RECENT CASES

Bankruptcy—Jurisdiction over Tax Claims—[Federal].—In a proceeding under section 77B of the Bankruptcy Act, claims of the state of Illinois for realty taxes were questioned by the trustee in bankruptcy as based upon an excessive valuation. Upon appeal from an order of the district court overruling the trustee's objections, *held*, although the court under section 77B has power to consider objections to taxes on the basis of excessive valuation, this power is confined to determinations of the validity of the tax under the laws of the state or the Constitution of the United States. There was here no violation of the federal constitution or of state law. There is no power in a court of bankruptcy to scale down an otherwise valid tax claim solely on the ground that the tax is excessive. Judgment affirmed. *In re 168 Adams Bldg. Corp.*[1]

Outside of bankruptcy proceedings, federal jurisdiction to restrain the collection of a tax is based upon the limitations on state action contained in the Fourteenth Amendment, or upon diversity of citizenship in actions alleging violation of a state law. Of these two grounds for jurisdiction, the Fourteenth Amendment has given rise to most litigation. Under the equal protection clause, when a tax based upon an excessive valuation of the property is attacked, relief will be granted upon the showing of an intentional discrimination either in the administration[2] of the taxing statute or in the system of classification adopted by the statute itself.[3] Overvaluation alone, in the absence of intent to overvalue, will not cause the court to set aside the valuation.[4] Nevertheless, an intent to overvalue may be inferred from the excessiveness of the valuation.[5] In addition to the sanction of the equal protection clause, in at least one case, *Great Northern R. Co. v. Weeks*,[6] the due process clause constituted the basis of setting aside an excessive tax. The court, despite the non-discriminatory nature of the tax, set it aside on the ground that the assessed valuation was so excessive as to violate due process.

Congressional power to invest bankruptcy courts with jurisdiction to set aside tax assessments other than those which constitute a denial of due process or equal protection, is predicated upon the constitutional grant of power to Congress to make uniform laws concerning bankruptcy.[7] Adjustment of all claims is a legitimate function of bankruptcy which is essentially a process of adjustment of debtor-creditor

[1] 105 F. (2d) 704 (C.C.A. 7th 1939).

[2] Cumberland Coal Co. v. Board of Revision, 284 U.S. 23 (1931); Raymond v. Chicago Traction Co., 207 U.S. 20 (1907).

[3] Louisville Gas & Electric Co. v. Coleman, 277 U.S. 32 (1928); Concordia Fire Ins. Co. v. Illinois, 292 U.S. 535 (1934); Stewart Dry Goods Co. v. Lewis, 294 U.S. 550 (1935).

[4] Chicago G. W. R. Co. v. Kendall, 266 U.S. 94 (1924).

[5] Sioux City Bridge Co. v. Dakota County, 260 U.S. 441 (1923); Sunday Lake Iron Co. v. Wakefield, 247 U.S. 350 (1918).

[6] 297 U.S. 135 (1936).

[7] Art. I, Section 8.

relations.[8] Tax claims of a state are not inviolate,[9] although they are entitled to priority under the bankruptcy statute.[10] Since an equitable distribution of the bankrupt's assets is dependent upon a thorough analysis of the validity of creditors' claims, state tax claims should be open to investigation.

Jurisdiction of bankruptcy courts over tax claims is derived from section 64a (re-enacted in section 64a(4))[11] of the Bankruptcy Act. This section provides that "in case any question arises as to the amount or legality of any such tax, the same shall be heard and determined by the court." Most courts have concluded that the power granted by section 64a may not be exercised in proceedings under section 77B since section 64a is only applicable after an order for liquidation has been entered.[12] This position is based upon the prohibitory language of section 77B[13] and upon the argument that the power to determine tax claims is much less important in bankruptcy for reorganization than in bankruptcy for liquidation.[14] Adopting this reasoning, the bankruptcy court has no greater jurisdiction over tax claims in reorganization proceedings under section 77B than any federal court would have over suits for reduction of tax claims brought apart from bankruptcy proceedings. The principal case suggests a departure from the usual view. It states that section 64a applies by implication even before an order for liquidation has been entered,[15] a result that directly contravenes the words of section 77B.

Evidencing the reluctance of the federal courts to assume jurisdiction in ordinary tax cases is the rule that a court will not assume jurisdiction in the first instance if a

[8] Williams v. U.S. Fidelity & Guaranty Co., 236 U.S. 549 (1915); see also Gilbert's Collier, Bankruptcy § 3 (4th ed. 1937).

[9] Van Huffel v. Harkelrode, 284 U.S. 225 (1931); First Nat'l Bank of Baltimore v. Staake, 202 U.S. 141 (1906); New York v. Irving Trust Co., 288 U.S. 329 (1933).

[10] 30 Stat. 563 (1898), 11 U.S.C.A. § 104 (Supp. 1939). The Bankruptcy Act of 1939 embodies the provision in section 64.

[11] 30 Stat. 563 (1898), 11 U.S.C.A. § 104(a) (Supp. 1939). The Bankruptcy Act of 1939 embodies the same provision in section 64a(4).

[12] In re Manning, 16 F. Supp. 932 (N.J. 1936); Springfield v. Hotel Charles Co., 84 F. (2d) 589 (C.C.A. 1st 1936); In re Denver & R.G.W.R. Co., 23 F. Supp. 298 (Colo. 1938).

[13] Section 77B (K) provides that ". . . . None of the sections enumerated in this subdivision (K), except subdivisions (g), (i), (j), and (m) of section 57, and subdivisions (a) and (e) of section 70, shall apply to proceedings instituted under this section 77B unless and until an order has been entered directing the trustee or trustees to liquidate the estate," 48 Stat. 912 (1934), 11 U.S.C.A. 207 (K) (Supp. 1939). Section 77B has been replaced by Chapter X, but no substantial change has been made.

The Bankruptcy Act of 1939 likewise excludes the application of section 64 in proceedings for reorganization. Chapter X, section 102 provides as follows: ". . . . Provided, however, that section 23, subdivisions h and n of section 47, section 64, and subdivision f of section 70, shall not apply in such proceedings unless an order shall be entered directing that bankruptcy be proceeded with pursuant to the provisions of chapters I to VII, inclusive."

[14] Springfield v. Hotel Charles Co., 84 F. (2d) 589 (C.C.A. 1st 1936); In re Eldridge Brewing Co. (D.C. N.H. 1940). The latter case also indicates that the failure to include the provisions of section 64 (a) in section 77B is indicative of a legislative purpose to remove tax abatements from the control of the bankruptcy court and place them under the control of the administrative machinery of the taxing sovereign.

[15] 105 F. (2d) 704, 707 (C.C.A. 7th 1939).

"plain, speedy, and efficient" remedy exists in the state courts[16] and if all administrative remedies have not been exhausted.[17] But under section 64a, jurisdiction has not been denied merely because of failure to make use of state statutory appeal provisions.[18] This practice appears consistent with the exhaustion of administrative and legal remedies doctrine since the doctrine applies only when such remedies are potentially adequate to provide relief. The Bankruptcy Act is intended to wind up a debtor's estate promptly and yet preserve it from unjust claims. These results can only be attained by permitting the bankruptcy court to "short-circuit" the system of statutory appeals available to an objecting taxpayer, and to hear objections which ordinarily would have to be presented to a board of tax appeals or some other statutory reviewing body.

Similarly the expiration of the statutory period within which appeal is permitted is no bar to relief under section 64a.[19] Were the rule otherwise, the bankrupt estate would often be subject to tax claims rendered incontestable because the time within which statutory appeals must be taken has passed. To hold claims incontestable for this reason would be manifestly unjust, because persons in failing financial circumstances are likely to be lax in appealing from levies of excessive taxes.[20] Moreover, the very excessiveness of the tax may itself be due to the fact that the failing debtor exaggerated his tax returns in order to preserve an appearance of financial stability.[21]

Assuming that jurisdiction to inquire into the validity of a tax claim exists under section 64a, the question arises as to the scope of reviewing power thus granted. Since the tax claim as presented by the state is entitled to a prima facie validity, as are other claims against the bankrupt's estate,[22] the trustee must produce some evidence to show that the tax was wrongly assessed.[23] Once this presumption has been overcome and the bankruptcy court has determined that the tax should be set aside, the court need not await further action by state officials, but may proceed itself to determine the correct tax.[24] But in invalidating the tax, it is not clear whether the bankruptcy court is merely exercising the orthodox reviewing function of federal courts, setting aside the tax for lack of due process or equal protection, or whether the court is going further and setting aside the tax on the ground that it is erroneous. Several statements in the cases seem to indicate that the bankruptcy court is performing the latter function.[25] Moreover, it appears that even if only orthodox review is given, bankruptcy

[16] 50 Stat. 738 (1937), 28 U.S.C.A. § 41 (1) (Supp. 1939).

[17] City Bank v. Schnader, 291 U.S. 24 (1934); Porter v. Investor's Syndicate, 286 U.S. 461 (1932).

[18] Henderson v. Wilkins, 43 F. (2d) 670 (C.C.A. 4th 1930); In re Williams, 265 Fed. 401 (D.C. Ky. 1920); Truman v. Thalmeier, 19 F. (2d) 468 (C.C.A. 9th 1927); In re Otto Freund Yeast Co., 178 Fed. 305 (D.C. N.Y. 1910). Contra: In re A. V. Manning's Sons, 16 F. Supp. 932 (N.J. 1936); In re Bushnell, 215 Fed. 651 (D.C. Conn. 1914).

[19] In re Otto Freund Yeast Co., 178 Fed. 305 (D.C. N.Y. 1910).

[20] In re Fischer, 229 Fed. 316 (D.C. Mass. 1915); Henderson v. Wilkins, 43 F. (2d) 670 (C.C.A. 4th 1930).

[21] Cases cited in note 20 supra. [22] In re Bradley, 16 F. (2d) 301 (D.C. N.Y. 1926).

[23] Whitney v. Dresser, 200 U.S. 532 (1906).

[24] In re Fischer, 229 Fed. 316 (D.C. Mass. 1915).

[25] Ibid.; In re Simcox, 243 Fed. 479 (D.C. N.Y. 1917).

courts are able to set aside income taxes because of a failure to follow the prescribed statutory procedure;[26] to set aside, in whole or in part, personal property taxes where the property taxed was exempt or non-existent;[27] and to set aside state corporation taxes in similar situations or in cases where the stock taxed was valueless.[28]

The distinction between the various theories of review may become important, however, in cases where, as in the instant one, it is objected that the tax on real property is too great because the assessed valuation is excessive. To require that the bankruptcy court make an "independent determination" of the tax in this situation would be undesirable even though it be assumed that the court will arrive at a result different from that of the tax assessor. The valuation process is at best a speculative one. Crude and approximately accurate valuations in tax cases may be justified by the tremendous administrative burden involved in placing annual values on thousands of different properties. Moreover, state taxing statutes give little meaning to the concept of value, relying for definition on such vague phrases as "true cash value," "fair market value," "true value," "actual value," etc.[29] State courts have permitted assessors to attach importance to various indicia of value: reproduction cost, original cost, earning power, security prices.[30] The variety of value criteria permits property valuations to vary over a wide range without it being possible to condemn any one method of valuation as wrong. Thus, the court in the present case seems justified in refusing to make a new valuation merely because it feels that it might arrive at a result different from that which the taxing body reached. In saying that it will not invalidate a tax for "mere excessiveness," the court apparently indicates that it will not set aside a valuation, which, with regard to all the variables in the valuation process, a taxing body might reasonably reach. If this interpretation is correct, section 64a of the Bankruptcy Act, although purporting to give the bankruptcy courts power to set aside valuations excessive in amount, has actually not expanded the general power of the federal courts to set aside illegal valuations in this particular class of cases; nor has it extended the scope of judicial review of assessors' and state courts' valuations in these cases.

The decision, with one exception, seems to be supported by prior cases before the bankruptcy court involving the same issue.[31] The exception is the case of *Henderson v.*

[26] In re Redmond, 17 F. (2d) 128 (D.C. Mass. 1927); In re Sheinman, 14 F. (2d) 323 (D.C. Pa. 1926).

[27] In re Otto Freund Yeast Co., 178 Fed. 305 (D.C. N.Y. 1910).

[28] In re Fischer, 229 Fed. 316 (D.C. Mass. 1915); In re General Film Corp., 274 Fed. 903 (C.C.A. 2d 1921); In re Heffron, 216 Fed. 42 (D.C. N.Y. 1914); In re Simcox, 243 Fed. 479 (D.C. N.Y. 1917); In re Thermiodyne, 26 F. (2d) 716 (D.C. Del. 1928) (incorrect method used to determine tax).

[29] Nat'l Industrial Conference Board, State & Local Taxation of Property 96–102, Table 2 (1930).

[30] 1 Bonbright, Valuation of Property 248, 490–2 (1937). This situation is particularly true in Illinois, cf. 168 Adams Bldg. Corp., 105 F. (2d) 705, 706 (C.C.A. 7th 1939). Where only one method of estimating value is recognized, the courts are able to exercise a closer surveillance over the actions of the assessing bodies, cf. Detroit v. Detroit & Canada Tunnel Co., 92 F. (2d) 833 (C.C.A. 6th 1937).

[31] In re Gould, 11 F. Supp. 644 (Wis. 1935); In re Schach, 17 F. Supp. 437 (Ill. 1936); In re Lang Body Co., 92 F. (2d) 338 (C.C.A. 6th 1937) (semble).

Wilkins,[32] in which the court apparently reassessed the property on the basis of new evidence and reduced the valuation from $250,000 to $100,000. That decision, however, may be reconciled with the present case if we assume that the original assessment in the *Henderson* case was so grossly excessive as to imply an intent to overvalue and thus to constitute a violation of the Fourteenth Amendment.

Corporations—Director's Liability—Debts in Excess of Capital Stock—[Oklahoma].—The receiver and creditors of a corporation brought suit against the distributees of a deceased director's estate to enforce the director's liability for authorizing, contrary to statute,[1] the creation of corporate debts in excess of the subscribed capital stock. The specific debts to which he had assented had been paid prior to the dissolution of the corporation, but on dissolution the total debt remained in excess of the capital stock. *Held*, under the statute, the directors of a corporation are liable only for those particular debts to which they assent which, at the time of their creation, produce a total corporate debt in excess of the statutory limit. Moreover, this liability is unenforceable before dissolution and is discharged, as to any particular excessive debt, by payment before dissolution. Recovery denied. *Warren v. Adams*.[2]

The principal case raises two problems: first, what creditors are within the protection of the statute, and second, what circumstances discharge the liability of a director. In disposing of the principal case, the Oklahoma court considered only the latter problem, adopting the rule that a director's liability is discharged by the corporation's payment of the particular excessive debt to which he assented. It is submitted that this question is secondary, and can be answered only by a consideration of the primary problem; for when it is known what creditors the legislature intended to protect, the problem of discharge resolves itself.

The words of the Oklahoma statute seem to indicate clearly the legislative intent. The statute specifies that the liability is "to the creditors . . . . to the full amount of the . . . . debt contracted."[3] The recovery, thus, is not confined to one creditor, nor is it specified to be for any particular debt, but only for the amount thereof. The Oklahoma Supreme Court has already held[4] that the quoted words are to be interpreted in accord with the majority rule, holding similarly worded statutes to mean that all creditors are entitled to share in the proceeds of the directors' liability,[5] the claims to be enforced in a single suit in equity.[6] The contrary rule, adopted by

[32] 43 F. (2d) 670 (C.C.A. 4th 1930).

[1] Okla. Stat. (Harlow, 1931) § 9763.

[2] C.C.H. Court Decisions Requisition no. 225065 (Okla. S.Ct. 1939). The case is now pending on second petition for rehearing, the first petition having been denied.

[3] Okla. Stat. (Harlow, 1931) § 9763.

[4] Colcord v. Granzow, 137 Okla. 194, 278 Pac. 654 (1928).

[5] Horner v. Henning, 93 U.S. 228 (1876); Colcord v. Granzow, 137 Okla. 194, 278 Pac. 654 1928); Nat'l Bank of Auburn v. Dillingham, 147 N.Y. 603, 42 N.E. 338 (1895); Woolverton v. Taylor, 132 Ill. 197, 23 N.E. 1007 (1890); Low v. Buchanan, 94 Ill. 76 (1879); Sturgis v. Burton, 8 Ohio St. 215 (1858).

[6] Horner v. Henning, 93 U.S. 228 (1876), is the leading case holding that a remedy at law will not lie in favor of a single creditor. But see the Tennessee cases cited in note 7 infra.