., 2d Sess. at 182, reprinted in 1978 U.S. CODE CONG. & AD. NEWS at 6143.

61. *Id.*

62. *Id.*

inventory), the delay could be fatal to the business.<sup>63</sup>

Under subsections 363(d) and (e), the use, sale, or lease of property is limited by the concept of adequate protection.<sup>64</sup> The bankruptcy court may prohibit or condition the use, sale, or lease of the property of the estate as is necessary to provide adequate protection of the creditor's interest.<sup>65</sup> Congress believed the issue becomes "most difficult when the property being used is collateral for a loan to the debtor."<sup>66</sup> The legislators felt that it was absolutely necessary that the secured creditor's property interest be protected, and that no constitutionally proscribed erosion could take place.<sup>67</sup> Thus, section 363 provides protection for both the debtor, in the operation of the business, and the secured creditor, in the debtor's use of the collateral.<sup>68</sup>

In *Whiting*, the Supreme Court first examined whether section 542(a) of the Bankruptcy Code authorizes the turnover of a debtor's property if that property has been seized by a secured creditor prior to the commencement of the debtor's reorganization proceeding.<sup>69</sup> Under section 542(a), an "entity . . . in possession" of property is required to deliver that property to the trustee, if the trustee of the reorganization proceeding can use, sell, or lease under section 363.<sup>70</sup> The Court viewed these statutes as defining that which is included in the estate as *all* "interests of the debtor in property," rather than limiting it to those interests at the time of the filing of reorganization.<sup>71</sup>

The Court held that the statutory language reflected a broad view of the scope of the bankrupt estate especially when coupled with the legislative intent behind the reorganization provisions.<sup>72</sup> Section 541(a)(1) provides that the "estate is comprised of all the following property, wherever located: . . . all legal or equitable interests of the debtor in property as of the commencement of the case."<sup>73</sup> The House and Senate Reports on the Bankruptcy Code indicate: "The scope of [section 541(a)(1)] is broad. It includes all kinds of property, including tangible or intangible property, causes of action, . . . and all other forms of property currently specified in section 70a of the Bankruptcy Act. . . ."<sup>74</sup> The Court determined that most impor-

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63. *Id.*

64. *Id.* at 56, 1978 U.S. CODE CONG. & AD. NEWS at 5842. See *supra* note 42 for text of section 363(e).

65. *Id.*

66. *Id.* at 181, 1978 U.S. CODE CONG. & AD. NEWS at 6142.

67. *Id.*

68. *Id.* at 182, 1978 U.S. CODE CONG. & AD. NEWS at 6142.

69. *United States v. Whiting Pools, Inc.*, 103 S. Ct. at 2312.

70. 11 U.S.C. § 542 (Supp. V 1976). See *supra* note 14 for text of section 542.

71. *United States v. Whiting Pools, Inc.*, 103 S. Ct. at 2312.

72. *Id.* at 2313.

73. 11 U.S.C. § 541(a)(1) (Supp. V 1976).

74. S. REP. NO. 989, 95th Cong., 2d Sess. at 82, reprinted in 1978 U.S. CODE CONG. & AD.



tantly section 541(a)(1) was intended to incorporate in the bankrupt estate any property made available by other provisions of the Bankruptcy Code, including property not in the debtor's possession when the bankruptcy commenced.<sup>75</sup>

The court found that section 542(a) broadened the term "property of the estate."<sup>76</sup> The House and Senate Reports expressly included property of the debtor recovered under section 542 as part of the estate.<sup>77</sup> The estate includes "property recovered by the trustee under Section 542 of proposed Title 11, if the property recovered was merely out of the possession of the debtor, yet remained 'property of the debtor.'"<sup>78</sup> Title to property is also included as part of the debtor's interest in property, as are the debtor's possessory interests.<sup>79</sup> Therefore, property of the debtor repossessed by a secured creditor may be drawn into the estate,<sup>80</sup> unless it falls into one of the limitations of section 542.<sup>81</sup>

Thus, section 542(a) grants to the estate a possessory interest in certain property of the debtor that was not held by the debtor at the commencement of the reorganization proceedings.<sup>82</sup> The broad scope of this provision is consistent with other provisions of the Bankruptcy Code, particularly section 544 (trustee has rights of lien creditor),<sup>83</sup> section 545 (trustee has power to avoid statutory liens),<sup>84</sup> and section 549 (trustee has power to avoid certain post-petition transactions).<sup>85</sup>

The Supreme Court held that this interpretation of section 542(a) was supported by legislative history<sup>86</sup> and by the analysis of the Second Circuit Court of Appeals.<sup>87</sup> The Second Circuit examined whether either section 542(a) or section 543(b)(1) required the IRS to turn over the seized property.<sup>88</sup> Section 543(b)(1) provides that a custodian shall ". . . deliver to the

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News at 5868.

75. *United States v. Whiting Pools, Inc.*, 103 S. Ct. at 2313; *see e.g.*, section 543, 547 and 548.

76. *United States v. Whiting Pools, Inc.*, 103 S. Ct. at 2313.

77. H.R. REP. NO. 595, 95th Cong., 2d Sess. at 367, *reprinted in* 1978 U.S. CODE CONG. & AD. NEWS at 6323; S. REP. NO. 989, 95th Cong., 2d Sess. at 82, *reprinted in* 1978 U.S. CODE CONG. & AD. NEWS at 5868.

78. *Id.*

79. *Id.*; *see* 4 L. King, *Collier on Bankruptcy* ¶ 541.16, p. 541-72.10 (15th ed. 1982).

80. *United States v. Whiting Pools, Inc.*, 103 S. Ct. at 2314.

81. *Id.* Section 542 provides that turnover is not required: (a) when the property is of inconsequential value of benefit to the estate; (b) when the holder of the property has transferred it in good faith without knowledge of the petition; or (c) when the transfer of the property is automatic to pay a life insurance premium. 11 U.S.C. § 542 (Supp. V 1976).

82. *United States v. Whiting Pools, Inc.*, 103 S. Ct. at 2314.

83. 11 U.S.C. § 544 (Supp. V 1976).

84. 11 U.S.C. § 545 (Supp. V 1976).

85. 11 U.S.C. § 549 (Supp. V 1976).

86. *United States v. Whiting Pools, Inc.*, 103 S. Ct. at 2315.

87. *United States v. Whiting Pools, Inc.*, 674 F.2d 144, 145 (2d Cir. 1982).

88. *Id.*

trustee any property of the debtor transferred to such custodian, or proceeds of such property, that is in such custodian's possession, custody, or control on the date that such custodian acquires knowledge of the commencement of this case. . . .<sup>89</sup> The court of appeals determined that section 101 defined "custodian" as agents authorized to take possession of or to liquidate a person's property.<sup>90</sup> The definition does not include anyone who is so authorized, but only a person who acts as a trustee, receiver, or agent.<sup>91</sup>

The court of appeals found that the IRS was not a trustee or receiver because seizure of property<sup>92</sup> by the IRS is not pursuant to a consensual relationship but is instead imposed by law irrespective of and contrary to the taxpayer's desires.<sup>93</sup> Although section 543(c) requires the bankruptcy court to provide a custodian with reasonable compensation, the court of appeals could not apply the congressional intent behind this to the IRS.<sup>94</sup> Thus, the court found that when secured creditors were involved, section 542 was more appropriate for resolving turnover disputes than section 543.<sup>95</sup> The court held that section 542's explicit reference to section 363 and to the adequate protection requirements would be the correct provision for a creditor with a secured interest in property.<sup>96</sup>

The Supreme Court found that this interpretation of section 542(a), authorizing the turnover of property of the debtor in the possession of secured creditors, was also consistent with judicial precedent predating the Bankruptcy Code.<sup>97</sup> Prior to the Bankruptcy Reform Act of 1978, the bankruptcy court could order the turnover of collateral in the hands of a secured creditor,<sup>98</sup> and nothing in the legislative history evinced a congressional intent to

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89. 11 U.S.C. § 543 (Supp. V 1976).

90. 11 U.S.C. § 101(10) (Supp. V 1976). Section 101(10) provides:

[C]ustodian means—

(A) receiver or trustee of any of the property of the debtor, appointed in a case or proceeding not under this title;

(B) assignee under a general assignment for the benefit of the debtor's creditors; or

(C) trustee, receiver, or agent under applicable law, or under a contract, that is appointed or authorized to take charge of property of the debtor for the purpose of enforcing a lien against such property, or for the purpose of general administration of such property for the benefit of the debtor's creditors. . . .

*Id.*

91. *United States v. Whiting Pools, Inc.*, 674 F.2d at 148.

92. 26 U.S.C. § 6331 (1976).

93. *United States v. Whiting Pools, Inc.*, 674 F.2d at 148.

94. *Id.* at 149.

95. *Id.* (citing *In re Whiting Pools*, 10 B.R. at 760).

96. 674 F.2d at 149.

97. *United States v. Whiting Pools, Inc.*, 103 S. Ct. at 2315.

98. *See, e.g., Reconstruction Finance Corp. v. Kaplan*, 185 F.2d 791, 796 (1st Cir. 1950) (the court held that although it might interfere with and postpone secured creditor's remedy, it must be careful not to impair the substantive rights of the secured creditor); *In re Third Ave. Transit Corp.*, 198 F.2d 703, 706 (2d Cir. 1952). *See also*, 6A J. Moore & L. King, *Collier on Bankruptcy* ¶14.03, at 741-42 (14th ed. 1977).

depart from that practice.<sup>99</sup> The Court found that if section 542(a) were interpreted in another manner, the bankrupt estate would be deprived of the assets and property needed for its rehabilitation, and the congressional purpose behind the reorganization provisions would be frustrated.<sup>100</sup> Thus, the Court concluded "that the reorganization estate included property of the debtor that has been seized by a creditor prior to the filing of a petition for reorganization."<sup>101</sup> However, the Court stated that while section 542(a) also governs turnovers in Chapters 7 (liquidation)<sup>102</sup> and 13 (individual adjustment of debt proceedings),<sup>103</sup> the Court could not express a view on whether section 542(a) has the same broad effect in those chapters.<sup>104</sup>

That the Court was deliberate in its decision not to extend its holding beyond Chapter 11 reorganizations is demonstrated by the Court's extensive use of legislative history to support its limited holding. If Congress had intended to include Chapters 7 and 13, then it would have indicated so in the Bankruptcy Act's legislative history. The courts should not be policymakers in the absence of legislative intent. The IRS may interpret the *Whiting* decision as allowing it greater rights than those presently afforded to a secured creditor in Chapters 7 and 13 bankruptcies, at least until the courts decide to address this issue.

The Supreme Court then examined whether a different result should be obtained when the IRS was the creditor.<sup>105</sup> By virtue of its tax lien, the IRS held a security interest in *Whiting's* property.<sup>106</sup> The Court determined that the IRS was bound by section 542(a) as any other secured creditor.<sup>107</sup> Section 101(14) of the Bankruptcy Code states that the term "entity," used in section 542(a), includes a governmental unit.<sup>108</sup> The Senate Finance Committee proposed an amendment to section 541 providing that taxes withheld or collected by the debtor from others before the bankruptcy case began, such as federal and state income taxes and Federal Insurance Contribution Act (FICA) taxes, are not property of the estate.<sup>109</sup> Congress did not adopt the amendment, although it did consider the effect of the new Bankruptcy Code on tax collection and decided to provide other protection to tax collectors.<sup>110</sup> The tax collectors can use the right to adequate protection under

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99. *United States v. Whiting Pools, Inc.*, 103 S. Ct. at 2315.

100. *Id.*

101. *Id.*

102. 11 U.S.C. §§ 701-66 (Supp. V 1976).

103. 11 U.S.C. §§ 1301-30 (Supp. V 1976).

104. *United States v. Whiting Pools, Inc.*, 103 S. Ct. at 2315 n.17.

105. *Id.* at 2315.

106. *Id.* at 2312.

107. *Id.* at 2315.

108. *Id.*; see also 11 U.S.C. § 101(14) (Supp. V 1976).

109. S. REP. NO. 1106, 95th Cong., 2d Sess. 33 (1978).

110. Section 507(a)(6) provides for priorities of unsecured tax claims, and section 523(a)(1) provides for nondischarge of tax liabilities. S. REP. NO. 989, 95th Cong., 2d Sess. at

section 363(e) if they have a lien on the property.<sup>111</sup> Thus, the Supreme Court held that "nothing in the Bankruptcy Code or its legislative history indicates that Congress intended a special exception for the tax collector in the form of an exclusion from the estate of property seized to satisfy a tax lien."<sup>112</sup>

However, if ownership of the property is transferred to the IRS subsequent to a tax levy or seizure, section 542 might not apply.<sup>113</sup> Although the Internal Revenue Code<sup>114</sup> empowered the IRS to enforce its tax liens that are senior to those possessed by private secured creditors under state law,<sup>115</sup> the ownership of the property is not transferred to the IRS.<sup>116</sup> The Court cited *Phelps v. United States*<sup>117</sup> as suggesting the contrary. In *Phelps*, the IRS levied a fund that was "held by an assignee of the debtor for the benefit of the debtor's creditors."<sup>118</sup> Under the old Bankruptcy Act, the trustee in the *Phelps* liquidation proceeding asked that the assignee turn over the funds to the estate.<sup>119</sup> The *Phelps* Court held that the levy conveyed constructive possession of the fund to the IRS, which would deprive the bankruptcy court of jurisdiction.<sup>120</sup> The Supreme Court in *Whiting* determined that this proposition was now irrelevant because of the expanded jurisdiction of bankruptcy courts under the Bankruptcy Reform Act of 1978.<sup>121</sup>

The Supreme Court found that the levy and seizure provisions<sup>122</sup> were

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14-15, reprinted in 1978 U.S. CODE CONG. & AD. NEWS at 5800-01.

111. *United States v. Whiting Pools, Inc.*, 103 S. Ct. at 2316.

112. *Id.*

113. *Id.*

114. 26 U.S.C. §§ 6321-26 (1976).

115. See *United States v. Rodgers*, 103 S. Ct. 2132 (1983); *United States v. Bess*, 357 U.S. 51, 56-57 (1958). In *Rodgers*, the Court held that the government's power to enforce its lien was greater than the homestead rights of a private citizen. 103 S. Ct. at 2135. The Court held that a district court, in order to satisfy a tax lien, may order the sale of the home of a delinquent taxpayer even though his spouse has a homestead interest in the residence under state law. *Id.* at 2134. The Court found that the IRS' lien cannot extend beyond the taxpayer's interest in the residence and that the IRS may not ultimately collect any of its judgment against the nonliable party's interest in the residence upon a sale. *Id.* However, the Supreme Court noted that the right to collect and the right to seek a forced sale are two different matters. *Id.* at 2135. Likewise the Supreme Court in *Bess* held that because of the tax liens which had attached to all of the insured's property before his death, the beneficiary is liable to the extent of the cash surrender values of the policies. *United States v. Bess*, 357 U.S. at 59. The Court found that under New Jersey law, the insured did not possess, prior to his death, "property" or "rights to property" in the proceeds of his life insurance policies, but did possess it in the cash surrender values. *Id.* at 56. Thus, the federal tax lien attached even if the insured's property right represented by the cash surrender values was not subject to creditor's liens. *Id.* at 57.

116. *United States v. Whiting Pools, Inc.*, 103 S. Ct. at 2316.

117. *Phelps v. United States*, 421 U.S. 330 (1975).

118. *Id.* at 331.

119. *Id.*

120. *Id.* at 337.

121. *United States v. Whiting Pools, Inc.*, 103 S. Ct. at 2316 n.18.

122. 26 U.S.C. §§ 6331, 6332 (1976).

special procedural devices employed by the IRS to protect its liens.<sup>123</sup> These provisions, however, do not define the IRS' rights to the seized property; rather the property is merely brought into the IRS' legal custody.<sup>124</sup> The Court determined that many factors ensure that the IRS' interest in the property never exceeds the value of the lien.<sup>125</sup> One is that the IRS must refund to the debtor any surplus from the sale.<sup>126</sup> Also, title to the property is only transferred after the property has been sold to a purchaser at a tax sale.<sup>127</sup> Ironically, the tax sale provision regards the debtor as the owner of the property even after the property has been seized but not sold.<sup>128</sup> The Court found that "[u]ntil such a tax sale takes place, the property remains the debtor's and thus is subject to the turnover requirement of Section 542(a)."<sup>129</sup>

In conclusion, the Court held that under section 542(a) of the Bankruptcy Code, the IRS is required to turn over property it seized to satisfy a tax lien prior to the debtor's filing for reorganization.<sup>130</sup> In affirming the decision by the Second Circuit Court of Appeals, the Supreme Court has resolved the conflict among the courts as to the inclusion of secured interests in "turnover" proceedings, and has held that the IRS is bound by section 542(a) like any other secured creditor.<sup>131</sup>

One inevitable effect of the *Whiting* decision will be the decreased revenue collected by the IRS in future reorganization bankruptcies. "[T]axes are the life-blood of government, and their prompt and certain availability [is] an imperious need."<sup>132</sup> If the IRS must stand in line with the other secured creditors, then the turnover of the property undoubtedly makes the taxing government bear more risk.<sup>133</sup> The IRS is more likely to collect the full amount of delinquent taxes if it sells seized property than if it is forced to allow the debtor to continue in business and make payments in protection of

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123. *United States v. Whiting Pools, Inc.*, 103 S. Ct. at 2316; *United States v. Sullivan*, 333 F.2d 100, 116 (3d Cir. 1964). The Court of Appeals in *Sullivan* held that a statutory levy effects a seizure of the delinquent's property tantamount to a transferral of ownership. 333 F.2d at 116.

124. *United States v. Whiting Pools, Inc.*, 103 S. Ct. at 2316. See 4 B. Bittker, *Federal Taxation of Income, Estate and Gifts* ¶111.5.5, at 111-18 (1981). See generally, Plumb, *Federal Tax Collection And Lien Problems*, pt. 1, 13 TAX L. REV. 247, 272 (1958).

125. *United States v. Whiting Pools, Inc.*, 103 S. Ct. at 2316; *United States v. Rodgers*, 103 S.Ct. 2132 (1983). See *United States v. Sullivan*, 333 F.2d at 116.

126. 26 U.S.C. § 6342(b) (1976).

127. 26 U.S.C. § 6339(a)(2) (1976). See *Bennett v. Hunter*, 76 U.S. (9 Wall.) 326, 336 (1870); Plumb, *supra* note 120 at 274-75.

128. 26 U.S.C. § 6335 (1976).

129. *United States v. Whiting Pools, Inc.*, 103 S. Ct. at 2317.

130. *Id.*

131. *Id.*

132. *Bull v. United States*, 295 U.S. 247, 259 (1935).

133. Nowak, *Turnover Following Prepetition Levy Of Distraint Under Bankruptcy Code* §542, 55 AM. BANKR. L.J. 313, 341 (1981).



the IRS' interests.<sup>134</sup> However, this risk of loss would only extend to Chapter 11 reorganizations since the Supreme Court clearly stated that it would not extend, in this decision, the broad effects of the turnover provision to Chapter 7 liquidations and Chapter 13 individual adjustment of debt proceedings.<sup>135</sup>

Nevertheless, of all creditors, the Federal Government is best able to absorb and distribute the effect of the loss.<sup>136</sup> Federal and state collectors are neither charged with the responsibility nor equipped with the means of ascertaining whether the public interest is better served by prompt collection of taxes or by extending to the delinquent taxpayer an opportunity to reorganize.<sup>137</sup> The Supreme Court in *Whiting* has adhered to congressional intent in its decision to limit the IRS. If the rights of the IRS are to extend in Chapter 11 bankruptcies, then it must come from Congress itself, not the courts.

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134. *Id.* at 340.

135. *United States v. Whiting Pools, Inc.*, 103 S. Ct. at 2315 n.17.

136. Wolfson, *Tax Superiority In Bankruptcy—A Study Of The Business Bankruptcy Distributions In The Southern And Western Districts Of New York*, 26 *BUR. L. REV.* 713, 726 (1977).

137. Nowak, *Turnover Following Prepetition Levy Of Distrainment Under Bankruptcy Code §542*, 55 *AM. BANKR. L.J.* at 341.