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Recent Decisions

William W. Allen

Alexander A. Hassani

Peter A. Schuller

RECENT DECISIONS

INCOME TAX—LIQUIDATION OF FOREIGN CORPORATIONS—SHAREHOLDERS IN A LIQUIDATING FOREIGN CORPORATION MUST INCLUDE IN THE CORPORATION'S EARNINGS AND PROFITS ACCOUNT THE AMOUNT OF RECAPTURED EXCESS DEPRECIATION REALIZED UPON THE SALE OF ITS ASSETS

Plaintiffs, stockholders[1] in a "controlled foreign corporation,"[2] brought suit for the refund of federal income taxes, challenging the Government's assertion that depreciation recaptured on the sale of assets in complete liquidation is includable in the liquidating corporation's earnings and profits account for the purpose of calculating "dividends" under § 1248(a).[3] In 1965 the corporation (Numar) adopted a plan of complete liquidation and sold its assets,[4] realizing a gain of $4,371,720. Within twelve months of the adoption of the plan, Numar distributed the proceeds of the sale to its United

1. Plaintiffs, Richard T. and Margaret H. Brigham, were owners of more than 10% of the voting stock of Numar, S.A. (Numar), a corporation organized under the laws of Costa Rica. They brought suit in the United States District Court for the Eastern District of Pennsylvania to recover $9,971 income tax paid for the fiscal year ended December 31, 1966.

2. I.R.C. § 957(a) defines a controlled foreign corporation as "any foreign corporation of which more than 50 percent of the total combined voting power of all classes of stock entitled to vote is owned . . . by United States shareholders on any day during the taxable year of such foreign corporation."

3. I.R.C. § 1248(a) provides in part:

(a) General Rule. —If—

(1) a United States person . . . receives a distribution from a foreign corporation which, under section . . . 331, is treated as an exchange of stock, and

(2) such person owns, within the meaning of section 958(a) . . . 10 percent or more of the total combined voting power of all classes of stock entitled to vote of such foreign corporation at any time during the 5-year period ending on the date of the sale or exchange when such foreign corporation was a controlled foreign corporation (as defined in section 957), . . .

Then the gain recognized on the sale or exchange of such stock shall be included in the gross income of such person *as a dividend, to the extent of the earnings and profits of the foreign corporation attributable . . . to such stock* which were accumulated in taxable years of such foreign corporation beginning after December 31, 1962, and during the period or periods the stock sold or exchanged was held by such person while such foreign corporation was a controlled foreign corporation. (Emphasis added).

4. Numar sold all its assets, including some that had been excessively depreciated, to United Fruit Company.

States shareholders, including plaintiffs. Plaintiffs conceded that under § 1248(a) the liquidating distribution was taxable to them as a dividend to the extent of Numar's earnings and profits attributable to their shares.[5] Plaintiffs, however, on the authority of § 1248(d)(2), excluded from their computation of Numar's earnings and profits the entire amount of net gain realized upon the sale of Numar's assets.[6] As a setoff defense, the Government claimed that, notwithstanding the exclusion authorized by § 1248(d)(2), §§ 1245(a) and (d)[7] required Numar to include in its earnings and profits account $210,586 of gain attributable to recaptured depreciation realized upon the sale, just as if it had been a domestic corporation liquidating under § 337(a).[8] The district court read § 1248(d)(2) literally, and held that all gain realized on the sale of corporate assets should have been excluded from Numar's earnings and profits account.[9] On appeal to the Third

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5. *See* I.R.C. § 1248(a)(2), *supra* note 3.

6. I.R.C. § 1248(d)(2) provides in part:

> For the purposes of this section, the following amounts shall be excluded, with respect to any United States person, from the earnings and profits of a foreign corporation:
>
> (2) Gain realized from the sale or exchange of property in pursuance of a plan of complete liquidation . . . and if section 337(a) would apply if such foreign corporation were a domestic corporation, earnings and profits of the foreign corporation attributable . . . to *any net gain* from the sale or exchange of property. (Emphasis added).

7. I.R.C. § 1245(a) requires taxpayers to recognize as ordinary income the portion of any gain realized on the disposal of property during the taxable year attributable to the recapture of depreciation deductions taken in prior years. Subsection (d) provides that the section shall apply "notwithstanding any other provisions of Subtitle A."

I.R.C. §§ 337(a), 1245 and 1248 are in Subtitle A. *See* Treas. Reg. § 1.1245-6(a)-(b) (1972).

8. I.R.C. § 337(a) authorizes non-recognition of gain or loss from the sale or exchange of property by a corporation that distributes its assets within twelve months of the adoption of a plan of complete liquidation. Section 1245, however, overrides § 337(a), and requires such corporation to recognize as ordinary income any gain attributable to recaptured excess depreciation.

The parties to the instant action stipulated that, had Numar been a domestic corporation, § 337(a) would have applied and permitted it to exclude from its taxable income the full amount of gain realized on the sale of its assets, less $210,586 of depreciation recapture.

For discussions of the application of § 337(a) to varying fact patterns, *see generally* Note, *Tax-Free Sales in Liquidation Under Section 337,* 76 HARV. L. REV. 780 (1963); Rock, *Corporate Liquidations Under Section 337,* TAX MNGM'T (BNA) Portfolio No. 18-5th (1975).

9. Brigham v. United States, 396 F. Supp. 823 (E.D. Pa. 1975).

Circuit Court of Appeals, *held,* reversed. Since § 1245 overrides the § 1248(d)(2) net gain exclusion, for the purpose of § 1248(a), shareholders in a liquidating foreign corporation must include in the corporation's earnings and profits account the amount of gain realized upon the sale of excessively depreciated property attributable to recaptured depreciation deductions taken in prior years. *Brigham v. United States,* 539 F.2d 1312 (3d Cir. 1976).

In 1924 Congress enacted § 331(a)(1), which permits shareholders to treat a distribution in complete liquidation of a corporation as "in full payment in exchange for the stock."[10] Therefore, if the stock of the liquidating corporation is a capital asset in the hands of the shareholder, any gain realized on the distribution is ordinarily reported as capital gain.[11] Since the size of each shareholder's pro rata distribution varies inversely with the amount of income tax paid by the liquidating corporation on gain realized upon the sale of its appreciated assets, taxpayer-shareholders sought to maximize the favorable tax treatment afforded by § 331 by attempting to characterize the transaction as a sale by the shareholders of property immediately after its receipt in complete liquidation, rather than as a sale by the corporation followed by a pro rata distribution to the shareholders,[12] thereby avoiding double

10. Under prior law, liquidating distributions were taxed as a dividend. The change was made to simplify administration of the taxation of such distributions. *See* S. REP. No. 398, 68th Cong., 1st Sess., *reprinted in* 1939-1 (Part 2) C.B. 266, 274.

The analogy between liquidation of a corporation and a sale of its shares by the taxpayer is not perfect. When a shareholder sells shares that are a capital asset within the meaning of § 1221, he realizes capital gain to the extent that the amount realized exceeds his adjusted basis. I.R.C. § 1001. The corporate earnings and profits account, however, remains intact, and is distributed to new shareholders as dividends and taxed as ordinary income. I.R.C. § 61(a)(7). On the other hand, if the same corporation is liquidated, the earnings and profits account is wiped clean, and escapes taxation as ordinary income entirely. There is no taxation of earnings and profits beyond a shareholder's recognition of capital gain or loss. I.R.C. § 331(a). *See* B. BITTKER & J. EUSTICE, FEDERAL INCOME TAXATION OF CORPORATIONS AND SHAREHOLDERS 11-3 (3d ed. 1971) [hereinafter cited as BITTKER & EUSTICE].

11. For a discussion of the computation and taxation of capital gain and loss, *see generally* J. CHOMMIE, FEDERAL INCOME TAXATION 324-439 (2d ed. 1973).

12. Prior to the passage of the Revenue Act of 1954, these two different methods of distributing corporate assets to shareholders had disparate tax consequences:

(1) If a corporation sold its appreciated assets and then distributed the proceeds to its shareholders, any gain realized on the sale would be taxed first to the corporation (usually as long term capital gain, I.R.C. § 1231), and then to the

taxation of the appreciated value of corporate property.[13] Disputes arose over the nature of such transactions, and the courts had difficulty determining when the sale fell in one category or the other. The uncertainty[14] created by the holding of the Supreme Court in *Commissioner v. Court Holding Co.*,[15] that whether such properties were sold by the shareholders or by the liquidating corporation was a question of fact to be decided on the circumstances in each case,[16] was resolved by the enactment of § 337(a). That section provides for non-recognition of gain realized by a corporation upon the sale or exchange of appreciated assets when the proceeds are distributed within twelve months of adoption of a plan of complete liquidation.[17] Congress limited the non-

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shareholder upon receipt of the distribution (again usually as long term capital gain, I.R.C. § 331(a)(1)).

(2) If the shareholders liquidated the corporation, however, and took title to the appreciated assets, the corporation would have recognized no income on the transaction. I.R.C. § 336. The corporation's accumulated earnings would have been taxed only once, as capital gain to shareholders on the receipt of the property. I.R.C. § 331(a)(1). Furthermore, the new basis of the appreciated property received would have been its fair market value at the time of the transfer. I.R.C. § 334(a). Therefore, if such property was sold immediately at fair market value, there would have been no gain, and consequently, no additional tax.

13. For an illustration of the magnitude of the tax saving that could have resulted under the latter characterization of the transaction, see BITTKER & EUSTICE, *supra* note 10, at 11-53.

14. Judicial emphasis on the form of the transaction as determinative of its tax consequences in *Commissioner v. Court Holding Co.*, and *United States v. Cumberland Pub. Serv. Co.*, discussed note 16 *infra*, had created a "trap for the unwary." H.R. REP. No. 1622, 83rd Cong., 2d Sess. 49 (1954).

15. 324 U.S. 331 (1945).

16. All of the outstanding stock of Court Holding Co., which was organized for the sole purpose of purchasing and holding a single apartment house, was owned by Miller and his wife. They negotiated a sale of the apartment house, but attempted to avoid income tax to the corporation by declaring a "liquidating dividend," which involved deeding the building to the Millers and a return of all outstanding stock. They subsequently executed a contract of sale, which embodied substantially the same terms previously agreed upon. The Supreme Court affirmed the Tax Court's imputation of income to the corporation, observing that, "[t]he incidence of taxation depends upon the substance of the transaction . . . which . . . must be viewed as a whole, and each step, from the commencement of negotiations to the consummation of the sale, is relevant." 324 U.S. at 334.

The opposite result was reached in *United States v. Cumberland Pub. Serv. Co.*, 338 U.S. 451 (1950), where the Court contrasted the Tax Court's finding that Court Holding Co. never dissolved with the Court of Claims' finding of a "genuine" liquidation of Cumberland Pub. Serv. Co. and a valid sale by its shareholders.

17. *See* note 8 *supra*.

recognition provision of § 337(a) in § 1245, which overrides all other provisions of Subtitle A,[18] and which requires the recognition as ordinary income of any gain realized upon the sale or exchange of certain depreciable property to the extent of depreciation allowed after 1961.[19] Prior to the enactment of § 1248 in 1962,[20] an investor in a foreign corporation enjoyed additional tax advantages to those available to an investor in a domestic corporation.[21] A United States taxpayer was able to invest in a controlling share of a foreign corporation, which would pay a small foreign corporate income tax on its accumulated earnings while withholding distribution of taxable dividends.[22] On complete liquidation, the repatriated accumulated earnings would ordinarily be reported by a shareholder as capital gain.[23] Tax savings would generally accrue to the extent that United States corporate income tax rates exceeded those of the country in which the liquidating corporation was located.[24] Section 1248 was enacted to discourage such transac-

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18. I.R.C. § 1245(d).

19. *See* note 7 *supra*.

> The general rule provides that ordinary income is to be recognized in the case of sales or exchanges to the extent the so-called recomputed basis, or amount realized in the sale or exchange, whichever is lesser, exceeds the basis of the property in the hands of the person making the sale or exchange.

H.R. REP. No. 1447, 87th Cong., 2d Sess. 472 (1962).

20. For the text of § 1248(a), enacted in the Revenue Act of 1962, see note 3 *supra*.

21. The following hypothetical transaction illustrates the tax advantages realized by investors in domestic corporations under pre-1962 law: (1) Shareholder invested in a domestic corporation; his basis was the purchase price of the shares. I.R.C. § 1012. (2) The corporation accumulated profits by foregoing dividends taxable to shareholder as ordinary income, on which it paid corporate income tax. No tax was paid on the mere appreciation of corporate property. Eisner v. Macomber, 252 U.S. 189 (1920). (3) No gain was recognized by the corporation on the sale of its appreciated assets in complete liquidation. I.R.C. § 337(a). (4) On distribution, the shareholder's gain, the amount by which the amount realized (which included the accumulated profits and any gain from the sale of appreciated assets) exceeded his basis, (I.R.C. § 1001), was ordinarily reported as capital gain. I.R.C. § 331(a).

22. The United States has no direct taxing jurisdiction over foreign source income of foreign corporations which is not "effectively connected with the conduct of a trade or business in the United States." I.R.C. §§ 332(a), 864, 881.

23. I.R.C. § 331(a).

24. Prior to the enactment of I.R.C. § 1248, the tax burden to a U.S. shareholder on income earned abroad was usually the sum of (1) the foreign corporate income tax, and (2) U.S. capital gains tax. The tax savings to a U.S. shareholder could have been considerable, unless the effective foreign tax rate was relatively

tions by equalizing the tax treatment of investors in domestic and foreign corporations.[25] This was accomplished by requiring the principal United States shareholders[26] of a controlled foreign corporation[27] to report their pro rata share of earnings and profits accumulated after 1962 as a dividend when the corporation is liquidated.[28] Calculation of earnings and profits of the liquidating foreign corporation is to be by a method "substantially similar"[29] to rules applicable to domestic corporations, with several exceptions.[30] The most pertinent of these rules is the exclusion from earnings and profits of any amount, "if § 337(a) would apply if such foreign corporation were a domestic corporation, . . . attributable to any net gain from the sale or exchange of property."[31] The

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high, and the availability of the foreign tax credit (I.R.C. §§ 901-905) made repatriation of earnings as dividends more advantageous. *See* Gifford, *Controlled Corporations—Section 1248,* TAX MNGM'T (BNA) Portfolio No. 240 (1975).

25. *See* H.R. REP. No. 1447, *supra* note 19, *reprinted in* 1962-3 C.B. 461-62, 480-82; S. REP. No. 1881, 87th Cong., 2d Sess. *reprinted in* 1962-3 C.B. 707, 813-15. The Senate report states:

> The bill has as one of its objectives in the foreign income area the imposition of the full U.S. tax when income earned abroad is repatriated. Full U.S. taxation will occur in the case of the ordinary taxable liquidations or sales or exchanges only if the earnings and profits are in effect taxed as dividends (to the extent of any gain) at the time the funds are brought back to the United States. This objective is accomplished by this section of the bill.

1962-3 C.B. at 813.

26. Section 1248(a)(2) requires United States persons owning 10% or more of the total combined voting power of all classes of stock to comply with the section. *See* note 3 *supra.*

27. *See* note 2 *supra.*

28. The "dividend" reported pursuant to I.R.C. § 1248(a) is taxed to the U.S. shareholder as is provided in I.R.C. § 1248(b). The purpose of subsection (b) is to tax § 1248 dividends in a manner that takes into account the difference in the amount of ordinary corporate income tax paid indireclty by U.S. shareholders of domestic corporations and the foreign corporate income tax paid by foreign corporations, thereby equalizing tax treatment of the two classes of shareholders. *See* Treas. Reg. § 1.1248-4 (1972). *See also* S. REP. No. 1881, *supra* note 25, *reprinted in* 1962-3 C.B. 707, 815.

29. I.R.C. § 1248(c).

30. Section 1248 excludes from the earnings and profits of the controlled foreign corporation:

(1) Pre-1963 earnings and profits (I.R.C. § 1248(a))
(2) Earnings and profits of certain less developed country corporations (I.R.C. § 1248(d)(3)) and
(3) Certain earnings and profits already taxed at the U.S. rate (I.R.C. §§ 1248(d)(1), (4), (5)).

31. I.R.C. § 1248(d)(2). In the Senate report accompanying the Revenue Act of 1962, the Senate Committee on Finance stated:

literal language of the statute suggests that when computing earnings and profits for the purposes of § 1248(a), § 1248(d)(2) operates to exclude recaptured depreciation, notwithstanding § 1245(d). It is well established that an unambiguous statute must be construed literally and given effect according to its language,[32] a rule that is applied with particular strictness in the case of a taxing act.[33] Even where a statute is found to be ambiguous, there is a prima facie presumption that congressional intent is embodied in the words of a statute,[34] and in the absence of evidence to the contrary, should be literally construed.[35] Arguably, therefore, § 1248 is not ambiguous, and after it is determined that § 337(a) would have applied to a liquidating foreign corporation had it been a domestic corporation, the inquiry is ended. Thereafter, the entire amount of gain realized on the sale of appreciated assets is excluded from earnings and profits for the purposes of § 1248(a), notwithstanding that § 337(a) would not have shielded a domestic corporation from recognition of recaptured depreciation under § 1245. The Supreme Court, however, has indicated that the manifest intent of the legislature may prevail over the literal words of a statute.[36] In

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> The earnings and profits for the purpose of this section do not include any amount attributable to gains on sales made in the course of a liquidation *if these sales would have been treated as tax-free sales on liquidation (under section 337(a)) had the foreign corporation been a domestic corporation.* (Emphasis added).

S. REP. No. 1881, *supra* note 25, *reprinted in* 1962-3 C.B. 815. *See also* Treas. Reg. § 1.1248-1(d)(ii)(1964), which provides:

> If a foreign corporation adopts a plan of complete liquidation in a taxable year of the corporation beginning after December 31, 1962, *and if because of the application of section 337(a) gain or loss would not be recognized by the corporation from the sale or exchange of property if the corporation were a domestic corporation,* then the earnings and profits of the corporation accumulated for the taxable year (computed without any reduction for distributions) shall be determined without regard to the amount of such gain or loss. See section 1248(d)(2). (Emphasis added).

32. Helvering v. N.Y. Trust Co., 292 U.S. 455 (1934); Commissioner of Immigration v. Gottlieb, 265 U.S. 310 (1924).

33. Crooks v. Harrelson, 282 U.S. 55 (1930).

34. *Id.* In that case the Court stated that "a construction adopted in harmony with what is thought to be the spirit and purpose of the act in order to give effect to the intent of Congress . . . [should be] applied to override the literal terms of a statute only under rare and exceptional circumstances." 282 U.S. at 59-60.

35. United States v. Hartwell, 73 U.S. (6 Wall.) 385 (1867); Detroit Citizens' St. R. Co. v. Detroit, 64 F. 628 (6th Cir. 1894).

36. *See, e.g.*, Kokoszka v. Belford, 417 U.S. 642 (1974), where the Court, construing the Consumer Credit Protection Act in light of the provisions of the Bankruptcy Act, stated:

Pielemeier v. United States,[37] the court rejected a literal construction of § 1248, holding that § 1245 overrides § 1248(d)(2), and has the effect of increasing the earnings and profits of the foreign corporation by the amount of the recaptured depreciation. The opposite result was reached under identical facts by the lower court in the instant case.[38] Although the district court recognized that § 1245(a) limits the benefits confered by § 337(a), it ruled that those sections deal with recognition of gain to the corporation, and not with computation of earnings and profits.[39] Consequently, § 1245(a) was found not to negate or limit the "unambiguous language"[40] of subsection (d)(2). These two conflicting interpretations of § 1248(d)(2) constituted the only judicial precedent for the instant decision.

In the instant decision,[41] the court analyzed § 1248(d)(2) to determine the sole issue: whether that section permitted the exclusion from Numar's earnings and profits of the $210,586 gain that would have been taxable to a domestic corporation "notwithstanding" the non-recognition provision of § 337(a). The court conceded that plaintiffs' argument that the phrase "any net gain" in § 1248(d)(2)[42] refers to the entire amount of any gain

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> [W]hen "interpreting a statute, the court will not look merely to a particular clause in which general words may be used, but it will take in connection with it the whole statute (or statutes on the same subject) and the objects and policy of the law, as indicated by its various provisions, and give it such a construction as will carry into execution the will of the legislature . . . ." Brown v. Duchesne, 19 How. 183 (1857).

417 U.S. at 650. *See*, United States v. Skelly Oil Co., 394 U.S. 678 (1969); Minnesota Mining & Mfg. Co. v. New Jersey Wood Finishing Co., 381 U.S. 311 (1965); United States v. Zacks, 375 U.S. 59 (1963); Richards v. United States, 369 U.S. 1 (1962). *See also* Helvering v. Hammel, 311 U.S. 504 (1941), where the Court stated:

> courts in the interpretation of a statute have some scope for adopting a restricted rather than a literal or usual meaning of its words where acceptance of that meaning . . . would thwart the obvious purpose of the statute . . . . But courts are not free to reject that meaning where . . . it appears to be consonant with the purposes of the Act as declared by Congress and plainly disclosed by its structure.

311 U.S. at 510-11.

37. 74-2 U.S. Tax Cas. ¶ 9,599 (C.D. Cal. 1974), *aff'd* 543 F.2d 81 (9th Cir. 1976).

38. Brigham v. United States, 396 F. Supp. 823 (E.D. Pa. 1975).

39. 396 F. Supp. at 825.

40. *Id.*

41. The instant court initially recited the stipulated facts. *See* text accompanying notes 1-10 *supra*.

42. 539 F.2d at 1314-15.

realized by a liquidating corporation, derives some support from the literal language of the statute,[43] regardless that a portion of the gain, notwithstanding § 337(a), would have been taxable to a domestic corporation under § 1245. The court, however, believed plaintiffs' interpretation[44] would produce the sort of inequity § 1248 as a whole was enacted to correct, since by avoiding dividend treatment of the $210,586 gain under §§ 1248(a) and (b), taxpayers would escape paying their pro rata share of the corporate tax they would have borne indirectly had Numar been a domestic corporation.[45] An examination of the legislative history of § 1248(d)(2), moreover, convinced the court that Congress specifically intended that section to produce the same tax consequences to shareholders of liquidating foreign corporations under § 1248(a) as those liquidating under § 337(a).[46] Consequently, the court reversed, holding that the amount of gain realized on the sale of appreciated assets attributable to recaptured depreciation was properly included in the liquidating foreign corporation's earnings and profits account for the purposes of § 1248.

The instant result effectuates congressional intent, which is manifested clearly in the legislative history[47] and implicit in the overall scheme of § 1248,[48] to equalize the tax treatment of United States shareholders in domestic and foreign liquidating corporations. The drafting technique utilized in § 1248(d)(2) makes it clear that the purpose of that subsection was to carry over the policy judgment made by Congress to resolve the *Court Holding Company* dispute through the passage of § 337 into the taxation of foreign corporate liquidations. It is logical and consistent with the overall scheme of § 1248 that § 1248(d)(2) and § 337(a) be construed to operate in a parallel manner to produce similar tax consequences to United States shareholders in domestic and foreign corporations, regardless of the corporation's domicile. This will be the case only if § 1245 operates as an exception to the § 1248(d)(2) net gain exception. The district court's expansive interpretation of subsection (d)(2) impermissibly broadened the nar-

43. *Id.* at 1316.

44. For an alternative statement of plaintiffs' argument, see text accompanying notes 35-36 *supra.*

45. 539 F.2d at 1317.

46. The court quoted the portion of Senate Report No. 1881 emphasized in note 31 *supra.*

47. *See* S. REP. No. 1881, *supra* note 25.

48. *See* note 28 *supra.*

row purpose for which it was enacted, and was contrary to the legislative intent because that construction conferred on a shareholder in a foreign corporation a tax benefit not enjoyed by shareholders in domestic corporations. The lower court's ruling, if permitted to stand, would have supported an argument that sales of inventory items by a foreign corporation during the year of liquidation could be excluded from earnings and profits,[49] which would further defeat the overall purpose of § 1248. For these reasons, the district court was properly reversed. The instant court's abbreviated analysis of the threshold issues of statutory construction, however, clouded the nature of its conflict with the lower court. The district court found the language of subsection (d)(2) to be "unambiguous,"[50] construed the words of the statute literally, and refused to consider evidence of a contrary legislative intent. The instant court implicitly reversed the lower court on this question to avoid the rule against non-literal construction of an unambiguous taxing statute.[51] The instant court then implicitly decided that evidence of legislative intent was strong enough to overcome the prima facie presumption[52] in favor of the literal language of § 1248(d)(2). A clearer exposition of this analytical method would have produced the same result and eliminated the appearance of a non-literal construction of an unambiguous taxing statute. In any case, the instant decision has apparently settled the issue of the effect of § 1245 recapture on a liquidating foreign corporation's earnings and profits account,[53] and has eliminated the need for clarification of congressional intent by an amendment to § 1248.

William W. Allen

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49. *See* 1 RHOADES, INCOME TAXATION OF FOREIGN RELATED TRANSACTIONS § 3.06, at 3-164 (1976).

50. 396 F. Supp. at 825.

51. *See* note 33 *supra*, and accompanying text.

52. *See* note 34 *supra*, and accompanying text.

53. In *Pielemeier v. United States*, 543 F.2d 81 (9th Cir. 1976) *aff'g* 74-2 U.S. Tax Cas. ¶ 9,599 (C.D. Cal. 1974), the Court of Appeals for the Ninth Circuit, when presented with the same issue under identical facts, cited the instant decision, and affirmed the lower court without further discussion.

CUSTOMS DUTIES—ANTIDUMPING ACT OF 1921—THE SECRETARY OF THE TREASURY HAS NO AUTHORITY TO TERMINATE A WITHHOLDING OF APPRAISEMENT PRIOR TO THE PUBLICATION OF A DUMPING FINDING BASED ON A LIKELIHOOD OF INJURY DETERMINATION BY THE INTERNATIONAL TRADE COMMISSION

On October 31, 1973, plaintiff, Timken Company, submitted to the Secretary of the Treasury a complaint that Japanese tapered roller bearings were being, or were likely to be, imported into the United States under circumstances justifying the imposition of dumping[1] duties under the Antidumping Act of 1921.[2] After investigating, the Treasury Department published a notice on June 5, 1974, stating that there was reason to believe or suspect that dumping was occurring and ordered customs officials to withhold appraisement[3] of tapered roller bearings from Japan. On September 6, 1974, the Treasury Department published a determination that these items were being, or were likely to be, sold at less than fair value (LTFV) and so advised the International Trade Commission (Commission). On January 23, 1975, the Commission determined that "an industry in the United States is likely to be injured" by the importation of these items at LTFV. Instead of publishing a dumping finding[4] immediately thereafter, the Secretary directed customs officials to appraise all Japanese tapered roller bearings covered by the withholding notice.[5] Since dumping duties are applicable only to unappraised merchandise,[6] these entries were no longer subject to potential imposition of such duties. Timken then filed a complaint against the Secretary in the District Court for the District of Columbia seeking injunctive and declaratory relief. Timken contended that the Secretary had no statutory authority to order this appraisement prior to the publication of a dumping finding. The district court entered a permanent injunction requiring the Secretary to publish a dumping finding immedi-

1. The term "dumping" refers to international price discrimination—the practice of selling goods in foreign markets at prices lower than in the home market.

2. 19 U.S.C. § 160 *et seq.* (1970 & Supp. V 1975).

3. "Appraisement" means the ascertainment or determination of value of imported merchandise. Timken Co. v. Simon, 539 F.2d 221, 224 n.2 (D.C. Cir. 1976).

4. For an explanation of the term "dumping finding," see notes 18 & 19 *infra*, and accompanying text.

5. For an explanation of the term "withholding notice," *see* page 156 *infra*.

6. 19 U.S.C. § 161(a) (1970).

ately and to withhold appraisement of the roller bearings until after publication. On appeal,[7] the Government argued that the Secretary is authorized by 19 U.S.C. § 160(b)(1)(B)[8] to terminate a withholding of appraisement prior to the publication of a dumping finding when the Commission determines that a United States industry is only "likely to be injured" by the LTFV sales.[9] Timken maintained that the "until further order of the Secretary" clause of the statute authorized the Secretary to terminate a withholding notice prior to the publication of a dumping finding only when he is unable to publish such a finding.[10] The Court of Appeals for the District of Columbia Circuit, *held*, affirmed. The Secretary of the Treasury has no authority under the Antidumping Act to order the appraisement of goods covered by a withholding notice prior to the publication of a dumping finding based on a likelihood of injury determination by the International Trade Commission. *Timken Co. v. Simon*, 539 F.2d 221 (D.C. Cir. 1976).

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7. The Circuit Court stayed, pending appeal, that portion of the District Court order requiring the Secretary to publish a dumping finding immediately. 539 F.2d at 225 n.5.

8. 19 U.S.C. § 160(b)(1)(B) (Supp. V 1975) provides that a withholding of appraisement is to remain in force "until the further order of the Secretary, or until the Secretary has made public a [dumping] finding . . . ."

9. The Government also argued that the District Court lacked jurisdiction to enter the challenged order because the Customs Court has exclusive jurisdiction over the subject matter of Timken's complaint. 28 U.S.C. § 1582(b) (1970) states that: "The Customs Court shall have exclusive jurisdiction of civil action brought by American manufacturers, producers, or wholesalers pursuant to section 516 of the Tariff Act of 1930, as amended." The Government argued further that jurisdiction was lacking because there is an implied statutory preclusion of judicial review of customs-related matters other than those matters reviewable in the Customs Court under section 516 of the Tariff Act of 1930, 19 U.S.C. § 1516(a) (Supp. V 1975). The Court of Appeals rejected both of these arguments and sustained the District Court's jurisdiction. The court held that this case was not a civil action brought pursuant to section 516 of the Tariff Act of 1930 and therefore did not fall within the exclusive jurisdiction of the Customs Court as defined in 28 U.S.C. § 1582(b). The court also held that since there is no persuasive evidence of any implied statutory preclusion of judicial review of customs-related matters other than those reviewable in the Customs Court, the powerful presumption of reviewability should prevail.

10. This could occur because the Secretary has reached a negative LTFV determination and therefore has not referred the complaint to the Commission, or because the Commission has concluded that the relevant U.S. industries are not subject to actual or probable injury. *See* notes 16 & 17 *infra*, and accompanying text.

The Antidumping Act of 1921[11] was enacted to prevent actual or threatened injury to a domestic market resulting from the sale of merchandise in the United States at prices lower than those in the country of origin.[12] The Act seeks to accomplish this by imposing a special dumping duty[13] when it is determined that such price discrimination injures, or is likely to injure an American industry.[14] Responsibility for the administration of the Antidumping Act is divided between the Treasury Department and the International Trade Commission. According to the established procedure, the Secretary of the Treasury, upon receiving a complaint that goods are being dumped, must determine whether that class of foreign merchandise "is being, or is likely to be, sold in the United States or elsewhere at less than its fair value."[15] Fair value is generally considered to be the price in the country of origin.[16] If the Secretary's determination is in the affirmative, he must advise the International Trade Commission, which then must notify him within three months whether an industry in the United States "is being or is likely to be injured, or is prevented from being established" by the LTFV sales.[17] If the Commission also reaches an affirmative determination, the Secretary must publish a notice of both determinations.[18] Once this notice, known as a "dumping finding," has

11. 19 U.S.C. § 160 *et seq.* (1970 & Supp. V 1975).

12. J.C. Penney Co. v. Department of the Treasury, 319 F. Supp. 1023, 1024 (S.D.N.Y. 1970), *aff'd,* 439 F.2d 63 (2d Cir. 1971), *cert. denied,* 404 U.S. 869 (1971). For general discussion of the dumping problem and the United States legislative response, see Baier, *Substantive Interpretations Under the Antidumping Act and the Foreign Trade Policy of the United States,* 17 STAN. L. REV. 409 (1965); Barcelo, *Antidumping Laws as Barriers to Trade—The United States and the International Antidumping Code,* 57 CORNELL L. REV. 491 (1972); Coudert, *The Application of the United States Antidumping Law in the Light of a Liberal Trade Policy,* 65 COLUM. L. REV. 189 (1965); Fisher, *The Antidumping Law of the United States: A Legal and Economic Analysis,* 5 L. & POL'Y INT'L BUS. 85 (1973); Kohn, *The Antidumping Act: Its Administration and Place in American Trade Policy,* 60 MICH. L. REV. 407 (1962); Weeks, *Introduction to the Antidumping Law: A Form of Protection for the American Manufacturer,* 35 ALBANY L. REV. 182 (1971); Note, *The Antidumping Act: Problems of Administration and Proposals for Change,* 17 STAN. L. REV. 731 (1965).

13. 19 U.S.C. §§ 160-161 (1970 & Supp. V 1975). The amount of the duty is approximately equal to the excess of the price in foreign markets over the price in the United States.

14. *Id.*

15. *Id.* § 160(a).

16. *Id.* § 161(a).

17. *Id.* § 160(a).

18. *Id.*

been published, all imported, unappraised merchandise described in that finding, and entered or withdrawn from its warehouse not more than 120 days before the complaint was presented to the Secretary, is subject to the special dumping duty.[19] To prevent goods imported during the pendency of the dumping complaint from being appraised by customs officials and thus escaping subsequent imposition of dumping duties, Congress enacted a provisional measure known as "withholding of appraisement." Under 19 U.S.C. § 160(b)(1)(B), whenever the Secretary of the Treasury has reason to suspect that a class or kind of merchandise is being dumped, he must publish notice of that fact, called a "withholding notice," in the Federal Register and must order customs officials to withhold appraisement of such merchandise. This merchandise can be appraised and released by customs officials only if a bond is filed to assure payment of any dumping duties subsequently assessed or if the withholding of appraisement order is terminated.[20] The statute provides that the withholding of appraisement is to continue "until the further order of the Secretary" or until a dumping finding is published.[21] The precise scope of the Secretary's authority to terminate withholding of appraisement orders under the "until further order of the Secretary" clause had never been judicially determined. Until 1972, however, the Secretary only terminated withholding notices after the publication of the dumping finding or when no dumping finding was to be published. Thus, dumping duties were retroactively assessed on entries covered by the withholding notice even in cases where the dumping finding was based on a likelihood of injury determination by the Tariff Commission.[22] Foreign objections to this retroactive assessment of dumping duties and other procedures under the Antidumping Act led to the negotiation of the International Anti-Dumping Code of 1967[23] to which the United States became a party

19. *Id.* § 161(a).

20. 19 U.S.C. § 167 (1970); 19 C.F.R. §§ 153.50-.51 (1976).

21. 19 U.S.C. § 160(b)(1)(B) (Supp. V 1975).

22. *See, e.g.,* Portland Cement from the Dominican Republic, Treas. Dec. 55883 (1963), Steel Jacks from Canada, Treas. Dec. 66-191 (1966). Until 1974 injury determinations were made by the United States Tariff Commission. The Tariff Commission was renamed the International Trade Commission by the Trade Act of 1974, P.L. No. 93-618, § 171, 88 Stat. 2009 (1975).

23. Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade, *opened for signature,* June 30, 1967, 19 U.S.T. 4348, T.I.A.S. No. 6431 (effective July 1, 1968), *reprinted in* 6 INT'L LEGAL MATERIALS 920 (1969) *and* 32 Fed. Reg. 14962 (1967) [hereinafter cited as International Antidumping

by executive agreement.[24] Article 11 of the Code prohibits the retroactive assessment of dumping duties except in cases where "a determination of material injury (but not a threat of material injury . . .) is made." Although the United States is under a binding international obligation to implement the Code,[25] as a non-self-executing agreement[26] it can have no binding effect in the United States unless it is actually implemented.[27] The Congress has, how-

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Code]. The International Antidumping Code was one product of the Sixth Round of Trade Negotiations (known as the Kennedy Round) under the auspices of the General Agreement on Tariffs and Trade (GATT), *done,* October 30, 1947, 61 Stat. Parts 5-6 (1974), T.I.A.S. No. 1700, 55 U.N.T.S. 194. The Code was formally negotiated as an agreement to elaborate the provisions of GATT, art. IV, which covers countervailing and antidumping duties.

For discussion of the negotiation and effect of the International Anti-Dumping Code, see Anthony, *The American Response to Dumping From Capitalist and Socialist Economies—Substantive Premises, and Restructured Procedures After the 1967 GATT Code,* 54 CORNELL L. REV. 159 (1969); Barcelo, *supra* note 12; Pintos & Murphy, *Commentary/Congress Dumps the International Antidumping Code,* 18 CATH. U.L. REV. 180 (1968); Shannon & Marx, *The International Anti-Dumping Code and United States Antidumping Law—An Appraisal,* 7 COLUM. J. TRANSNAT'L L. 171 (1968).

24. Ambassador Michael Blumenthal signed the International Anti-Dumping Code for the United States in Geneva, Switzerland, on June 30, 1967. *See* Shannon & Marx, *supra* note 23, at 173 n.14.

25. *See,* RESTATEMENT (SECOND) OF FOREIGN RELATIONS LAW § 138 (1965).

26. International agreements may be non-self-executing because of a constitutional requirement, the generality of the agreement's provisions, or because those provisions indicate that implementing legislation of some kind is contemplated. *See* RESTATEMENT (SECOND) OF FOREIGN RELATIONS LAW §§ 141-145 (1965). The International Anti-Dumping Code is non-self-executing by its own terms since it requires signatories to bring their laws and regulations into conformity. Article 14 of the Code requires that each party to the Agreement:

> take all necessary steps, of a general or particular character, to ensure, not later than the date of the entry into force of the Agreement for it, the conformity of its laws, regulations, and administrative procedures with the provisions of the Anti-Dumping Code.

International Anti-Dumping Code, art. 14, *supra* note 23, 6 INT'L LEGAL MATERIALS at 930.

27. *See* RESTATEMENT (SECOND) OF FOREIGN RELATIONS LAW §§ 141-145 (1965). The Executive hoped to implement the Code through the administrative decisions of the Treasury Department and the Tariff Commission.

The Executive might have sought implementation by other means. "Congressional legislation, the most common means, would have established the superiority of the Code over the Act, but this alternative was unpromising because of strong protectionist sentiment in Congress. The executive branch might have argued plausibly that the Code was based on the power delegated to the President in the Trade Expansion Act of 1962, which authorized participation in the Kennedy Round. Implementation could then have been achieved through the Presiever, severely limited the extent to which the Code might be implemented by enacting the Renegotiation Amendments Act of 1968,[28] which instructs the Treasury Department and the Tariff Commission (now the International Trade Commission) to give effect to the Code only insofar as it is not inconsistent with the Antidumping Act. The determination of the scope of the Secretary's authority, therefore, still depends upon an interpretation of the Antidumping Act. In 1972 the Secretary departed from the practice of terminating withholding notices only after the publication of the dumping finding or where no dumping finding was to be published, and began terminating withholding notices prior to the publication of dumping findings based on a likelihood of injury determination by the International Trade Commission.[29] This brought the Government's practice into conformity with article 11 of the International Anti-Dumping Code. The Government's conclusion that 19 U.S.C. § 160(b)(1)(B) authorized this newer practice rested on the premise that when the International Trade Commission determines that a United States industry is "likely to be injured" by the LTFV sales it is actually saying that although there is no present injury, future LTFV sales occurring after the Secretary publishes the dumping finding will cause injury.[30] This premise was supported to some extent by *City Lumber Co. v.*

dent's special proclamation power authorized in that Act. But the delegating language in the 1962 Act was weak; it merely authorized reduction of 'existing duty or other import restriction.' Moreover, a number of Congressmen argued strongly that there was no authority for the Code in the 1962 Act." Barcelo, *supra* note 12, at 533.

28. Renegotiation Amendments Act of 1968, Pub. L. No. 90-634, § 201(a), 82 Stat. 1347 (1968), which provides:

> Nothing contained in the International Antidumping Code, signed at Geneva on June 30, 1967, shall be construed to restrict the discretion of the United States Tariff Commission in performing its duties and functions under the Antidumping Act, 1921, and in performing their duties and functions under such Act the Secretary of the Treasury and the Tariff Commission shall —
>
> (1) resolve any conflict between the International Antidumping Code and the Antidumping Act, 1921, in favor of the Act as applied by the agency administering the Act, and
>
> (2) take into account the provisions of the International Antidumping Code only insofar as they are consistent with the Antidumping Act, 1921, as applied by the agency administering the Act.

29. 539 F.2d at 228. It is not clear from the court's opinion why it concluded that 1972 was the year in which the Secretary departed from the previous practice.

30. *Id.* at 229.

United States,[31] in which the Court of Customs and Patent Appeals held it proper for the Tariff Commission to take into consideration the intent of the importer in reaching an injury determination, because "the statute refers not only to injury but also to *likelihood of injury which clearly evisages future events* and the probability of their occurrence according to someone's intent."[32] (Emphasis added.) Relying on this premise, the Government concluded that the "until further order of the Secretary" clause must authorize the termination of a withholding notice prior to the publication of a dumping finding based on a likelihood of injury determination. The Government reasoned that in such a case the continued withholding of appraisement and the resulting retroactive assessment of dumping duties would be improper since goods entered prior to the publication of the dumping finding would not have been determined to have caused injury.[33]

In the instant case, the Court of Appeals rejected the Government's new interpretation of 19 U.S.C. § 160(b)(1)(B), noting several flaws in the Government's analysis of the antidumping regulatory scheme. The court first observed that the Government's premise regarding the meaning of a likelihood of injury determination by the Commission was unfounded and unrealistic. The court noted that a review of Commission injury determinations indicated that even the Commission itself did not take the present injury-future injury approach suggested by the Government. The court ruled that a likelihood determination was not a statement that future injury will occur, but rather a way of saying that, although the Commission cannot conclude with certainty that injury is occurring, it can, nevertheless, conclude that there is such a high risk of injury that antidumping duties should be assessed. Secondly, the court noted that the Government's interpretation would have, as it did in the instant case, the absurd result of immunizing entries covered by the withholding notice from regulatory review since the entries at issue here entered after the case was referred to the Commission but before the Secretary could ever publish a dumping finding. There was no way the Commission could make either a present injury or a likelihood of injury determination with respect to these goods. Thirdly, the court observed that it was impossible to reconcile the Government's more recent

31. 457 F.2d 991 (C.C.P.A. 1972).
32. *Id.* at 997.
33. 539 F.2d at 229-30.

interpretation of the statutory language with its prior willingness to assess dumping duties retroactively even in cases where the Commission had reached only a likelihood of injury determination. Finally, the court pointed out that perhaps the most crucial flaw in the Government's argument was its failure to show any legislative history supporting a denial of retroactive assessment of duties based solely on the fact that the Commission reached a likelihood of injury determination. The court concluded that the "until further order of the Secretary" clause should be interpreted according to its plain meaning, and therefore did not authorize the Secretary to terminate a withholding of appraisement notice prior to the publication of a dumping finding even when the International Trade Commission determines that injury is only likely.

This decision provides the first judicial clarification of the scope of the Treasury Secretary's authority under 19 U.S.C. § 160(b)(1)(B). The court's narrow interpretation maximizes the deterrent effect of the United States antidumping laws by making it clear that even importations that merely threaten injury will be subject to potential retroactive assessment of dumping duties. The broader significance of the instant opinion is twofold. First, it evidences the court's reluctance to accept new interpretations of the language of the Antidumping Act designed to give effect to the International Anti-Dumping Code without violating the terms of the Renegotiation Amendments Act. The court dismissed the Government's suggested interpretation without mention of *City Lumber Co. v. United States,*[34] which provided support for the Government's conclusions regarding the meaning of likelihood determinations. Furthermore, in construing the statutory language, the court relied upon the Treasury Department's previous practice as a guide to the proper interpretation. This approach made it unlikey that the Treasury Department would be able to convince the court that its previous practice reflected a faulty interpretation of the statutory language. Secondly, this decision may have international ramifications. The success of the International Anti-Dumping Code depends upon the ability of the Treasury Department to satisfy the United States courts that the Code is not controlling domestic antidumping procedures and to convince the other contracting parties that the Code is being fully enforced.[35] The other seventeen signatories to the Code have already implemented its

34. 457 F.2d at 991.
35. Shannon & Marx, *supra* note 23, at 202.

provisions. They will view this decision as further evidence of the failure of the United States to do so and consequently may repudiate the Code.[36] Repudiation might be accompanied by the retaliatory application of foreign antidumping laws against United States companies.[37] The instant decision has cut off what appeared to be the most promising method for implementing the Code; namely, a liberal interpretation of the Antidumping Act consistent with the Code. If this decision remains, and unless the Congress passes implementing legislation,[38] there is little chance that article 11 or any other Code provision judged inconsistent with the Antidumping Act will be given effect in the United States.

Alexander A. Hassani

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36. The strongest evidence that the United States does not intend to implement the Code is the passage of the Renegotiation Amendments Act of 1968. *See* note 27 *supra.*

37. Barcelo, *supra* note 12, at 560.

38. Although there might be speculation that the changes in the U.S. antidumping laws effected by the Trade Act of 1974, Pub. L. No. 93-618, 88 Stat. 1978 (1975), were designed to conform U.S. law to the provisions of the International Anti-Dumping Code, it is quite doubtful that the changes were so motivated or that they even succeeded in achieving such conformity. McDermid & Foster, *The U.S. International Trade Commission's 30-Day Inquiry Under the Antidumping Act: Section 210(c)(2),* 27 MERCER L. REV. 657, 661 (1976).

INTERNATIONAL BANKING—BANKRUPTCY—FOREIGN BANKS NEITHER REGULATED BY NOR LICENSED TO DO BUSINESS IN THE UNITED STATES MAY FILE FOR VOLUNTARY BANKRUPTCY UNDER THE NATIONAL BANKRUPTCY ACT

Israel-British Bank (London) Ltd.[1] (IBB), a bank organized under the laws of the United Kingdom, was not licensed to do banking business in the United States under either state or federal law.[2] Although it did not engage in banking in the United States, IBB maintained deposits in and borrowed from various United States banks, including Franklin National Bank[3] (Franklin) and Bank of the Commonwealth (Commonwealth). In July 1974, having already defaulted on a loan from Franklin,[4] IBB failed to make payment on a loan from Commonwealth.[5] Commonwealth instituted an action to recover its loan and obtained an order of attachment, which, after service on United States banks holding IBB deposits, resulted in a default judgment against IBB. Subsequently, Franklin also initiated an action to attach IBB deposits. In the meantime, IBB became insolvent and filed for voluntary liquidation proceedings in the United Kingdom.[6] The High Court of England, which had jurisdiction over the proceedings, appointed a receiver to wind up IBB's affairs in the United States.[7] In Sep-

1. Israel-British Bank (London) Ltd. became insolvent shortly after its affiliate, the Israel-British Bank, Ltd., of Tel Aviv failed and could not pay its debts to the London bank.

2. Only Alaska, California, Georgia, Hawaii, Illinois, New York, Massachusetts, Missouri, Oregon, and Washington license branches or agencies of foreign banks. In each case, the foreign banks are supervised by state bank authorities. *See generally*, Lichtenstein, *Foreign Participation in United States Banking: Regulatory Myths and Realities*, 15 B.C. INDUS. & COM. L. REV. 879 (1974); Halperin, *The Regulation of Foreign Banks in the United States*, 9 INT'L LAW. 661 (1975).

3. Franklin National Bank was itself being liquidated at the time this suit was brought. Its successor in interest was the Federal Deposit Insurance Corporation. This comment, however, will refer to Franklin National Bank as the party in interest.

4. The principal and interest on the loan amounted to approximately $2,100,000.

5. Commonwealth's loan to IBB was substantially less than Franklin's, amounting to approximately $500,000.

6. When it was unable to pay its debts, IBB instituted voluntary liquidation proceedings pursuant to section 222 of the English Companies Act, 1948, 11 & 12 Geo. 6, c.38, in the High Court, Chancery Division, of the United Kingdom.

7. On August 6, 1974, a receiving order was issued by the High Court constituting Arthur Thomas Check as Receiver and Provisional Liquidator of IBB's assets. The Receiver filed the voluntary bankruptcy petition considered in this

tember 1974, before Franklin could obtain a judgment and before Commonwealth could compel payment, the Receiver filed a voluntary straight bankruptcy petition, pursuant to section 2 of the National Bankruptcy Act,[8] which entitles a foreign corporation with assets in the United States to file a voluntary petition in bankruptcy. IBB was adjudicated a bankrupt the same day. Franklin and Commonwealth filed motions to vacate the adjudication and to dismiss the voluntary petition in an attempt to remove the limitation placed upon the enforcement of their prior liens by section 67(a)(1) of the Bankruptcy Act, which gives the trustee in bankruptcy the power to avoid all liens acquired within four months of the filing of a bankruptcy petition.[9] Franklin and Commonwealth argued that section 4 of the Bankruptcy Act[10] excludes

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case because the High Court had no extraterritorial jurisdiction over United States assets.

8. The Bankruptcy Act of 1898, ch. 541, 30 Stat. 544, *as amended by* Chandler Act of 1938, ch. 575, 52 Stat. 840, 11 U.S.C. § 1 *et seq.* (1970) [hereinafter cited as Bankruptcy Act]. Bankruptcy Act § 2, 11 U.S.C. § 11(a)(1) states:

> (a) The courts of the United States hereinbefore defined as courts of bankruptcy are created courts of bankruptcy and are invested, within their respective territorial limits as now established or as they may be hereafter changed, with such jurisdiction at law and in equity as will enable them to exercise original jurisdiction in proceedings under this title, in vacation, in chambers, and during their respective terms, as they are now or may be hereafter held, to
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> (1) Adjudge persons bankrupt who have had their principal place of business, resided, or had their domicile within their respective territorial jurisdictions for the preceding six months, or for a longer portion of the preceding six months than in any other jurisdiction, or who do not have their principal place of business, reside, or have their domicile within the United States, but have property within their jurisdiction, or in any cases transferred to them pursuant to this title.

9. Both Franklin's and Commonwealth's liens on IBB assets in other United States banks were obtained by order of attachment within four months of the filing of IBB's voluntary petition in bankruptcy. Section 67(a)(1) of the Bankruptcy Act, 11 U.S.C. § 107 (1970), provides that, if there is jurisdiction to sustain the American adjudication in bankruptcy, the American trustee will be in a position to bring a proceeding for avoidance of all liens obtained within four months of the filing of the voluntary petition in bankruptcy as long as the bankrupt was insolvent at the time of filing.

10. Bankruptcy Act, § 4, 11 U.S.C. § 22 (1970) states in relevant part:

> [Who May Become Bankrupts] (a) Any person, except a municipal, railroad, insurance, or banking corporation, or a building and loan association, shall be entitled to the benefits of this title as a voluntary bankrupt.
>
> (b) Any natural person, except a wage earner or farmer, any moneyed, business, or commercial corporation, except a building and loan association, a municipal, railroad, insurance, or banking corporation, owing debts

IBB as a "banking corporation" from the provisions of the Act, thereby depriving the bankruptcy court of subject matter jurisdiction.[11] Reflecting the concern of an order from the High Court of England authorizing the Receiver to insure that IBB's assets became available for the benefit of creditors in general, the bankruptcy judge held that IBB was not a "banking corporation" within the meaning of section 4 of the Bankruptcy Act. On appeal, the United States District Court for the Southern District of New York reversed, ruling that the statutory words "banking corporation" must be literally construed to include all foreign banks whether or not they are regulated by state or federal banking laws.[12] On appeal to the United States Court of Appeals for the Second Circuit, *held*, reversed. When a foreign bank has assets in United States banks but is neither licensed to do banking business in the United States nor regulated by state or federal banking laws, it is excluded from the "banking corporation" exception of section 4 of the Bankruptcy Act and is entitled to file a voluntary petition in bankruptcy. *Israel-British Bank (London) Ltd. v. Federal Deposit Insurance Corporation,* 536 F.2d 509 (2d Cir. 1976).

The Constitution empowers Congress to establish "uniform laws on the subject of bankruptcies throughout the United States."[13] With reference to this provision, the Supreme Court has ruled that the states are without power to enforce any law governing bankruptcies that conflicts with congressional action in this area.[14] The states may enact insolvency laws, however, provided their sphere of regulation does not infringe on Congress' constitutionally delegated authority in Article I section 8.[15] Pursuant to its constitutional authority, Congress enacted the National Bankruptcy Act[16] (Act) to redress the inconsistencies present in creditors' rights

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> to the amount of $1000 or over, may be adjudged an involuntary bankrupt upon default or an impartial trial and shall be subject to the provisions and entitled to the benefits of this title . . . .

11. Franklin and Commonwealth argued that "banking corporation" included all banks, regardless of whether they were foreign or domestic or whether they were licensed in the United States, thereby including IBB within the § 4 exception.

12. *In re* Israel-British Bank (London) Ltd., 401 F. Supp. 1159 (S.D.N.Y. 1975).

13. U.S. CONST. art. 1, § 8.

14. International Shoe Co. v. Pinkus, 278 U.S. 261, 264 (1929); *In re* Watts and Sachs, 190 U.S. 1, 27 (1903).

15. Butler v. Goreley, 146 U.S. 303 (1892); Tua v. Carrierre, 117 U.S. 201 (1886).

16. 11 U.S.C. § 1 *et seq.* (1970).

under state insolvency laws.[17] While the Act primarily sought to promote equal distribution of a debtor's assets, it also sought to improve the administration of bankruptcy liquidations, establish a uniform system of bankruptcy proceedings, and provide the bankruptcy court[18] with sufficient discretion to arrive at the most equitable solution in any given case.[19] Thus the Act sought to diminish the emphasis placed by state insolvency laws on notice to creditors, early perfection of liens, and lien priorities.[20] Although the Act encompasses a wide range of debtors in order to accomplish these objectives, it specifically stipulates in section 4 that "banking corporations" may not be subjects of voluntary or involuntary bankruptcy proceedings.[21] In excluding "banking corporations," Congress decided that the complexity of the banking system required the more sophisticated regulation and liquidation of insolvent banks provided by the state or federal banking statutes that created or licensed them.[22] When an insolvent foreign bank is not licensed or regulated by a state or federal banking statute, however, the congressional rationale behind the section 4 "banking corporation" exception is inapplicable,[23] leaving it unclear whether such foreign banks were to be included in the provisions of the Bankruptcy Act. Because section 2 of the Act entitles a foreign corporation with assets in the United States to file a voluntary petition[24] in bankruptcy upon becoming insolvent, an unregulated

17. COLLIER ON BANKRUPTCY ¶ 0.01, at 2 (14th ed. 1975). For a general discussion of the philosophy behind bankruptcy, see Shuchman, *An Attempt at a "Philosophy of Bankruptcy"*, 21 U.C.L.A. L. REV. 403 (1973).

18. Although in some cases a Master is appointed to rule on federal bankruptcy matters, the federal district court is usually established as the bankruptcy court. 1 COLLIER BANKRUPTCY MANUAL ¶ 2.00, at 2-2 (2d ed. 1976).

19. For a good discussion of the district court's decision in the instant case as it affects the rights of United States banks and creditors, see Howard, *United States Bankruptcy Jurisdiction Over Unregulated Foreign Banks*, 17 HARV. INT'L L.J. 359 (1976) [hereinafter cited as Howard]. The article also outlines the advantages and disadvantages of the bankruptcy system and state insolvency proceedings.

20. *Id.* at 379.

21. 11 U.S.C. § 22 (1970). *See* note 10 *supra*.

22. *See In re* Union Guarantee & Morgage Co., 75 F.2d 984 (2d Cir.), *cert. denied*, 296 U.S. 594 (1935); Woolsey v. Security Trust Co., 74 F.2d 334 (5th Cir. 1934). These cases not only point up Congress' intention that state and federal banking laws should regulate the liquidation of all licensed banks but also that Congress specifically intended to divide this regulatory power between state and federal law.

23. Howard, *supra* note 19, at 361.

24. The language of § 2 provides that any "person" with property within the

foreign[25] bank so situated may be excluded from the provisions of the Act only if the bank is held to fall within the section 4 "banking corporations" exception.[26] Unfortunately, section 4 does not define what constitutes a "banking corporation." Furthermore, prior judicial definitions of a "banking corporation" as "corporations which were authorized by the laws of their creation to do a banking business"[27] may be inapposite because the cases so holding have never involved an unregulated foreign bank. Nor does the background of section 4 and its predecessors define the "banking corporation" exception. The original exception provision in section 4(b) of the 1898 Bankruptcy Act provided that "private bankers, but not national banks or banks incorporated under State or Territorial laws, may be adjudged involuntary bankrupts."[28] The legislative history of this provision indicates that it was concerned with the division of power between state and federal banking authorities on the regulation and liquidation of domestic banks.[29] Exactly

jurisdiction of the United States is subject to the provisions of the Bankruptcy Act. The Act defines "persons" to include "corporations", so any corporation, foreign or domestic, with property assets in the United States would be subject to the provisions of the Act, unless excluded under § 4. 11 U.S.C. § 1(23) (1970).

25. The term unregulated foreign bank will be used to denote those foreign banks that are not licensed to do banking business in the United States or regulated by state or federal banking statutes.

26. The major emphasis in this comment is placed on interpretation of the "banking corporation" exception in § 4 as it affects the subject matter jurisdiction of the bankruptcy court over voluntary petitions in bankruptcy. The jurisdictional issue carries over into other sections of the Bankruptcy Act, however, notably involuntary petitions in bankruptcy and ch. X petitions for reorganization. In *In re Bankhaus I.D. Herstaat KGa A. i l.*, No. 74B 1134 (R.B.) (S.D.N.Y. 1974), a case involving the determination of the bankruptcy court's jurisdiction over an unregulated foreign bank under an involuntary bankruptcy petition, the parties settled out of court before the court could decide the issue. In *In re Banque de Financement, S.A.*, No. 75 B 764 (R.B.) (S.D.N.Y. 1975), however, the issue of the bankruptcy court's jurisdiction in a ch. X petition for reorganization by an unregulated foreign bank has not been resolved and will likely be affected by the decision in the instant case.

27. Gamble v. Daniel, 39 F.2d 447, 450 (8th Cir.) *appeal dismissed,* 281 U.S. 705 (1930) (holding that the receipt of deposits for use in the banking business was essential to the classification of a "banking corporation" under § 4 of the Bankruptcy Act).

28. Section 4(b) of the 1898 Act dealt only with involuntary bankruptcies. The provision excluding such banks was carried over to voluntary bankruptcies as well when the 1910 Amendment changed the exclusion to "banking corporations." *See* Act of June 25, 1910, § 4, 36 Stat. 838, 839.

29. 30 Cong. Rec. 602, 606 (1897); H.R. Rep. No. 65, 55th Cong., 2d Sess. (1897). For a general view of the Bankruptcy Act and its legislative history, see

which banks were to be excluded under the 1898 Act, however, was not further defined in the legislative history. When it replaced the language of section 4(b) of the 1898 Act with the words "banking corporations" in the 1910 Amendment to the Bankruptcy Act, Congress intended to provide a more comprehensive definition of the excluded corporations in section 4. This definition is limited by the fact that Congress never contemplated the existence of foreign banks in the United States when section 4 was drafted.[30] Since the legislative history of section 4 does not define the term "banking corporation", the policy considerations that prompted the exclusion in section 4 become relevant in determining Congress' intent. The major policy considerations behind section 4 were the desirability of unarrested banking operations, protection of the banking industry's image, and the inappropriateness of the bankruptcy machinery in the affairs of banking corporations.[31] Since these policies should be equally applicable to each institution that is to be included within the "banking corporation" exception, they may indicate which banks Congress intended to exclude in section 4. Nevertheless, because of the failure of section 4 and its legislative history to define the "banking corporation" exception, the task of applying these policies and determining whether an unregulated foreign bank falls within the exception has been left to the courts.

At the first appellate level, the district court reversed the bankruptcy judge's ruling that a foreign bank not licensed to do business in the United States was not included in the section 4 "banking corporation" exception.[32] The court rejected IBB's argument that because it was not regulated by state or federal banking statutes it was not even a "bank" as such within the United States and therefore did not fall within the "banking corporation" exception. The court noted that since IBB was authorized under the laws of the United Kingdom to conduct a banking business and since "banking corporations" has been construed to include "corporations which were authorized by the laws of their creation

Sovern, *Section 4 of the Bankruptcy Act: The Excluded Corporations*, 42 MINN. L. REV. 171 (1957).

30. H.R. 511, 61st Cong., 2d Sess. (1910). H.R. 18694, 60th Cong., 2d Sess. (1909).

31. H.R. 18694, 90th Cong., 2d Sess. (1909). *See also In re* Supreme Lodge of the Mason's Annuity, 286 F. 180, 184 (1923) (in which the court enumerated the purposes for enacting the "banking corporation" exception).

32. 401 F. Supp. at 1159.

to do a banking business,"[33] IBB was a qualified "banking corporation" under the plain meaning of the term. The court nevertheless reviewed the legislative history and underlying purposes of section 4 in order to support its adoption of the exception's plain meaning.[34] The court reasoned that although Congress had not contemplated the existence of foreign banks in the United States when the section 4 exception was drafted, the 1910 Amendment was designed to produce a new comprehensive definition that included all "banking corporations," regardless of their place of incorporation or charter. Ultimately, the court concluded that since the legislative history of both the 1898 Act and the 1910 Amendment was ambiguous and non-determinative,[35] the adoption of the plain meaning of "banking corporations" could be defined. Next the court rejected IBB's contention that the section 4 exception should be interpreted with reference to the general objective of the Bankruptcy Act to equalize the distribution of assets rather than to the underlying purposes of the section 4 exception. The court cited these purposes to support its conclusions, noting that they apply equally to unregulated foreign banks and domestic banks.[36] The court stated that the purpose of subjecting banks to more effective state or federal banking statutes could be satisfied in the case of unregulated foreign banks by regulation under foreign liquidation laws.[37] The court then pointed out that the purpose of protecting

33. Although the case of *Gamble v. Daniel, supra* note 27, does define "banking corporation" in this manner, its holding is limited to the determination of which United States institutions doing some banking business should fall into the "banking corporations" exception. Therefore, it cannot stand for a definition of "banking corporation" as regards unregulated foreign banks. In support of its position, however, the court further pointed out that § 1(23) of the Bankruptcy Act defined the word "person" to include corporations and that § 1(8) of the Act defines "corporations" as "all bodies having any of the powers and privileges of private corporations not possessed by individuals . . . ." 11 U.S.C. § 1(8) (1970). The court then considered the "banking corporation" exception of § 4, read together with § 1 (23) and § 1(8). 401 F. Supp. 1162-63.

34. The court also cited a number of cases holding that courts have been willing to consider the legislative history of a statute if such history sheds light on even superficially "clear" statutory language. Although the district court decided that the language of § 4 was clear, it maintained that a review of its legislative history would be helpful. *Id.* at 1163.

35. *Id.* at 1169.

36. The court enumerated the policies set out in the text accompanying note 31 *supra*. 401 F. Supp. at 1173.

37. After careful review of the legislative history of § 4, the court concluded that it had not been definitively established that the "banking corporation" exception was promulgated because of the existence of extensive regulatory banking

public faith in the banking system demanded the inclusion of unregulated foreign banks as well as all regulated banks. The court further noted that the remaining purposes of the "banking corporation" exception, to insure the continuity of the banking system and to avoid the application of the inappropriate bankruptcy system to bank insolvencies, were applicable to insolvencies of unregulated foreign banks.[38] Finally, the court justified its holding by stating that the words of a statute must be given effect as they read, unless that interpretation frustrates the purpose of the legislation or is contrary to legislative intent, neither of which occur in this case.

On appeal, the court of appeals reversed the district court's decision.[39] The instant court first pointed out that IBB would come within the provisions of the Bankruptcy Act under section 2 as a foreign corporation with assets in the United States. The court then noted that since Congress had never considered the question of the bankruptcy court's jurisdiction over unregulated foreign banks, there could be no clear meaning that included such banks within the section 4 exception.[40] The court emphasized instead the necessity of referring to rules of statutory construction and the legislative history of section 4 in interpreting the meaning of the term "banking corporations". The court stated that whereas words creating a general inclusionary category may warrant a liberal interpretation, normal rules of construction require that words of an exception be strictly construed to limit the exception.[41] The court

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laws. Nevertheless, the court noted that had this been the primary purpose of Congress, foreign banks could be just as easily regulated by foreign liquidation laws, leaving the liquidation of the foreign banks' United States assets to local laws such as the N.Y. BUS. CORP. LAW § 1202(a)(4) (McKinney), which provides that a receiver may be appointed to preserve the assets of a foreign corporation for distribution to the corporation's creditors. 401 F. Supp. at 1172-73.

38. 401 F. Supp. at 1174.

39. 536 F.2d 509 (2d Cir. 1976).

40. The court cited as evidence for the position that there is no plain meaning in "banking corporation" the case of *McBoyle v. United States*, 283 U.S. 25 (1931), where Justice Holmes found that an airplane was not a "motor vehicle" though it was propelled by a motor. The instant court noted that in both these cases the items to be considered within these exceptions, respectively an unregulated foreign bank and an airplane, had not been considered when the exception was formulated.

41. The court cited numerous cases in support of this principle, most notably, *Piedmont & N. Ry. v. ICC*, 286 U.S. 299 (1932) (holding that an electric railway company did not fall within the purposes of § 22 of the remedial Transportation Act).

noted the appropriateness of this rule where the underlying purpose of the exception did not apply to the situation purported to fit into the exception.[42] Thus, a foreign bank not licensed to do banking business in the United States should not be included in an exception whose primary purpose was to subject banks to the insolvency regulations of the state or federal banking statutes that created them. The court further found it more logical to include unregulated foreign banks within the Bankruptcy Act since its general remedial purpose could be appropriately applied to them. In support of this conclusion, the instant court also cited the legislative history of the "banking corporation" exception. The court reasoned that had Congress contemplated the situation of an unregulated foreign bank when it drafted section 4 in the 1910 Amendment, such banks would have been excluded from the exception for the same reason private bankers were excluded from section 4(b) of the 1898 Act.[43] The court concluded that since the legislative history of the 1910 Amendment indicated Congress did not intend to change the law under section 4,[44] the "banking corporations" exception merely excluded the same licensed state, national, or territorial banks that had been excluded from the 1898 Act. Finally, the court noted that applying the "banking corporation" exception to IBB would impair the effectiveness of the Bankruptcy Act and the banking system by forcing it into liquidation proceedings under state insolvency laws.[45] For these reasons, the instant court held it would be more logical and reasonable to exclude unregulated foreign banks from the section 4 exception and therefore allow them to file voluntary bankruptcy petitions.

Since the statutory interpretations of the "banking corporation" exception by both the district court and the court of appeals have their respective merits, it would be inappropriate to discuss their

42. The court compared the situation of an unregulated foreign bank to the underlying purpose of the § 4 "banking corporation" exception, stating that the existence of alternative foreign regulatory banking laws was largely irrelevant to the § 4 purpose.

43. 536 F.2d at 513.

44. As authority for this, the court cited the Hearing before Subcommittee No. 1 of the House Committee on the Judiciary, set out in note 30 *supra.* Although sections of this hearing strongly suggest the intention of Congress not to change the law in substituting "banking corporations" for the words of exception in § 4(b) of the 1898 Act, it should be noted that this is merely evidence from the record of a subcommittee hearing and therefore hardly conclusive.

45. 536 F.2d at 515.

differences any further. The proper area of focus lies rather in the common ground of the two decisions. Both courts emphasized the point that Congress had not contemplated the existence of foreign banks when the section 4 exception was formulated. This fact, together with the concededly ambiguous nature of section 4's legislative history, indicates that Congress did not specifically intend to include unregulated foreign banks within the section 4 exception. Thus, in order to determine whether such banks ought to be included within the exception, it becomes necessary to go beyond the words of section 4 and its underlying policies to consider the practical effects of excluding an unregulated foreign bank from the jurisdiction of the federal bankruptcy court.[46] First, excluding IBB from the provisions of the Act would not accomplish the purpose of the section 4 exception, for IBB as an unregulated foreign bank is not subject to state or federal banking statutes. On the other hand, excluding an unregulated foreign bank from the jurisdiction of the federal bankruptcy court and thereby forcing the bank into state insolvency proceedings would have a major effect on international debtor-creditor relationships. Since most foreign jurisdictions deal with foreign creditors of domestic bankrupts on a reciprocal basis, treatment of unregulated foreign banks in the United States will have an impact on the way United States creditors are treated abroad.[47] Thus, if the United States were to guarantee the protection of a foreign bank's local assets for the benefit of both foreign and local creditors, the beneficiary foreign jurisdictions would be more likely to do the same for United States creditors and their insolvents. As the court of appeals properly points out, the federal bankruptcy system affords a more effective process for protection of a foreign creditor's rights than do state insolvency laws, for several reasons. Under state laws, liens that are perfected first invariably enjoy priority in a liquidation proceeding.[48] If an unregulated foreign bank's assets are inadequate to cover all the

46. There is no reason why the characterization of IBB as an institution authorized to do banking business in a foreign country should affect IBB's functional role as an insolvent in the United States. IBB instituted its voluntary bankruptcy petition under section 2 of the Act as a foreign corporation, making its status as a banking institution in a foreign country irrelevant.

47. The bankruptcy laws of Mexico, for example, require that creditors of local branches of foreign enterprises be paid first if there is a concurrent foreign bankruptcy proceeding. The bankruptcy laws in other countries, such as Uruguay, Paraguay, Peru, Argentina, and Germany, effectively discriminate similarly in favor of the local creditor.

48. *See* Howard, *supra* note 19, at 369.

claims against them, those creditors who do not perfect their liens first may receive nothing. This puts foreign creditors at a disadvantage, since local creditors[49] are usually the first to receive notice of the debtor's financial embarrassment and have easier access to the local courts where their liens can be swiftly perfected. Furthermore, state courts generally prefer local creditors' claims arising under state law to the claims of foreign creditors arising under foreign law,[50] so that even if foreign creditors' claims were perfected first in their own jurisdiction, the local creditor might be paid first.[51] Secondly, the inability of state courts to adjust the order of liens except in the cases of specific defenses such as fraud may contribute to increased discrimination against United States banks and creditors in foreign jurisdictions.[52] For example, foreign creditors who are not treated equitably under state laws may put pressure on foreign jurisdictions to subordinate the claims of United States creditors. Furthermore, in order to be effectively applied toward foreign jurisdictions, a more flexible lien adjustment system would have to be uniformly adopted by all the states. On the other hand, the federal bankruptcy system is uniform and does not have the same rigid lien priorities that would lead to the unequal distribution of an unregulated foreign bank's assets. Thus both local and foreign creditors are given ample opportunity to protect their rights to the bank's assets. More importantly, the federal bankruptcy system has more discretion to adjust its proceedings or to decline jurisdiction in order to arrive at the most equitable solution in a particular case.[53] By exercising its discretion

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49. The term "local creditor" refers only to United States citizens, although strictly according to Art. IV § 2 of the United States Constitution it could include certain aliens. *Id.*

50. *Id.* at 370.

51. *Id.* at 379.

52. Since state courts cannot adjust the order of liens, they cannot favor local creditors in order to put pressure on foreign creditors with prior liens whose jurisdictions discriminate in favor of local creditors to the disadvantage of United States creditors. It is admittedly not often the case, however, that foreign creditors are able to establish liens prior to those of local creditors. For a discussion on the discrimination of foreign bankruptcy laws and how it may effect treatment of foreign creditors in the United States, see Nadelman, *Discrimination in Foreign Bankruptcy Laws Against Non-Domestic Claims*, 47 REF. J. 147 (1973).

53. Bankruptcy courts are courts of equity, provided with considerable discretionary powers by section 2 of the Bankruptcy Act to disallow or subordinate claims in light of equitable considerations. Pepper v. Litton, 308 U.S. 295 (1931). *See also* Annot., 100 ALR 660 (1936). Furthermore, the bankruptcy court may reject or accept jurisdiction according to how foreign creditors are treated under

to reject or accept jurisdiction over a bankrupt according to how an unregulated foreign bank and its creditors may be treated under state laws, the bankruptcy court may still protect local creditors that have perfected liens against the bank's assets in state courts, protect foreign creditors who have had a chance to acquire a lien in state court, or favor local creditors in order to put pressure on particular foreign jurisdictions that discriminate against United States creditors. Similarly, the court may use its power to adjust dividends and void preferential liens to the advantage or disadvantage of foreign banks and their creditors.[54] Finally, the federal bankruptcy system is better equipped to protect the banking system through orderly liquidation of an unregulated foreign bank's assets, thereby avoiding the instability and lack of confidence in foreign banks that might be promoted under state insolvency proceedings. Through section 67(a), providing for avoidance of liens acquired within four months of the filing of a bankruptcy petition, the Bankruptcy Act minimizes the pressure to anticipate insolvency that is often present under state laws. This reduces the possible instability in the banking system that might result from premature or unnecessary liquidation proceedings. Therefore, although the instant court failed to deal with the practical effects of exercising bankruptcy jurisdiction over an unregulated foreign bank, its exclusion of IBB from the "banking corporation" exception nevertheless occasioned a beneficial result. The advantages to be derived from protecting unregulated foreign banks and foreign creditors, stabilizing the international banking system, and promoting the rights of United States banks and creditors in foreign jurisdictions far outweigh the gain realized by local creditors with prior liens, that would result from forcing IBB into the alternate route of state insolvency proceedings.

Peter Appleton Schuller

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state laws. Thus, if foreign courts do not discriminate against United States banks and creditors, then the bankruptcy court may reciprocate by accepting jurisdiction in a case where foreign creditors would otherwise be disadvantaged under state laws. Howard, *supra* note 19, at 383.

54. For an example, the court can, under section 65(d) of the Act, withhold dividends from foreign creditors where in a reciprocal case in a foreign jurisdiction a United States creditor failed to receive its proper dividends.