No. 10-875

In The Supreme Court of the United States

LYNWOOD D. HALL and BRENDA A. HALL,

Petitioners,

v.

UNITED STATES OF AMERICA,

Respondent.

On Writ Of Certiorari To The Ninth Circuit Court Of Appeals

BRIEF FOR PETITIONERS

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QUESTION PRESENTED

Chapter 12 of the Bankruptcy Code permits family farmers to reorganize their debts. After filing a Chapter 12 petition, Petitioners sold their family farm with the consent of their bankruptcy trustee and court approval, and with sale proceeds administered through the bankruptcy estate to pay creditors. The sale of the farm generated taxable capital gains. In 2005, Congress modified Chapter 12 by enacting Bankruptcy Code 1222(a)(2), which excepts from the priority scheme established in Bankruptcy Code Section 507 claims by the government, including claims for taxes, arising from the sale of farm assets. Specifically, taxes covered by Section 1222(a)(2)(A) are deemed nonpriority, unsecured claims, which need not be paid in full if the estate is insufficient. The Ninth Circuit held that Internal Revenue Code Section 1399, which provides that a bankruptcy other than an individual Chapter 7 or individual Chapter 11 case does not give rise to a "separate taxable entity," strips taxes on postpetition farm sales from Section 1222(a)(2)(A)'s coverage. The question presented is whether Section 1222(a)(2)(A)'s reference to "claims entitled to priority under section 507" means all tax claims described in Section 507, including taxes on postpetition sales, or whether, instead, the Ninth Circuit was correct that Congress meant for an entirely separate section of the IRC to impliedly remove one of the key portions of Section 507 from Section 1222(a)(2)(A)'s special protections.

LIST OF PARTIES

Lynwood D. Hall and Brenda A. Hall are the petitioners. The United States of America is the respondent.

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OPINIONS BELOW

The opinion of the United States Court of Appeals for the Ninth Circuit is reported at 617 F.3d 1161 (9th Cir. 2010) and set forth at Petition Appendix ("Pet. App.") 1. The August 6, 2008 order of the United States District Court for the District of Arizona is reported at 393 B.R. 857 (D. Ariz. 2008), and set forth at Pet. App. 18. The October 7, 2007 memorandum decision of the United States Bankruptcy Court for the District of Arizona is reported at 376 B.R. 741 (Bankr. D. Ariz. 2007) and set forth at Pet. App. 34.

JURISDICTION

This Court's jurisdiction is invoked under 28 U.S.C. § 1254(1). The jurisdiction of the Bankruptcy Court and District Court were invoked under 28 U.S.C. §§ 157, 158, and 1334. The dates of relevant orders are at Pet. 1.

STATUTES AND CONSTITUTIONAL PROVISIONS INVOLVED

This case involves the Bankruptcy Code (11 U.S.C. §§ 101 *et seq.*), the principal sections of which are 11 U.S.C. §§ 503(b)(1)(B)(i), 507(a)(2), 507(a)(8), and 1222(a)(2)(A); and the Internal Revenue Code ("IRC"), 26 U.S.C. §§ 1 *et seq*., the principal sections of which are 26 U.S.C. §§ 1398 and 1399. Relevant

provisions of the United States Bankruptcy Code and IRC are set forth in full in Pet. App. 49-55 and the Appendix.

STATEMENT OF THE CASE

Lynwood and Brenda Hall owned and operated a 320-acre farm in Willcox, Arizona (the "Hall Farm"). On August 9, 2005, they filed a petition for bankruptcy relief as family farmers under Chapter 12 of the Bankruptcy Code. 11 U.S.C. §§ 1201-1231; J.A. 26. Chapter 12 is a special Chapter of the Bankruptcy Code for family farmers, intended to make it easier for them to reorganize their financial affairs. Chapter 11 reorganizations impose difficult plan requirements and prevent many asset sales without secured creditor consent, and Chapter 13 wage-earner reorganizations have lower debt eligibility thresholds than many farmers can meet, do not provide for asset sales during case administration, and cannot be used by farmers operating as partnerships or corporations. Chapter 12 helps family farmers over these bankruptcy hurdles. They operate farms as debtors-in-possession with limited trustee involvement, and confirm reorganization plans.

Prior to filing their bankruptcy petition, the Halls had contracted to sell the Hall Farm for $960,000. J.A. 26. The sale was complicated by the fact that the Hall Farm secured a disputed claim of Brenda Hall's father, his wife and their family trust (the "Osborns"),

and the Osborns had filed a state court foreclosure action that would have enabled them to recover all the Hall Farm value. J.A. 26-27.

Chapter 12 authorizes the sale of bankruptcy estate assets free and clear of secured creditor liens. 11 U.S.C. § 1206. The Halls moved for Bankruptcy Court authority to proceed with the Hall Farm sale and the Osborns objected. J.A. 20. Thereafter, the Halls and the Osborns, with the consent of the Chapter 12 trustee, agreed to go forward with the sale on the conditions that $400,000 would be paid from escrow to the Osborns, and the Osborns' claims and Halls' counterclaims would be resolved thereafter by the court. The Bankruptcy Court approved this agreement. *Id*. After payment of a bank crop lien claim, closing costs and the $400,000 payment to the Osborns, the Chapter 12 trustee held the remaining sale proceeds of $422,229.59. J.A. 22, 53.

After substantial litigation and mediation, the Halls and Osborns settled, with the Osborns receiving an additional $215,000. J.A. 27, 53. From the remaining estate funds, the Halls and the Chapter 12 trustee obtained Bankruptcy Court approval to pay the Internal Revenue Service ("IRS" or the "Government") $58,470.76 and Cochise County $1,410.68 for secured claims resulting from prepetition taxes. J.A. 48-49.

Most Bankruptcy Code provisions apply in Chapter 12 cases, including Sections 507 and 503, which give certain kinds of unsecured claims "priority"

rights to payment from bankruptcy estate assets before other unsecured claims. 11 U.S.C. § 103(a). Priority claims are given preferential treatment due to Congress's determination that those claims are more important than others. "Administrative expenses," the costs of operating and administering bankruptcy estate assets, have the highest priority of payment second only to domestic support obligations such as child support. 11 U.S.C. § 507(a)(2). These include fees of any trustee, the debtor's attorneys, and costs of operating a farm or other business during the period of bankruptcy estate administration before a reorganization plan is confirmed. Certain taxes are also administrative expenses.

The sale price of the Hall Farm exceeded the Halls' basis in the assets, resulting in capital gains. The presumptive tax on these gains, under applicable prevailing rates in the IRC, was approximately $29,000. J.A. 35. Effective April 20, 2005, however, Congress enacted a special provision of Chapter 12 so that a priority tax claim resulting from the sale of "any farm asset used in the debtor's farming operation" could be treated as an unsecured claim and discharged. 11 U.S.C. § 1222(a)(2)(A).

The IRS did not file an administrative expense claim for the capital gains tax. Governmental units are not required to file such claims for taxes to be treated as administrative expenses. 11 U.S.C. § 503(b)(1)(D). The Halls, relying on Section 1222(a)(2)(A), filed an amended plan providing for the tax to be treated as an unsecured claim and paid pro rata to the extent

funds were available after satisfying higher priority claims. *See* J.A. 35, 40-41.

The IRS objected to the debtors' plan based on IRC 1399. Pet. App. 35. It states that no "separate taxable entity" results from the commencement of a bankruptcy case under any Chapter of the Bankruptcy Code except for Chapter 7 liquidation or Chapter 11 reorganization cases of individual debtors. *See* 26 U.S.C. § 1399. According to the IRS, the postpetition capital gains tax was not an administrative expense under Bankruptcy Code 507(a)(2) and 503(b), and therefore not covered by Section 1222(a)(2)(A), because it was not "incurred by the estate" as required to qualify as an administrative expense claim in the Halls' bankruptcy case. The IRS argued instead that it was an obligation of the Halls individually to be paid from non-bankruptcy estate assets, and could not be discharged under their Chapter 12 reorganization plan. *See* Pet. App. 35, J.A. 45. Without administrative expense status, the IRS claimed, Bankruptcy Code 1222(a)(2)(A) is simply inapplicable to postpetition tax claims due to the sale of bankruptcy estate assets, so debtors like the Halls have to pay the entire capital gains tax as though it arose outside the bankruptcy. *See* Pet. App. 40.

The Bankruptcy Court agreed with the IRS and sustained the Government's objection. *See* Pet. App. 46, J.A. 50. On appeal, the District Court reversed the Bankruptcy Court. *See* Pet. App. 32-33. The Ninth Circuit, in a 2-1 decision, agreed with the Bankruptcy Court, and reversed the District Court. *See id.* 6, 16.

The Ninth Circuit recognized that its decision created a circuit split with *Knudsen v. IRS*, 581 F.3d 696 (8th Cir. 2009), which reached an opposite conclusion. Pet. App. 9.

During this litigation, the Chapter 12 trustee has used additional Hall Farm sale proceeds to pay court-approved fees and costs of the Chapter 12 trustee, the trustee's attorney, accountant, the trustee's bond premiums, and the Halls' bankruptcy attorney, leaving a balance of approximately $42,500. J.A. 54. Other claims including priority claims have not been paid, and there are insufficient funds to satisfy the entire capital gains tax in full as an unsecured claim. *See* J.A. 36-37. The Halls would lose their home if forced to pay the IRS outside their plan for the capital gains tax generated from the Hall Farm sale because tax liens are not subject to state law homestead exemptions. *See* 26 U.S.C. § 6334(c); *United States v. Mitchell*, 403 U.S. 190, 204-05 (1971).

SUMMARY OF ARGUMENT

By the plain language of Bankruptcy Code 1222(a)(2)(A) and the Sections cross-referenced therein – 507(a) and through it 503(b)(1)(B) – taxes based on sales of farm assets during a Chapter 12 bankruptcy case are entitled to be treated as non-priority unsecured claims. Section 1222(a)(2)(A) provides that, so long as a tax claim is one that is entitled to priority under Section 507, it will be stripped of that priority

status if it arises from the sale of farm assets. Although resolution of this case requires travel through cross-referenced sections of the Bankruptcy Code, in the end, the language is clear. The tax generated upon the sale was a Section 503(b) "administrative expense" claim; it is entitled to second-level priority under Section 507; and the tax therefore is excepted from such priority by Section 1222(a)(2)(A).

The Ninth's Circuit's opinion to the contrary is, in a word, strained. It held that Section 1222(a)(2)(A) applies only to taxes specified in Section 507(a)(8). Pet. App. 4-6. Not only does this position disregard Sections 507(a)(2) and 503(b)(i)(B), but it also cannot be squared with the statutory scheme. Section 507(a)(8) was amended at the same time Section 1222(a)(2)(A) was enacted in 2005. At that time, there was confusion whether Section 507(a)(8) should be read to give eighth-level priority to claims for taxes incurred prepetition but during the year in which a bankruptcy case was filed (the "straddle year"), instead of the higher priority given to administrative expense claims. Congress amended Section 507(a)(8) to make clear that all taxes incurred during the tax year in which the bankruptcy petition occurs are ***not*** covered by Section 507(a)(8) and must be treated as administrative expenses (and thus have higher priority). So understood, the holding that Section 1222(a)(2)(A)'s special protections only apply to claims covered by Section 507(a)(8) means that in order to obtain the exception from priority claim status for a sale of farm assets under Section 1222(a)(2)(A),

a farmer would have to sell his farm many months before bankruptcy – that is, sufficiently far enough in advance that Section 507(a)(8), as amended, would apply. Far more logical and harmonious with Congress's purpose is the unstrained interpretation – that Section 1222(a)(2)(A) applies to administrative expense tax claims.

The underlying rationale for the Ninth Circuit's conclusion is a belief that taxes resulting from sales of bankruptcy estate assets are not administrative expense claims unless the debtor's estate is a "separate taxable entity" under the IRC. This holding cannot be squared with decades of decisions to the contrary from this Court in single taxable entity cases and evidence of legislative intent to continue that policy. It also erroneously uses a 1980 IRC provision that created separate taxable entities in some bankruptcy cases to construe a 1978 Bankruptcy Code provision regarding payment priority from bankruptcy estate assets in all cases, again contrary to principles established by this Court. The rationale for the IRC provision does not support that construction or justify disrupting the priority scheme for claim payments in bankruptcy cases.

More fundamentally, the Ninth Circuit's opinion conflates two distinct laws with separate purposes. The IRC determines what transactions are taxable and in what amounts. The Bankruptcy Code determines priority of distributions of estate assets to pay claims, with postpetition taxes and other administrative expense claims next to the top. The IRC provision

for a single taxable entity in some cases and a separate taxable entity in others has nothing to do with the priority with which estate assets are distributed among different classes of claimants. The IRS has long argued for administrative expense treatment of taxes incurred due to transactions involving bankruptcy estate assets, consistent with decisions of this Court. The IRS's reversal of course after Congress enacted Bankruptcy Code 1222(a)(2)(A) is an aberration that should not be adopted here.

The Ninth Circuit also erred in holding that administrative expense tax claims may not be treated in a Chapter 12 plan or discharged, and instead concluding that they are left in limbo for effective nondischargeability. This interpretation is inconsistent with express Bankruptcy Code provisions for treatment of administrative expense tax claims under a plan and their discharge.

The requirement that administrative expense claims be paid in full to confirm a plan used to give the IRS veto power over Chapter 12 cases when a family farmer needed to downsize his operations, but a sale would result in substantial tax liability. Congress enacted Section 1222(a)(2)(A) as an ***exception*** to the priority classification scheme, to enable such sales and allow Chapter 12 plans to be confirmed, and to discharge farmers from such tax claims. The capital gains tax from the sale of the Hall Farm meets the criteria for applicability of Section

1222(a)(2)(A), and the judgment of the Ninth Circuit should be reversed.

ARGUMENT

I. Under the Plain Language of the Bankruptcy Code, Section 1222(a)(2)(A) Applies to Taxes Arising from Postpetition Farm Sales.

When interpreting the Bankruptcy Code, if "the statute's language is plain, 'the sole function of the courts is to enforce it according to its terms.'" *See United States v. Ron Pair Enters.*, 489 U.S. 235, 241 (1989). The central provision at issue here requires that a Chapter 12 plan

> provide for the full payment . . . of all claims entitled to priority under section 507, unless . . . the claim is a claim owed to a governmental unit that arises as a result of the sale . . . of any farm asset used in the debtor's farming operation, in which case the claim shall be treated as an unsecured claim that is not entitled to priority under section 507. . . .

11 U.S.C. § 1222(a)(2)(A).

The statute accordingly strips the priority of claims "owed to a governmental unit" that "arise" from the sale "of any farm asset," and makes them general unsecured claims. The dispute here is whether the

claim at issue is one of the types of "claims" referred to in Section 1222(a)(2)(A).

Section 507 identifies and ranks ten types of expenses and claims, with "administrative expenses" second. *See* 11 U.S.C. § 507(a)(2) (cross-referencing "administrative expenses under section 503(b) of this title"). Section 503(b), in turn, includes as "administrative expenses," "any tax . . . incurred by the estate . . . except a tax of a kind specified in section 507(a)(8) of this title." 11 U.S.C. § 503(b)(1)(B)(i). The tax at issue is not of the kind specified in Section 507(a)(8), because Section 507(a)(8) refers to taxes on sales that occur well before the bankruptcy, and the sale at issue here was postpetition. It accordingly is an "administrative expense" within Section 1222(a)(2)(A)'s reference to claims "entitled to priority under 507." The Section 1222(a)(2)(A) carve-out for "the claim" that "is a claim owed to a governmental unit" refers on its face to being a subset of "all claims entitled to priority under section 507," not just those in Section 507(a)(8).

The Ninth Circuit turned away from this plain language reading. It took a much more winding road in holding that capital gains taxes arising from postpetition sales are not "administrative expenses" within the meaning of Section 1222(a)(2)(A). The plain language reading is better.

A. A Straightforward Reading of the Statute Addresses Taxes from Postpetition Farm Sales.

The Ninth Circuit and the Government have recognized, as they must, that Section 1222(a)(2)(A) has to apply to ***something*** – that is, Congress plainly intended to grant non-priority, unsecured status to some taxes arising from sales of farm assets by Chapter 12 debtors. They say the something to which Section 1222(a)(2)(A) applies is merely taxes of a type specified in Section 507(a)(8).

The most natural reading of Section 1222(a)(2)(A), however, is that Congress meant what it said – that when it referred to "all claims entitled to priority under section 507," Congress meant both of the subsections of Section 507 relating to taxes, not just one of them. *Cf.* Mike Lowry, *A New Paint Job on an '85 Yugo: BAPCPA Improves Chapter 12 but Will It Really Make a Difference?*, 12 DRAKE J. AGRIC. L. 231, 247 (2007) ("Sales after bankruptcy will undoubtedly qualify. . . . "); Katherine M. Porter, *Phantom Farmers: Chapter 12 of the Bankruptcy Code*, 79 AM. BANKR. L.J. 729, 738 (2005) ("Certainly any dispositions made after the bankruptcy filing under the terms of the Chapter 12 plan qualify under Section 1222(a)(2).").

If Congress intended only prepetition taxes to be affected by Section 1222(a)(2)(A), it could have easily referred only to Section 507(a)(8) claims instead of all priority claims. Or it could have used the phrase

"arose before the bankruptcy petition was filed." *See Gwaltney of Smithfield v. Chesapeake Bay Found.*, 484 U.S. 49, 57 (1987) ("Congress could have phrased its requirement in language that looked to the past ('to have violated'), but it did not choose this readily available option."). Rather, Section 1222(a)(2)(A)'s plain language clearly creates an exception to the full-payment requirement of all priority claims, and envisions claims for taxes that arise (and thus sales that occur) after the filing of a petition.[1]

B. A Postpetition Tax Is a "Claim" Under the Bankruptcy Code.

Section 1222(a)(2)(A) applies to all "claims" entitled to priority under Section 507. "Claim" is defined extremely broadly in the Bankruptcy Code, and covers any "right to payment," which "'means nothing more nor less than an enforceable obligation.'" *See* 11 U.S.C. § 101(5)(A); *Johnson v. Home State Bank*, 501

[1] Section 1222(a)(2)(A) could even be read to apply only to postpetition sales. It provides for the contents of a Chapter 12 debtor's "plan" and refers to a tax claim "that *arises* as a result of the sale" of a farm asset used in the "*debtor's* farming operation." The verb "arises" is in the present tense and the statute applies facially to farming by a person "concerning which a case under [Title 11] has been commenced." *See* 11 U.S.C. § 101(13) (definition of "debtor"). *See Carr v. United States*, 130 S. Ct. 2229, 2236 (2010) (applying the Dictionary Act, 1 U.S.C. § 1, and holding that "a statute that regulates a person who 'travels' is not readily understood to encompass a person whose only travel occurred before the statute took effect").

U.S. 78, 83 (1991) (quoting *Pa. Dep't of Pub. Welfare v. Davenport*, 495 U.S. 552, 559 (1990)).

Other provisions in the Code make clear that Congress intended administrative expenses set forth in Section 507(a)(2) to be "claims." *See, e.g.*, 11 U.S.C. § 1226(b)(1) ("Before or at the time of each payment to creditors under the plan, there shall be paid . . . any unpaid claim of the kind specified in Section 507(a)(2)."); 11 U.S.C. § 726(b) (referring to "claim" of the kind specified in Section 507(a)(2)); 11 U.S.C. § 1123(a)(1) (Chapter 11 plan shall "designate . . . classes of claims, other than claims of the kind specified in Section 507(a)(2)"); 11 U.S.C. § 1129(a)(9)(A) (repeatedly referring to an administrative expense under 507(a)(2) as a "claim"); 11 U.S.C. § 1326(b)(1) (using the same language as Section 1226(b)(1)). "[T]he basic canon of statutory construction [is] that identical terms within an Act bear the same meaning." *Estate of Cowart v. Nicklos Drilling Co.*, 505 U.S. 469, 479 (1992); *see also* I.R.S. Chief Couns. Advice 200518002 (May 6, 2005), 2005 WL 1060956 (stating that when a Chapter 12 debtor does not pay significant postpetition taxes, "the preferred course of action for the Service is to move for dismissal of the case, rather than to file an administrative expense claim").

That administrative expenses fall within the scope of "claims" is also borne out by the Code's definition of "creditor" as an "entity that has a claim against the debtor that arose at the time of or before the order for relief concerning the debtor." 11

U.S.C. § 101(10)(A). If the word "claim" signifies only prepetition debt as the Ninth Circuit held, then "creditor" would simply be "an entity that has a claim against the debtor." The rest of the statutory definition would be superfluous. *See TRW Inc. v. Andrews*, 534 U.S. 19, 31 (2001) (noting that statutes should not be read to make any provision "superfluous, void, or insignificant"). Congress's reference in Section 1222(a)(2)(A) to "all claims entitled to priority under section 507" thus concisely addresses all taxes to be dealt with in a plan – Section 507(a)(2) administrative expense claims as well as lower priority Section 507(a)(8) claims.

C. A Tax Is "Incurred by the Estate" When It Arises During a Bankruptcy Case.

For a tax to be an administrative expense claim under Section 503(b)(1)(B)(i), it must be "incurred by the estate." The Ninth Circuit held that a Chapter 12 bankruptcy estate cannot incur taxes because IRC 1399 creates a "separate taxable entity" only in individual (*i.e.*, non-corporate) Chapter 7 liquidations and Chapter 11 reorganizations, but not in Chapter 12 and other cases. Pet. App. 6.

This Court interpreted Section 503(b) contrary to the Ninth Circuit's opinion, however, in *United States v. Noland*, 517 U.S. 535, 537, 541-42 (1996). That case did not involve a "separate taxable entity" under IRC 1399, because the debtor was a corporation, not an individual. Yet the Court held that a postpetition

tax penalty was, indeed, an administrative expense claim.

The IRS in *Noland* had filed claims for taxes, interest, and penalties that accrued after a Chapter 11 filing and before conversion to a Chapter 7 liquidation. The parties agreed that the taxes were entitled to priority as "administrative expenses" under Section 503(b), but disagreed about the priority of the penalties. The Court of Appeals found the penalties were entitled to priority under Section 507(a)(1)[2] as "administrative expenses," but found they were subject to "equitable subordination" under another section of the Bankruptcy Code. The issue before the Court was whether equitable subordination could be applied on a categorical basis. In the course of answering that question, the Court first held, unanimously, that the penalties were indeed entitled to "administrative expense" priority under 507. *Id.* at 541, 543.[3] Thus, *Noland* confirms that, even in a case

[2] At the time, administrative expenses had first priority. They now are second in priority, after certain domestic support obligations.

[3] The Court found it necessary to reach that question for two reasons. First, the Court's ultimate holding was that courts may not make categorical equitable subordination judgments that undermine the policy judgments Congress made in setting priorities in Section 507. Necessary to that analysis was a threshold conclusion that penalties "relating to a tax of a kind specified in subparagraph (B)" (the tax priority at issue in the present case), were in fact entitled to priority as "administrative expenses." *See Noland*, 517 U.S. at 541 ("The Court of Appeals' decision thus runs directly contrary to Congress's policy

(Continued on following page)

where there is no "separate taxable entity," taxes arising postpetition are "administrative expense claims" under Section 503(b).

Similarly, the Court interpreted Chapter XI of the predecessor Bankruptcy Act in a corporate case with no separate entity taxpayer to mean that "taxes incurred during the arrangement period are expenses of the Chapter XI proceedings and are therefore technically a part of the first priority under § 64a(1)." *Nicholas v. United States*, 384 U.S. 678, 687-88 (1966). The "arrangement period" under Chapter XI is the equivalent of the postpetition/pre-confirmation period under the current Bankruptcy Code. *See also* S. Rep. No. 95-989 at 66 (1978), *as reprinted in* 1978 U.S.C.C.A.N. 5787, 5852 (stating that 503(b) "is derived mainly from section 64a(1) of the Bankruptcy Act").

The Courts of Appeals have long been in accord. As the Fourth Circuit has explained, taxes "incurred by the estate" means postpetition taxes, "since by definition there can be no bankruptcy estate until the petition in bankruptcy is filed." *See United States v. Friendship College, Inc.*, 737 F.2d 430, 431 (4th Cir.

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judgment that a postpetition tax penalty should receive the priority of an administrative expense"). Second, the debtor in *Noland* argued that the penalties should be treated as lower-priority prepetition expenses. *Id.* at 541 n.3. The Court rejected the argument, holding that Section 503(b) is clear. *Id.* ("We agree with the Sixth Circuit . . . that the penalties at issue here are postpetition administrative expenses").

1984); *see also In re Sunnyside Coal Co.*, 146 F.3d 1273, 1278 (10th Cir. 1998); *Towers for Pacific-Atlantic Trading Co. v. United States (In re Pacific-Atlantic Trading Co.)*, 64 F.3d 1292, 1294 (9th Cir. 1995); *Mo. Dep't of Revenue v. L.J. O'Neill Shoe Co. (In re L.J. O'Neill Shoe Co.)*, 64 F.3d 1146, 1148 (8th Cir. 1995); *W. Va. State Dep't of Tax & Revenue v. IRS (In re Columbia Gas Transmission Corp.)*, 37 F.3d 982, 984 (3d Cir. 1994); *United States v. Ledlin (In re Mark Anthony Constr., Inc.)*, 886 F.2d 1101, 1101 (9th Cir. 1989).

Two such cases specifically involve capital gains taxes arising from postpetition asset sales where there were no separate taxable entities under the IRC. *See In re I.J. Knight Realty Corp.*, 501 F.2d 62, 66 (3d Cir. 1974) (holding in Chapter XI case under the Bankruptcy Act that the bankruptcy trustee of an entity debtor must use estate assets to pay capital gains tax on sale of estate assets); *United States v. Sampsell*, 266 F.2d 631, 634-35 (9th Cir. 1959) (holding in corporate bankruptcy that liquidating trustee must use estate assets to pay capital gains tax); *see also* 8 William L. Norton, Jr., NORTON BANKRUPTCY LAW & PRACTICE § 155:12, at 155-25 (3d ed. 2010) ("Any tax liability that is create [sic] by the estate on the disposition of property or on the transfer of property in settlement of the debt is an administrative expense of the estate under Code § 503(b)(1)(B)(i). The tax obligation is not a debt of the debtor but of the estate.").

Postpetition tax claims thus have a venerable history of administrative expense status, both under the Bankruptcy Act of 1898 and the current Bankruptcy Code, without regard to whether a separate taxable entity exists. In the absence of clear legislative intent to alter well-recognized interpretations of bankruptcy law, subsequent enactments do not change existing law. *See Dewsnup v. Timm*, 502 U.S. 410, 419 (1992) ("[T]his Court has been reluctant to accept arguments that would interpret the Code, however vague the particular language under consideration might be, to effect a major change in pre-Code practice that is not the subject of at least some discussion in the legislative history."); *Midlantic Nat'l Bank v. N.J. Dep't of Envtl. Prot.*, 474 U.S. 494, 501 (1986) ("The Court has followed this rule with particular care in construing the scope of bankruptcy codifications."); *Ron Pair Enters.*, 489 U.S. at 244 (holding that deviations from pre-Code practice require clear expression of Congressional intent).

The legislative history to the Bankruptcy Code confirms there was no intent to alter the longstanding rule that "[t]axes arising from the operation of the estate after bankruptcy are entitled to priority as administrative expenses." *See* H.R. Rep. No. 95-595, at 193 (1977), *as reprinted in* 1978 U.S.C.C.A.N. 5963, 6153 (stating that this was existing law, and that the Bankruptcy Code codified this rule, citing *Security-First Nat'l Bank v. United States (In re F.P. Newport Corp.)*, 153 F.2d 563 (9th Cir. 1946), which held that a tax imposed on income derived

from the lease of estate assets is an administrative expense); S. Rep. No. 95-989, at 66 (1978), *as reprinted in* 1978 U.S.C.C.A.N. 5787, 5852 ("[A]dministrative expenses include taxes which the trustee incurs in administering the debtor's estate, *including taxes on capital gains from sales of property by the trustee* and taxes on income earned by the estate during the case." (emphasis added)).

Indeed, the legislative history of the specific words on which the Ninth Circuit and the Government heavily rely – "incurred by the estate" – is described at length in *Pacific-Atlantic*, 64 F.3d at 1299-1300. It shows that Congress focused on when the tax became due – prepetition or postpetition – rather than the taxable entity status of the debtor. Congress intended for a tax on income to be considered "incurred" on the last day of the income period, by the debtor-bankruptcy estate, which in 1978 was a single taxable entity in all cases, with the postpetition portion payable as an administrative expense claim and the prepetition portion as a priority claim from bankruptcy estate assets. *Id*.

The Government's argument also is inconsistent with the IRC itself. The phrase "incurred by the estate" appears in IRC 6658, entitled "Coordination with Title 11," which concerns a taxpayer's obligation while in, or just before, bankruptcy. It provides that penalties and interest do not accumulate for failure to make a timely tax payment "with respect to a period during which a case is pending under title 11 of the United States Code . . . if such tax was incurred by

the estate and the failure occurred pursuant to an order of the court finding probable insufficiency of funds of the estate to pay administrative expenses," or if the tax was incurred prepetition but with a tax return due postpetition, *i.e.*, a straddle year tax. 26 U.S.C. § 6658.

Congress used the words "incurred by the estate" in IRC 6658 to refer to the postpetition incurrence of taxes, just as it used them in Bankruptcy Code 503(b)(1)(B)(i) for the same purpose. The Senate Report for IRC 6658 confirms the point:

> In the case of a tax incurred by the estate, the relief [from penalties and interest] is granted if the failure occurs pursuant to a court order finding probable insufficiency of funds to pay such taxes. In the case of a tax incurred by the debtor before commencement of the bankruptcy case, the relief provision of the bill applies if either the bankruptcy petition is filed before the tax return due date, or the date for imposing the penalty occurs after commencement of the bankruptcy case.

S. Rep. No. 96-1035, at 51 (1980), *as reprinted in* 1980 U.S.C.C.A.N. 7017, 7064. Thus, Congress viewed a tax "incurred by the estate" as not incurred "before commencement of the bankruptcy case," *i.e.*, postpetition. Notably, IRC 6658 was enacted as part of the same Bankruptcy Tax Act that created a separate taxable estate for individual Chapter 7 and 11 debtors. It shows that in 1980, even as it enacted provisions for

separate taxable estates in certain types of cases, Congress meant "incurred by the estate" to turn on whether the tax was incurred after commencement of the bankruptcy case with administrative expense claim treatment. There is no reason to read the same words in Bankruptcy Code 503(b)(1)(B)(i) differently. Congress intended taxes incurred postpetition to be administrative expenses, and Section 1222(a)(2)(A) therefore applies.

The Ninth Circuit effectively rewrote Bankruptcy Code 503(b)(1)(B) by replacing the bankruptcy term "estate" with the IRC term "taxable entity," despite the fact that they are not the same thing. *See Abbott v. Abbott*, 130 S. Ct. 1983, 2003 (2010) ("In interpreting statutory text, we ordinarily presume that the use of different words is purposeful and evinces an intention to convey a different meaning.").

II. The Legislative History of Section 1222(a)(2)(A) Confirms Congressional Intent to Apply to Postpetition Farm Sales.

A. The Principal Sponsor of the Provision Explained its Purpose.

Before the 2005 amendment to Section 1222(a)(2)(A), the Bankruptcy Code required full payment of all priority claims under Section 507, unless the holder of the claim agreed that its claim could be treated differently. 11 U.S.C. §§ 1222(a)(2), 1225(a)(1) (2004). The IRS could object to any plan that did not provide for full payment of its tax claim, and effectively veto

it. *See* 14A Arthur Boelter, MERTEN'S LAW OF FEDERAL INCOME TAXATION § 54.61 (updated 2010) ("Before enactment of the provision in 2005, these dispositions created large priority tax claims that barred confirmation of Chapter 12 plans."); 7 William L. Norton, Jr., NORTON BANKRUPTCY LAW & PRACTICE § 122:10, at 122-19 (3d ed. 2010) (noting that the change to Section 1222(a)(2)(A) effected a "paradigm shift" because before the change "debtors would seek to sell their low tax basis assets to reduce their indebtedness to levels where they could operate profitably but could not confirm their Chapter 12 plans due to the significant income taxes that were occasioned by the sale for capital gains and depreciation recapture"). Family farms are often owned by family members for many years, resulting in the assets having a low tax basis, and significant capital gains taxes when sold. *See* Boelter, *supra*, § 54.61; 7 Norton, *supra*, § 122:10 at 122-19. The entire purpose of Section 1222(a)(2)(A) was to permit family farmers in Chapter 12 cases to liquidate portions of their farms and increase profitability without worrying about the tax consequences of the sale. *See* 7 William L. Norton, Jr., NORTON BANKRUPTCY LAW & PRACTICE § 1333:6 at 133-10 (3d ed. 2010).

This purpose is shown by the repeated floor statements of Senator Grassley, one of the sponsors of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, § 1103, 119 Stat. 23, 190 (2005) ("BAPCPA"), who was largely responsible for the inclusion of Section 1222(a)(2)(A) in the Bankruptcy Code. In January of 1999, Senator

Grassley introduced a bill called "Safeguarding America's Farms Entering the Year 2000 Act," known as "Safety 2000." It contained language identical to the language that was enacted in BAPCPA. S. 260, 106th Cong. § 3 (1999). In his statements to Congress on Safety 2000, Senator Grassley stated that the bill was intended to

> help[ ] farmers to reorganize by keeping tax collectors at bay. Under current law, farmers often face a crushing tax liability if they need to sell livestock or land in order to reorganize their business affairs. . . . [H]igh taxes have caused farmers to lose their farms. Under the bankruptcy code, the I.R.S. must be paid in full for any tax liabilities *generated during a bankruptcy reorganization*. If the farmer can't pay the I.R.S. in full, then he can't keep his farm. This isn't sound policy. Why should the I.R.S. be allowed to veto a farmer's reorganization plan? "Safety 2000" takes this power away from the I.R.S. by reducing the priority of *taxes during proceedings*. This will free up capital for investment in the farm, and help farmers stay in the business of farming.

See 145 Cong. Rec. S727, S764 (1999) (statement of Sen. Charles Grassley) (emphasis added).

Safety 2000 was never enacted, but Senator Grassley persisted in trying to provide capital gains tax relief in Chapter 12 cases. In March of 1999, he introduced the Bankruptcy Reform Act of 1999 (the "1999 Reform Act"), which included language identical

to current Section 1222(a)(2)(A). *See* 145 Cong. Rec. S2695, S2738, S2764 (1999); S. 625, 106th Cong. § 1004 (1999). The Senate passed the 1999 Reform Act, and it was sent to a conference committee. *See* Susan Jensen, *A Legislative History of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005*, 79 AM. BANKR. L.J. 485, 531 (2005). After changes in the conference committee (none of which affected Section 1222(a)(2)(A)), Senator Grassley reintroduced the legislation as the Bankruptcy Reform Act of 2000 in S. 3186, and the conference committee filed the same language as the H.R. 2415 conference report. *See* S. 3186, 106th Cong. (2000); H.R. Rep. No. 106-970 (2000) (Conf. Rep.); Jensen, *supra*, at 536. Congress passed the Bankruptcy Reform Act of 2000, but President Clinton pocket vetoed it. *See* 146 Cong. Rec. H9817, H9840 (2000) (house vote); 146 Cong. Rec. S11663, S11730 (2000) (senate vote); Jensen, *supra*, at 539.

In three floor statements to the Senate, Senator Grassley said that the parts of the 1999 Reform Act that amended Chapter 12 were intended to make Chapter 12

> more accessible and helpful for farmers. . . . [The Reform Act would] reduce[ ] the priority of capital gains tax liabilities for *farm assets sold as part of a reorganization plan*. This will have the beneficial effect of allowing cash-strapped farmers to sell livestock, grain, and other farm assets to generate cash flow when liquidity is essential to maintaining a family farm operation.

See 145 Cong. Rec. S11075, S11093 (1999); 145 Cong. Rec. S14051, S14055 (1999); 146 Cong. Rec. S6185, S6249 (2000) (emphasis added). Senator Grassley also introduced a letter signed by five senators saying the same thing. *See* 145 Cong. Rec. S11075, S11093 (1999).

In 2001, Senator Grassley introduced the Bankruptcy Reform Act of 2001, which again included language identical to current Section 1222(a)(2)(A). *See* S. 220, 107th Cong. § 1003 (2001); S. 420, 107th Cong. § 1003 (2001); *Jensen*, *supra*, at 543. He introduced a written statement in a Senate hearing that this language was intended to reduce the priority of taxes resulting from farm assets "sold as part of a reorganization plan." *See The Bankruptcy Reform Act of 2001: Hearing Before the S. Comm. on the Judiciary*, 107th Cong. 121 (2001) (statement of Sen. Grassley), *available at* http://www.gpo.gov/fdsys/pkg/CHRG-107shrg76343/pdf/CHRG-107shrg76343.pdf. The Senate passed the Bankruptcy Reform Act, but it died on a technicality. *See Jensen*, *supra*, at 545; 147 Cong. Rec. S2323, S2379 (2001).

Senator Grassley's statements show that Section 1222(a)(2)(A) was intended to cover postpetition taxes "generated during a bankruptcy reorganization" or "sold as part of a reorganization plan." Significantly, there is no legislative history indicating that Section 1222(a)(2)(A) was intended to apply only to prepetition sales.

This Court has been reluctant to consult legislative history relating to unenacted legislation and to impute an earlier Congress's intent to a subsequent Congress. But much of the long history that led to the enactment of BAPCPA was incorporated into the legislative history for BAPCPA itself. *See* H.R. Rep. No. 109-31, at 6-8 & n.34 (2005), *as reprinted in* 2005 U.S.C.C.A.N. 88, 92-95. The Court recently recognized that the House Report on BAPCPA cited several hearings from previous Congresses, thus making the hearings part of the record of BAPCPA. *See Milavetz, Gallop & Milavetz, P.A. v. United States*, 130 S. Ct. 1324, 1332 n.3 (2010).[4] The House Report also notes that Congress passed Senator Grassley's Bankruptcy Reform Act of 2000, and that the Senate passed Senator Grassley's Bankruptcy Reform Act of 2001. *See* H.R. Rep. No. 109-31, at 6 & nn.25 & 32.

The relevant language of all these predecessor bills is identical to that enacted in BAPCPA, Senator Grassley was a sponsor of all of them, and Congress actually approved that language when it passed the Bankruptcy Reform Act of 2000. Under similar circumstances, this Court has considered statements made in hearings from which the statutory provision under consideration "emerged." *See United States v. Whiting Pools, Inc.*, 462 U.S. 198, 207-08 (1983) (consulting legislative history relating to Bankruptcy

[4] The Senate hearing in which Senator Grassley introduced his written statement is not expressly cited in the House Report, but that hearing is part of the background of BAPCPA.

Code 542(a) located in records of hearings from prior Congresses where "[t]he section remained unchanged through subsequent versions of the legislation"); *United States v. Plesha*, 352 U.S. 202, 205-08 (1957) (looking to legislative history of similar previous legislation); *see also United States v. O'Neil*, 11 F.3d 292, 300-01 (1st Cir. 1993) (noting that courts, including this Court have looked to legislative history of bills considered in different Congresses as providing "some probative value," especially when sponsoring legislators are the same).

The legislative history confirms the statutory plain language of Section 1222(a)(2)(A).

B. The 2005 Amendment to Section 507(a)(8) Shows That Section 1222(a)(2)(A) Must Apply to Administrative Expense Tax Claims.

As noted, Bankruptcy Code Section 507 contains two subsections dealing with taxes. Section 507(a)(2) gives second-level priority to taxes "incurred by the estate" by cross-reference to Section 503(b). 11 U.S.C. § 503(b)(1)(B)(i). Section 507(a)(8) gives eighth-level priority to certain taxes that arose before the petition. By holding that taxes in Section 507(a)(2) are not covered by Section 1222(a)(2)(A), the Ninth Circuit necessarily held that the ***only*** type of taxes to which Congress intended to extend Section 1222(a)(2)(A)'s special protection are those prepetition taxes described in Section 507(a)(8). In so holding, the Ninth Circuit has ascribed an unlikely intent to Congress,

and one that would make little sense, especially given a BAPCPA amendment to Section 507(a)(8).

Before 2005, the coverage of Section 507(a)(8) was disputed. The IRS contended that all tax liability for the tax year in which a bankruptcy petition is filed should be treated as incurred postpetition at the end of the debtor's tax year and thus have higher priority, unless the debtor was permitted to, and did, split the tax year under IRC 1398. The IRS interpreted Section 507(a)(8)(A)(iii) to mean that all taxes incurred in the tax year in which a bankruptcy petition is filed – those resulting from income earned both pre- and postpetition that year – were outside Section 507(a)(8) and thus should be given the higher administrative expense priority. If a calendar year taxpayer filed a bankruptcy petition on September 1, 2003, the IRS would say that all taxes incurred that calendar year (including January 1 through August 31, 2003) were outside Section 507(a)(8) and thus had to be treated as postpetition and assigned "administrative expense" priority under Section 507(a)(2). *See United States v. Hillsborough Holdings Corp. (In re Hillsborough Holdings Corp.)*, 116 F.3d 1391, 1394 (11th Cir. 1997); *Pacific-Atlantic*, 64 F.3d at 1298; I.R.S. Chief Couns. Advice 200235024 (Aug. 30, 2002), 2002 WL 1999525; I.R.S. Litigation Bulletin 448 (Jan. 1998).

Courts often disagreed with this interpretation, concluding that taxes for the "straddle year" were split into a prepetition portion and a postpetition portion. *See Hillsborough Holdings*, 116 F.3d at 1394-96; *Pacific-Atlantic*, 64 F.3d at 1302; *O'Neill Shoe*, 64

F.3d at 1150-51. These courts held that the prepetition portion of the taxes did not qualify as administrative expenses because Section 503(a)(2) expressly excludes taxes "of a kind specified in Section 507(a)(8)."

Congress legislatively overruled these cases and essentially adopted the IRS's view in 2005 when it amended Section 507(a)(8). As amended, it provides eighth-level priority to:

> [A]llowed unsecured claims of governmental units, only to the extent that such claims are for –
>
> > (A) a tax on or measured by income or gross profits *for a taxable year ending on or before the date of the filing of the petition* –
> >
> > . . .
> >
> > (iii) other than a tax of a kind specified in Section 523(a)(1)(B) or 523(a)(1)(C) of this title, not assessed before, but assessable, under applicable law or by agreement, after, the commencement of the case[.]

BAPCPA, *supra*, § 705, 119 Stat. 23, 126; 11 U.S.C. § 507(a)(8) (new language emphasized).

As a result, Section 507(a)(8) now applies only to taxes that are incurred in the tax year before the year in which a bankruptcy petition is filed, and those incurred in the straddle year of the petition filing are treated entirely as administrative expenses. *See*

In re FR & S Corp., No. 08-08659 ESL, 2011 WL 1261329 (Bankr. D.P.R. Mar. 30, 2011); 15 COLLIER ON BANKRUPTCY ¶ TX4.03 (15th ed. rev. 2010) (stating that after the amendment, "income and gross receipt taxes for the year of the bankruptcy filing are post-petition administrative expense claims that must be paid in full in the ordinary course, rather than pre-petition priority claims that are not payable until emergence from bankruptcy"); Gregory L. Germain, *Income Tax Claims in the Year of Bankruptcy: A Congressionally Created Quagmire*, 59 TAX LAW. 329, 376-78 (2006). As the IRS explains in its Manual:

> (1) Because Chapter 11 debtors ordinarily continue to operate their businesses after filing for bankruptcy and seldom file bankruptcy on the first day of a new tax reporting period, there are frequently federal tax liabilities owed by Chapter 11 debtors for taxes arising in the year in which the bankruptcy petition was filed.
>
> . . . .
>
> (b.) However, income taxes are incurred on the last day of the income tax year. 11 USC § 507(a)(8)(A), as amended by BAPCPA, clarifies that only income taxes for tax years ending on or before the petition date will receive priority treatment in the bankruptcy case. Thus, income taxes that accrue in the year for which the bankruptcy petition is filed are entirely administrative expense taxes.

> **Note:** Section 507(a)(8)(A) was clarified by BAPCPA to provide that income taxes will be considered prepetition (priority) claims only when the tax year ended before the bankruptcy petition was filed, overturning pre-BAPCPA case law that relied on that section to hold that the petition-year liability should be split into prepetition and postpetition portions. See In re Pacific-Atlantic Trading Co., 64 F.3d 1292 (9th Cir. 1995).

Internal Revenue Manual § 5.17.10.6.2 (2011).

The Ninth Circuit's holding that the only taxes covered by Section 1222(a)(2)(A) are those described in Section 507(a)(8) thus means that family farmers are entitled to Section 1222(a)(2)(A)'s special protections only if they sell their farms well before filing a bankruptcy petition – by as much as a year. Family farmers in dire financial straits in February would have to sell the farm (likely at an urgent "fire sale") and then wait until the following January to file a Chapter 12 petition in order to take advantage of Section 1222(a)(2)(A). If, like the Halls, they faced a foreclosure sale that would prevent their farm equity from being used to pay other creditors, they could not file for Chapter 12 relief and downsize their farm assets at a market value sale under the supervision of the Bankruptcy Court without losing the benefit of Section 1222(a)(2)(A).

The Ninth Circuit's analysis strains credulity – it means that Congress went to the trouble of enacting

Section 1222(a)(2)(A) merely to protect those family farmers with the foresight or ability to sell their farms well in advance of filing a Chapter 12 petition. And not only does it mean that Congress exempted the vast majority of tax claims from Section 1222(a)(2)(A)'s coverage (*i.e.*, those identified in Section 507(a)(2)), but that it did so by assuming that words tucked away in a provision of an entirely separate Code with an entirely separate purpose would do that work. The more natural interpretation is that all "claims entitled to priority under section 507" are covered by Section 1222(a)(2)(A), which also has the benefit of having the more natural and commonsensical consequence. It means Section 1222(a)(2)(A) applies to taxes arising from farm asset sales in the bankruptcy petition filing year and through the administration of the case, when most sales to restructure farm debt are likely to occur. *Cf.* 11 U.S.C. § 503(b)(9) (similarly treating certain prepetition reclamation claims as administrative priority claims).

III. Postpetition Taxes Have Administrative Expense Priority Without Regard to Taxable Entity Status Because Priority of Payment is a Bankruptcy Law Concept that Does Not Depend on What the IRC Says.

The Ninth Circuit said that a tax claim due to a postpetition sale of bankruptcy estate assets is not a Section 503(b)(1)(B)(i) "tax . . . incurred by the estate" because a Chapter 12 bankruptcy estate is not a separate taxable entity under the IRC, unlike the

estates of individual Chapter 7 and 11 debtors. 26 U.S.C. §§ 1398, 1399; Pet. App. 6-7. This holding reflects a fundamental misunderstanding of the nature of the bankruptcy "estate" and liabilities for estate transactions. A bankruptcy filing creates an estate consisting of property. Sales of estate property are taxable, and the resulting tax claims are payable from estate property. The Bankruptcy Code, not the IRC, controls rights and obligations to distribute bankruptcy estate funds to pay taxes and other claims. IRC provisions making the debtor and estate a single taxable entity or separate taxable entities do not alter these rights and obligations or disrupt the priorities set forth in the Bankruptcy Code. The person in control of the bankruptcy estate is responsible to pay the taxes, but using bankruptcy estate money. The Government was in accord on this until Section 1222(a)(2)(A) created an exception to the administrative expense priority such tax claims would otherwise enjoy. If the Government's about-face were to be adopted by this Court, it would upend fundamental bankruptcy principles and practice.

A. The Bankruptcy "Estate" Consists of Property Liquidated for Creditors that Can Generate Taxable Income.

A bankruptcy "estate" consists of property that is liquidated for the purpose of paying creditors, and is the *res* of *in rem* bankruptcy jurisdiction. *See Tenn. Student Assistance Corp. v. Hood*, 541 U.S. 440, 447-48 (2004); *Gardner v. New Jersey*, 329 U.S. 565, 574

(1947). The estate is formed upon the entry of the order for relief and consists of virtually all of the debtor's assets. *See* 11 U.S.C. § 541. Farm assets are property of the farmer-debtor's estate in a Chapter 12 bankruptcy case, as are proceeds from the sale of those assets. *See* 11 U.S.C. §§ 541(a)(6), 1207(a). Indeed, all property acquired by the farmer-debtor postpetition is property of the estate, including earnings from services. *See* 11 U.S.C. § 1207(a).

Income that is earned by the estate through the sale of assets or ordinary business operations is taxable. *See Nicholas*, 384 U.S. at 686; *Phila. Co. v. Dipple*, 312 U.S. 168, 175 (1941) (recognizing that a bankruptcy trustee had to pay taxes incurred in the course of operating the debtor's business under predecessor to 28 U.S.C. § 960); *Boteler v. Ingels*, 308 U.S. 57, 61 (1939) (holding that bankruptcy trustee was subject to tax penalty for failure to pay licensing taxes while operating the debtor's business); *see also Holywell Corp. v. Smith*, 503 U.S. 47, 53-56 (1992) (holding that the bankruptcy estates of individual Chapter 11 and corporate Chapter 11 debtors include proceeds of postpetition sales of property, which are taxable, with estate assets and tax payment responsibility assigned to corporate plan trustee and fiduciary of individual plan trust).

B. Bankruptcy Estate Transactions Are Taxable Whether the Debtor and Estate Are a Single Taxable Entity or Separate Taxable Entities.

1. The Bankruptcy Tax Act of 1980 Made Certain Bankruptcy Estates into Separate Taxable Entities.

When the Bankruptcy Code was enacted, Congress did not make bankruptcy estates into "separate" taxable entities. The debtor was taxed as a continuous entity, and the Bankruptcy Code determined the status of the tax as an administrative expense, or a claim entitled to lower priority. The determination turned solely on whether the taxes were incurred before or after the petition was filed. *See Pacific-Atlantic*, 64 F.3d at 1299-1300.

In 1980, Congress enacted the Bankruptcy Tax Act, requiring that the bankruptcy estate of an individual debtor in a Chapter 7 or 11 case be taxed as a separate taxable entity, with no separate taxable entity status for all other bankruptcy cases. Bankruptcy Tax Act of 1980, Pub. L. No. 96-589, § 3, 94 Stat. 3389, 3397-3401 (1980); 26 U.S.C. §§ 1398, 1399. At that time, postpetition earnings of individual debtors in Chapter 7 and 11 cases, and most property acquired by those individual debtors after they filed their bankruptcy petitions, was not included in the

property of the estate.[5] *See* 11 U.S.C. § 541(a)(1), (6); S. Rep. No. 96-1035, at 24 (1980), *as reprinted in* 1980 U.S.C.C.A.N. 7017, 7038-39. ("[W]ages earned by the individual after commencement of the case and after-acquired property do not become part of the bankruptcy estate, but belong to the individual. . . ."). Non-exempt assets belonging to the debtor as of the petition date were administered as the *res* of the bankruptcy estate, and paid to creditors by a Chapter 7 trustee or under a plan of reorganization. Exempt assets, postpetition income, and subsequently-acquired assets belonged to the debtor individually as part of his "fresh start," so the debtor, rather than the estate, paid the taxes on that income. This was the primary reason for the creation of a "separate taxable entity" in Sections 1398 and 1399. *See* S. Rep.

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[5] Congress determined in 2005 to include postpetition earnings and assets of individual Chapter 11 debtors in the bankruptcy estate. *See* BAPCPA, *supra*, § 321(a), 119 Stat. 23, 94. At that point, the reason for treatment as a separate taxable entity ended in those cases too. Commentators have noted the havoc that this apparent oversight has created. *See, e.g.*, Wm. Robert Pope, Jr. & Francis D. Sheehy, *Federal Income Taxation of the Individual Debtor and the Bankruptcy Estate: Double Taxation-Really?*, NORTON BANKR. L. ADVISER, May 2011, at 1 (noting that "Congress added § 1115 to the Bankruptcy Code and created a tax problem under I.R.C. § 1398" that could only be resolved by "removing the individual Chapter 11 from § 1398"); Jack F. Williams & Jacob L. Todres, *Tax Consequences of Post-Petition Income as Property of the Estate in an Individual Debtor Chapter 11 Case and Tax Disclosure in Chapter 11*, 13 AM. BANKR. INST. L. REV. 701, 717 (2005) ("[T]he conflict now posed by Section 1398 and the new provision codified at Bankruptcy Code Section 1115 is inescapable.").

No. 96-1035, at 24, 25 & n.2 (1980), *as reprinted in* 1980 U.S.C.C.A.N. 7017, 7038, 7040.[6]

Consistent with this scheme and the policy underlying it, Congress also concluded that "an individual debtor in a bankruptcy case generally should be given an election to close his or her taxable year at the date of bankruptcy." *Id.* at 26; *see also* 26 U.S.C. § 1398(d)(2)(A) (permitting individual Chapter 7 or 11 debtor to divide a taxable year into prepetition and postpetition portions). If such an election is made, the

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[6] The Tenth Circuit recently stated in *In re Dawes* that Congress enacted Sections 1398 and 1399 for a "pragmatic" purpose. ___ F.3d ___, ___, No. 09-3129, 2011 WL 2450930, at *3 (10th Cir. June 21, 2011). The court said that in Chapter 12 and 13 cases, "[d]isregarding the temporary existence of a bankruptcy estate for purposes of tax liability tidies the accounting somewhat, because there's only a single return – the debtor's – that needs to be filed and kept track of." *Id.* at *3. *Dawes* cites no authority for either of these propositions, and none exists. As noted, the legislative history of the separate taxable entity statutes shows the rationale is the cleavage between prepetition property and postpetition property in individual Chapter 7 and (when the statute was enacted) 11 cases. *Dawes* also says that Congress must have intended to tax debtors individually instead of bankruptcy estates in Chapter 12 and Chapter 13 cases because their plans are confirmed faster than Chapter 11 plans, so the expectation is that the "debtor's post-petition earnings and taxes will meet up in his hands soon enough." *Id.* But the length of the period from petition filing to plan confirmation does not alter the taxability of sales of estate assets during that period. And the Chapter 12 debtor's obligation to file tax returns (like corporate Chapter 11 debtors) does not alter the right and obligation to use the proceeds of estate asset sales to pay taxes and other liabilities on account of the sales.

debtor's income tax liability for the prepetition 'short' taxable year becomes collectible out of the bankruptcy estate, to the extent the estate has assets to pay debts of that priority. As to postpetition income, IRC 1398(e) provides that "[t]he gross income of the estate for each taxable year shall include the gross income of the debtor *to which the estate is entitled under Title 11 of the United States Code.*" 26 U.S.C. § 1398(e) (emphasis added). In cases in which IRC 1398 applies, and in which the debtor elects to split the tax year, "the taxes owed for the prepetition partial 'year' are treated as Section 507(a)(8) prepetition priority taxes, and taxes owed for the post-petition partial 'year' are treated as Section 507(a)(1) administrative expenses, if the benefit of the income redounded to the estate, or as personal obligations of the debtor, if the benefit redounded to the debtor as part of the debtor's fresh start." *See* Gregory L. Germain, *Income Tax Claims in the Year of Bankruptcy: A Congressionally Created Quagmire*, 59 TAX LAW. 329, 356-57 (2006).

In contrast, the postpetition income, profits and assets of a Chapter 13 debtor have always been property of the bankruptcy estate. *See* 11 U.S.C. § 1306(a). Accordingly, like an entity Chapter 11 debtor, taxable-year election rights were not extended to Chapter 13 debtors. *See* S. Rep. No. 96-1035, at 24-26 & n.2. The same estate property concept was used in Chapter 12 cases when Chapter 12 was enacted in 1986. *See* 11 U.S.C. §§ 541(a)(6), (7), and 1207(a). Chapter 12 cases are accordingly within IRC 1399, along with the other kinds of bankruptcy cases that have estates

generating income from actions of the debtor during the bankruptcy case. Because there is no distinction between the debtor's income and the estate's income, income of the debtor and the estate is taxed collectively before plan confirmation. The debtor and the bankruptcy estate are a single taxpayer entity that is responsible for filing returns for all taxes incurred during estate administration. *See* William Tatlock, *Discharge of Indebtedness, Bankruptcy and Insolvency*, TAX MANAGEMENT A-59 (2009).

Nowhere in the course of enacting the Bankruptcy Tax Act did Congress even hint that it was changing the existing treatment of postpetition taxes on income earned with estate assets as administrative expenses. IRC 1398 and 1399 do not mention priority payment status from estate assets. That stands to reason, because the rationale for individual Chapter 7 and 11 debtors' separate taxation has nothing to do with whether a tax that arises from an estate asset sale is payable from estate assets as an administrative expense. *See also* discussion of 26 U.S.C. § 6658 in section I.C., *supra*.

2. Taxation of Income After Plan Confirmation Is Unclear, but Irrelevant to This Case.

The Bankruptcy Code is inconsistent in providing, on one hand, that individual earnings and assets acquired after the petition date and before a case is closed, dismissed, or converted to a Chapter 7

liquidation are included in the estate of an individual reorganizing debtor. 11 U.S.C. §§ 1207(a), 1306, 1115 (as amended in BAPCPA in 2005). On the other hand, it also provides that when a plan is confirmed, property of the estate vests back in the debtor unless otherwise provided in the plan. 11 U.S.C. §§ 1141(b), 1227(b), 1327(b). Given the multi-year nature of an individual's plan, courts have analyzed the postconfirmation status of debtor earnings and income tax liability in various ways, with the majority concluding that only property necessary to plan implementation is property of the estate after plan confirmation and protected by the automatic stay, and the remainder vests back in the debtor. *See Telfair v. First Union Mortgage Corp.*, 216 F.3d 1333, 1340 (11th Cir. 2000); *In re Heath*, 115 F.3d 521, 524 (7th Cir. 1997); *see also Sec. Bank of Marshalltown, Iowa v. Neiman*, 1 F.3d 687, 691 (8th Cir. 1993).

The case before the Court does not concern postpetition earnings that arguably vested back in the individual debtor upon plan confirmation. It concerns taxes incurred on account of the disposition before plan confirmation of real property that was clearly part of the bankruptcy estate, and the capital gains income tax that arose preconfirmation on account of that transaction. The Halls' bankruptcy estate received the proceeds from the Hall Farm sale, not the Halls individually, and payment of any taxes from those proceeds is consistent with the general principle that income taxes are imposed only on the one that actually earns the income. *See United States v.*

Bayse, 410 U.S. 441, 447 (1973) ("[I]ncome is taxed to the party who earns it."); *Comm'r v. Culbertson*, 337 U.S. 733, 739-40 (1949) (holding that "the first principle of income taxation" is that "income must be taxed to him who earns it").

C. Administrative Expense Tax Claims Are Payable from Estate Assets, Unless the Code Expressly Provides Otherwise.

1. Bankruptcy Code Priority Payment Provisions Apply Uniformly, Without Distinguishing Between Single Taxable Entity and Separate Taxable Entity Debtors.

The IRC provides for the assessment of taxes, while Bankruptcy Code Sections 503 and 507 determine the priority treatment of taxes and other claims in bankruptcy cases from bankruptcy estate assets. "Priority is a bankruptcy term of art; its meaning cannot be gleaned from any other source of law." C. Richard McQueen & Jack F. Williams, TAX ASPECTS OF BANKRUPTCY LAW AND PRACTICE § 14.9 (3d ed. updated 2011). As explained by the Eighth Circuit in a case concerning state income taxes where the debtor was a corporate entity, and thus taxed under IRC 1399, the government taxes the debtor as it would outside of bankruptcy as a continuous single entity. *O'Neill Shoe*, 64 F.3d at 1152. The amount of the tax is a claim against the bankruptcy estate, and the priority of claim treatment is determined by the Bankruptcy Code. *Id.*; *see also Hillsborough Holdings*, 116 F.3d at

1396 ("In keeping with the IRC, the taxes will be imposed as if no bankruptcy petition had ever been filed. The payment of the taxes, however, will be governed by the principles and priorities of the bankruptcy laws.").

The priority provisions of Bankruptcy Code 503 and 507 apply in all bankruptcy cases under all Chapters, and to individual and entity debtors. 11 U.S.C. § 103(a). This reflects the fundamental principle that bankruptcy estate assets must be used to pay taxes and other liabilities incurred on account of bankruptcy estate transactions. *Swarts v. Hammer*, 194 U.S. 441, 444 (1904) (bankruptcy estate funds must be used to pay state and municipal taxes; any exception from such liability must be clearly expressed); *Reading Co. v. Brown*, 391 U.S. 471, 483-84 (1968) (tort claims and other costs ordinarily incident to operation of a business during bankruptcy administration, along with state and federal taxes, are actual and necessary costs of a Chapter XI arrangement and payable as administrative expenses). The Ninth Circuit's opinion is wrong because it "fails to appreciate that new § 1222(a)(2)(A) is a bankruptcy priority provision that regulates the priority and dischargeability of certain claims of any governmental unit and is not simply a federal income tax provision embedded in the Bankruptcy Code." *See* McQueen & Williams, *supra*, § 14.9.

2. Chapter 13 Includes a Unique Mechanism for Addressing Postpetition Taxes.

The Ninth Circuit reasoned in part that Chapter 12 cases are like Chapter 13 cases. Pet. App. 6. Unlike Chapter 11 and 12 cases, in Chapter 13 bankruptcies the IRS has an express option to file a proof of claim for postpetition taxes, but is not required to. *See* 11 U.S.C. §§ 1305(a)(1), 503(b)(1)(D). If the IRS files a proof of claim, the debtor may include the postpetition tax claim in the Chapter 13 plan, but it will be treated as a prepetition claim. *See* 11 U.S.C. § 1305(b). If the IRS declines to file a proof of claim, the postpetition tax claim is no longer treated in the bankruptcy case, and becomes a personal liability of the debtor. Section 1305(a) does not alter the taxable nature of transactions during a Chapter 13 case, but provides a unique option for treating such claims under the plan. *In re Joye*, 578 F.3d 1070, 1076-77 (9th Cir. 2009); *In re Fowler*, 394 F.3d 1208, 1214 (9th Cir. 2005).

Chapter 12 has no provision like Section 1305(a) for individual, corporate or partnership Chapter 12 debtors. *See* 11 U.S.C. § 101(19) ("family farmer" may be individual, corporation or partnership). In that and other respects, Chapter 12 cases are more like Chapter 11 cases than Chapter 13 cases. *See In re Seger*, 444 B.R. 492, 493 (Bankr. D. Mass. 2011); Keith M. Lundin & William H. Brown, *Chapter 13 Bankruptcy*, § 57.1, at ¶¶ 7-8 (4th ed.), Sec. Rev. Apr. 30, 2004, www.Ch13online.com (footnotes omitted).

Chapter 12 debtors may sell estate assets with court approval, for example, and their estate administration period prior to plan confirmation takes months if not years. 11 U.S.C. §§ 1206, 1221, 1224. The dissimilarities between Chapter 13 and Chapter 12 preclude dependence on Chapter 13 cases to interpret Section 1222(a)(2)(A).

D. IRC Taxable Entity Provisions Do Not Control Bankruptcy Code Priority Provisions.

The IRC provisions on which the Ninth Circuit relied for its interpretation of Bankruptcy Code 503(b)(1)(B), IRC 1398 and 1399, were enacted two years after the Bankruptcy Code, in 1980. They do not establish Congressional intent in 1978 when it enacted the Bankruptcy Code with its bankruptcy estate priority distribution provision for taxes incurred on account of estate transactions. Congress did enact Bankruptcy Code 346 in 1978, anticipating the Bankruptcy Tax Act, but it did not apply to federal taxation. Current Section 346 simply provides for state and local taxes to be handled consistently with federal taxation. 11 U.S.C. § 346. There is no indication in any statutory language or any legislative history of Bankruptcy Code 346 or the Bankruptcy Tax Act that Congress intended them to have any effect on whether a particular kind of tax claim is entitled to administrative priority payment status. Indeed, "[t]he House of Representatives acknowledged that, historically and in the 1978 version of the

Bankruptcy Code, 'Congress has taken great care to insure that tax policy will not frustrate the operation of bankruptcy.'" *Pacific-Atlantic*, 64 F.3d at 1299 (citing H.R. Rep. No. 95-595, at 274 (1977)).

This Court has repeatedly held that the IRC does not determine the meaning of the Bankruptcy Code. In *United States v. Reorganized CF & I Fabricators*, 518 U.S. 213, 224 (1996), the Court held that the "1978 Act [enacting the Bankruptcy Code] reveals no congressional intent to reject generally the interpretive principle that characterizations in the Internal Revenue Code are not dispositive in the bankruptcy context. . . ." The Court noted multiple Bankruptcy Code provisions where Congress specifically directed the significance for bankruptcy law of a term used elsewhere in federal statutes, including "referential use of the Internal Revenue Code." 518 U.S. at 219. The Court found it "significant, therefore, that Congress included no such reference in § 507(a)(7)(E)," one of the subsections of Bankruptcy Code 507 regarding priority treatment of tax and other claims. 518 U.S. at 220.

In *United States v. Randall*, the IRS argued that an IRC provision stating that withheld taxes are in trust for the United States required a liquidating bankruptcy trustee to turn over funds withheld by the debtor while in Chapter XI, but not paid to the IRS. 401 U.S. 513, 514-16 (1971) (citing 26 U.S.C. § 7501(a)). The Court held that Bankruptcy Code priority provisions control over IRC provisions, such that the IRS had a Chapter XI administrative expense

priority claim that was subordinate to the administrative expense priority claim of the successor trustee when the case was converted to a liquidation. *Id*. at 516-17. As the Court explained, "[w]e deal, however, with a Bankruptcy Act which we conclude is an overriding statement of federal policy on this question of priorities." *Id.* at 515; *see also United States v. Sotelo*, 436 U.S. 268, 275 (1978) ("We . . . cannot agree with the Court of Appeals that the 'penalty' language of Internal Revenue Code § 6672 is dispositive of the status of respondent's debt under Bankruptcy Act § 17(a)(1)(e)"); *United States v. Energy Resources Co*., 495 U.S. 545, 550 (1990) (Bankruptcy Code authorizes debtor to direct application of tax payments to trust fund liability despite adverse affect on IRS).

Under this authority, the Ninth Circuit's decision to interpret Section 1222(a)(2)(A) by looking to a single provision of the IRC was inappropriate.

E. The IRS Recently Changed Its Historical Position on Administrative Expense Claim Status.

Until the enactment of Section 1222(a)(2)(A), the IRS did not contest the principle that taxes incurred during bankruptcy estate administration have administrative expense priority. To the contrary, it embraced that legal concept in all types of bankruptcy cases, enshrined in multiple decisions of this Court and countless interpretations of the Bankruptcy Act and Bankruptcy Code. The historical position of the

IRS demonstrates the true meaning of the priority provision for administrative expense tax claims, Bankruptcy Code Section 503(b)(1)(B).

IRS arguments that postpetition taxes are administrative expense claims in cases where the bankruptcy filing does not create a separate taxable entity include *United States v. Noland*, 517 U.S. 535, 537 (1996); *United States v. Fleet Bank (In re Calore Express Co.)*, 288 F.3d 22 (1st Cir. 2002); *Hillsborough Holdings*, 116 F.3d at 1393; *Pacific-Atlantic*, 64 F.3d at 1294; *Small Bus. Admin. v. Preferred Door Co., (In re Preferred Door Co.)*, 990 F.2d 547, 548 (10th Cir. 1993); *In re Flo-Lizer, Inc.*, 916 F.2d 363, 365 (6th Cir. 1990); *United States v. Cranshaw (In re Allied Mech. Servs.)*, 885 F.2d 837, 838 (11th Cir. 1989); *see also Holywell Corp. v. Smith*, 503 U.S. 47, 58 n.1 (1992) (IRS conceded in entity Chapter 11 case that liquidating trust was not a separate taxable entity, but that the concession did not affect IRS's position that trust was still liable for tax); I.R.S. Chief Couns. Advice, 200235024 2002 WL 1999525 (Aug. 30, 2002) (stating that postpetition taxes are "entitled to be paid as administrative expenses as long as they are not of the type in B.C. § 507(a)(8)"); I.R.S. Litigation Bulletin 448 (Jan. 1998) ("We also note that there may be cases where the Service will have a basis for asserting the entire tax as an administrative expense, such as where there is no net income prepetition but there is income from the sale of assets by the trustee postpetition.").

The IRS issued a Chief Counsel Advice memorandum after BAPCPA was enacted that addressed the treatment of "administrative claim[s] for federal taxes in a Chapter 12 case." *See* I.R.S. Chief Couns. Advice 200518002, 2005 WL 1060956 (May 6, 2005). In it, the IRS took the position that its administrative expense claims for postpetition taxes must be paid before any creditor with a lower priority claim could be paid. *See id.* This internal policy position shows that the IRS has considered postpetition taxes to be administrative expenses in Chapter 12 cases. Indeed, before Congress enacted Section 1222(a)(2)(A), the IRS argued in at least one Chapter 12 case that a capital gains tax arising from the postpetition sale of a farm asset was an administrative expense that must be paid in full. *See In re Ryan*, 228 B.R. 746, 747 (Bankr. D. Or. 1999).

Given the high priority afforded administrative expense claims, the IRS's position made sense, and appears to have rarely been questioned. In light of Section 1222(a)(2)(A), however, the IRS has changed its tune in Chapter 12 cases, despite no changes to the operative Sections of the IRC or Bankruptcy Code 503 or 507. This Court has rejected prior attempts by the IRS to "espouse[ ] [a] novel theory" that represents a "sudden and unwarranted volte-face from a consistent administrative and judicial practice." *See*

Fribourg Navigation Co. v. Comm'r, 383 U.S. 272, 279-82 (1966).[7]

IV. Administrative Expense Tax Claims Are Treated and Discharged Under Reorganization Plans to Advance Overall Goals of Bankruptcy Law.

A. Reorganization Plans Must Provide for Administrative Expense Claims.

The Ninth Circuit ruled that the capital gains tax from the Hall Farm sale must be paid by the Halls individually, even though their bankruptcy estate received all the sale proceeds, because it said the Bankruptcy Code only allows a Chapter 12 plan to address prepetition claims. Pet. App. 7-8 n.2. Its rationale was that Chapter 12 plans bind "each creditor" and a "creditor" is an entity that holds a prepetition claim. *Id*. (citing 11 U.S.C. §§ 1227, 101(10)(A)).

In fact, the Bankruptcy Code expressly requires that administrative expense claims, as well as other priority tax claims, be paid in full for any reorganization plan to be confirmed in a Chapter 12 case,

[7] The Halls recognize that some of the IRS materials they cite in this brief may not be regarded as precedential under IRC Section 6110(k)(3). These materials are not cited for their precedential value, but rather to illustrate the long-standing interpretation of bankruptcy law that even the Government accepted as established. As this Court recognized in *Fribourg*, the Government should not be permitted to attempt to change established law for a perceived advantage.

like Chapter 11 and 13 cases, subject to the exception of Section 1222(a)(2)(A) at issue here. 11 U.S.C. §§ 1222(a)(2), 1129(a)(9)(A), (B), 1322(a)(2). The Chapter 12 trustee is required to make distributions to administrative expense claims prior to or at the same time the trustee makes distributions under the plan to prepetition creditors. 11 U.S.C. § 1226(b)(1).[8] The gist of the Ninth Circuit's position is that postpetition tax claims are entirely outside of the bankruptcy case. *See* Pet. App. 7-8 n.2. The notion that postpetition taxes are excluded from plan treatment is inconsistent with these Bankruptcy Code requirements that they be paid prior to or with other creditors' payments and be paid in full.

The Bankruptcy Code also authorizes a trustee or debtor-in-possession to "request a determination of any unpaid liability of the estate for any tax incurred during the administration of the case" by submitting a tax return and request for an expedited determination to the IRS. 11 U.S.C. § 505(b)(2) (applicable in all types of bankruptcy cases under 11 U.S.C. § 103(a)); *see also* 11 U.S.C. § 1231(b) (authorizing bankruptcy

[8] The potential that a debtor might not receive a discharge would not warrant payment of Section 1222(a)(2)(A) administrative expense tax claims ahead of unsecured creditor distributions, to be thereafter repaid by the IRS to the Chapter 12 trustee and turned over to other creditors. Rather, the IRS would share in unsecured creditor distributions *pro rata*, and if the court were to later deny the debtor a discharge, the automatic stay would expire and the IRS could then pursue collection of the balance.

court to determine legal questions regarding income tax effects of Chapter 12 plan). These provisions likewise demonstrate that postpetition, pre-confirmation taxes are an integral part of bankruptcy case administration.

The Ninth Circuit is correct that 11 U.S.C. § 1227(a) says that the provisions of a confirmed Chapter 12 plan bind "each creditor," and a "creditor" is defined as the holder of a prepetition claim. A Chapter 12 plan nonetheless binds holders of administrative expense claims treated in the plan by discharging them. Section 1227(a) is the Chapter 12 counterpart to the same language in 11 U.S.C. § 1141(a) for Chapter 11 debtors. In Chapter 11, such postpetition, pre-confirmation claims are discharged by 11 U.S.C. § 1141(d). In Chapter 12 cases, administrative expense claims provided for in the plan are discharged under 11 U.S.C. § 1228(a) ("all debts provided for by the plan allowed under section 503 of this title" are discharged). The Chapter 12 discharge does not take effect until the plan is completed, but the automatic stay continues in effect until the discharge occurs at the end of the plan. 11 U.S.C. § 362(c)(2)(C). If tax claim amounts are not established when the plan is confirmed, and insufficient funds are made available to pay them in full when known, the case may be converted thereafter to a Chapter 7 liquidation or dismissed. *See, e.g.*, *In re Escobedo*, 28 F.3d 34, 35 (7th Cir. 1994).

In any event, the language of Section 1227(a) is not dispositive of Section 1222(a)(2)(A), which applies

to "claims" rather than "creditors," and thus encompasses both pre- and postpetition claims.

B. Debtors in Possession, Not Just Trustees, File Tax Returns for Administrative Expense Tax Claims to Determine Plan Treatment.

The Ninth Circuit also justified its decision that taxes on account of bankruptcy estate asset sales could not be paid as administrative expenses from sale proceeds or under a plan, and would have to be borne by the debtor individually, because the Chapter 12 trustee is not responsible to file tax returns or liable for the tax. Pet. App. 7 (citing 26 U.S.C. § 1398(c)(1) (tax payable by trustee in individual Chapter 7 and 11 cases), and *In re Lindsey,* 142 B.R. 447, 448 (Bankr. D. Okla. 1992) (interpreting specific provisions of a Chapter 12 plan and property sold after plan confirmation, not the administrative expense priority of taxes incurred during administration of the bankruptcy estate)).

The Ninth Circuit is correct that Chapter 12 trustees are not responsible for filing tax returns, at least in cases where the debtor has not been removed as debtor-in-possession. 11 U.S.C. §§ 1202 (trustee's duties), 1204 (removal of debtor as debtor-in-possession). That does not mean that bankruptcy estate transactions are payable only by the individual debtor from his non-estate assets as nondischargeable debts. Rather, the debtor-in-possession files the

return for taxes incurred from bankruptcy estate transactions, with payment from estate assets as a priority or administrative expense claim, and with dischargeability of any deficiency determined in accordance with Bankruptcy Code provisions.

Responsibility for filing tax returns for taxes arising from bankruptcy estate transactions rests on the people in control of estate transactions. *See Nicholas v. United States*, 384 U.S. at 693 & n.27 (trustee appointed during bankruptcy liquidation must file tax return for income earned during period of Chapter XI arrangement); *id.* at 690 ("As an officer of the bankruptcy court, the debtor-in-possession was fully subject to taxes and interest incurred during his operation of the business in the Chapter XI arrangement."); *see also* 28 U.S.C. § 960(a), (b) (persons conducting a business under the authority of a federal court subject to all federal, state and local taxes to same extent as if conducted by a private business, on the due date unless payment excused under a specific Bankruptcy Code provision); *Olson v. Deutscher (In re Nashville White Trucks, Inc.)*, 731 F.2d 376, 377 (6th Cir. 1984) ("[I]t undoubtedly was improper for the debtor-in-possession to have continued the operation of the business without making appropriate provision for the payment of all federal and state taxes as specifically called for by 28 U.S.C. § 960. . . ."); *In re Samuel Chapman, Inc.*, 394 F.2d 340, 341-42 (2d Cir. 1968) (debtor-in-possession is liable under 28 U.S.C. § 960 for failure to make tax returns).

In most bankruptcy reorganization cases, the debtor remains in control of the bankruptcy estate as debtor-in-possession, operating a business and generating money to fund the plan and pay administrative expenses and prepetition creditors under a plan. *See* 11 U.S.C. §§ 1104 (appointment of trustee), 1106(a)(6) (Chapter 11 trustee shall furnish tax return information to governmental unit without personal liability if debtor has not filed return), 1107 (Chapter 11 debtor-in-possession), 1203 (Chapter 12 debtor-in-possession), 1204 (removal of Chapter 12 debtor as debtor-in-possession), 1202(b)(5) (greater trustee role if debtor removed as debtor-in-possession), 1303 (Chapter 13 debtor rights), 1304 (Chapter 13 business debtor). The trustee is generally a "standing trustee" in Chapter 12 and 13 cases with a limited role primarily focused on distributing plan funds to creditors. 11 U.S.C. §§ 1202, 1222(a)(1), 1302, 1322(a)(1); *In re Griner*, 240 B.R. 432, 438 (Bankr. S.D. Ala. 1999); *In re Freeman*, 72 B.R. 850, 854 (Bankr. E.D. Va. 1987). Thus, while responsibility to file tax returns rests on the person in charge of operating bankruptcy estate assets and collecting the taxable income, that person may or may not be a "trustee." 26 U.S.C. §§ 6012(b)(3) (bankruptcy trustee appointed for corporation shall file income tax return), 6062 (corporate tax return to be signed by authorized officer or by its bankruptcy trustee, if appointed), 6012(b)(4) (tax return of estate of individual under Chapter 7 or 11 "shall be made by the fiduciary thereof"); 28 U.S.C. § 960(a), (b) (officers and agents conducting business under authority of a court subject to all taxes).

The person with responsibility to file the tax return is responsible for paying the tax set forth on the return. 26 U.S.C. § 6151(a); *Holywell*, 503 U.S. at 52 (this IRC provision ties the duty to pay federal income taxes to the duty to make an income tax return). In a bankruptcy case, the money that the trustee or debtor-in-possession uses to make the required payments is property of the bankruptcy estate, under the priorities set forth in the Bankruptcy Code. *See Nicholas*, 384 U.S. at 693, n.28 ("Nothing in § 6151 of the Internal Revenue Code, 26 U.S.C. § 6151 (1964 ed.), which obliges the person required to file a return to pay the tax in question, imposes any obligation on the trustee other than in his capacity as the representative of the bankrupt estate."); *Holywell*, 503 U.S. at 53-55 (source of payment not addressed, but Court expressly recognized that trustee held property of bankruptcy estates); *Knight Realty*, 501 F.2d at 66 (interpreting IRC 6151 and other provisions, and holding Chapter XI trustee liable to pay income tax "provided the trustee has possession of, or title to, substantially all the bankrupt's property").

C. Administrative Expense Claims May Be Discharged Under Completed Plans, Including Capital Gains Taxes from Farm Asset Sales in Chapter 12 Cases.

The Ninth Circuit's ruling that the individual debtor is personally liable for postpetition taxes incurred on account of a Bankruptcy Court sale of estate assets during the postpetition, pre-plan confirmation

existence of the bankruptcy estate, before any assets vest back in the debtor under a confirmed plan, makes that debt non-dischargeable as well as non-payable from estate assets. It ignores the specific provisions of Chapter 12 on dischargeability. *See* 11 U.S.C. §§ 1228, 523. It also contravenes the purpose of 11 U.S.C. § 1222(a)(2)(A).

Many years ago, all taxes were non-dischargeable in bankruptcy cases. *See Bruning v. United States*, 376 U.S. 358, 361 (1964) (holding that under Bankruptcy Act of 1898, debtor remained personally liable after his discharge for tax debt and interest not satisfied out of the bankruptcy estate). Now, most prepetition taxes are non-dischargeable in individual bankruptcy cases, including in Chapter 12 cases. *See IRS v. Cousins*, 209 F.3d 38, 41-42 (1st Cir. 2000) (applying *Bruning* in Chapter 12 case); *see also* 11 U.S.C. §§ 1228(a)(2), (c) (incorporating § 523(a)(1)(A)). Administrative expense tax claims are not encompassed by Section 523, but must be paid under the plan or the case will be dismissed and there will be no discharge. 11 U.S.C. §§ 1222(a)(2) (Chapter 12 plan must provide for full payment of all claims entitled to priority under § 507, with a carve-out exception in § 1222(a)(2)(A)); 1228(a) (all "debts" provided for in the plan must be paid in full to obtain discharge); 101(12) ("debt" is a liability on a "claim," and thus includes postpetition as well as prepetition claims provided for in the plan). When a Chapter 12 debtor receives a discharge, it covers administrative expenses. *See* 11 U.S.C. § 1228(a) (providing

for discharge of "all debts provided for by the plan allowed under section 503 of this title"); 8 COLLIER ON BANKRUPTCY ¶ 1228.02[4][a] (discussing scope of Chapter 12 discharge).

Chapter 12 was written for the purpose of permitting family farmers to more easily reorganize their financial affairs than was provided by Chapters 11 or 13. *See Rowley v. Yarnall*, 22 F.3d 190, 193 (8th Cir. 1994); H.R. Rep. 99-958, at 45 (1986) (Conf. Rep.), *as reprinted in* 1986 U.S.C.C.A.N. 5246, 5249 (stating that Chapter 12 is intended to "give family farmers facing bankruptcy a fighting chance to reorganize their debts").[9] They were hamstrung in that fight by the inability to sell farm assets to fund their plans, because resulting capital gains taxes would have to be paid in full. Congress undoubtedly thought that sales of bankruptcy estate assets resulted in administrative expense tax claims in Chapter 12 cases just like all other types of bankruptcy cases. That is what the IRS had long contended, this Court had long held, and Section 503(b)(1)(B) clearly provided. Section 1222(a)(2)(A) was written broadly to

[9] The Court may seek guidance in congressional purposes that are reflected in the Act in which a particular statute is located. "When 'interpreting a statute, the court will not look merely to a particular clause in which general words may be used, but 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 to it such a construction as will carry into execution the will of the Legislature. . . .'" *Kokoszka v. Belford*, 417 U.S. 642, 650 (1974).

provide an exception to all priority taxes from farm asset sales, including postpetition administrative expense priority tax claims. The whole point of the statute was to enable family farmers to confirm plans that would downsize their farm assets, pay their creditors with sale proceeds, and be discharged from the tax liability arising from the sale.

To benefit by Section 1222(a)(2)(A), the family farmer still must fulfill all plan obligations, because the benefits of this provision are available only if the family farmer debtor receives a discharge. 11 U.S.C. § 1222(a)(2)(A). He still must dedicate any disposable income to the Chapter 12 plan for three to five years. *See* 11 U.S.C. § 1225(b)(1)(B) (which likely precludes individual payment of a substantial capital gains tax as a practical matter). But access to Section 1222(a)(2)(A) allows family farmers like the Halls to use their farm assets to pay secured creditors, use the equity to pay the IRS and other creditors, and proceed with a fresh start and without continuing liability to pay taxes on sale proceeds that were used to pay estate claims. It allows them to use the Bankruptcy Code and Chapter 12 for their intended purpose, disposing of assets in an orderly way under court supervision instead of losing those assets to foreclosing secured creditors. The Halls request the Court to construe Section 1222(a)(2)(A) by its plain terms, which reflects Congress's intent to help distressed family farmers utilize the Bankruptcy Code by removing the major obstacle of obligatory full

payment of a capital gains tax upon the sale of farm assets during a Chapter 12 case.

CONCLUSION

For the reasons set forth above, the decision of the Ninth Circuit should be reversed and the case remanded for Bankruptcy Court consideration of the Halls' amended plan with capital gains tax treatment under Bankruptcy Code Section 1222(a)(2)(A).

Respectfully submitted,

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11 U.S.C. § 101. Definitions

In this title the following definitions shall apply:

* * *

(10) The term "creditor" means –

(A) entity that has a claim against the debtor or that arose at the time of or before the order for relief concerning the debtor

* * *

(13) The term "debtor" means person or municipality concerning which a case under this title has been commenced.

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11 U.S.C. § 103. Applicability of chapters

(a) Except as provided in section 1161 of this title, chapters 1, 3, and 5 of this title apply in a case under chapter 7, 11, 12, or 13 of this title, and this chapter, sections 307, 362(o), 555 through 557, and 559 through 562 apply in a case under chapter 15.

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11 U.S.C. § 346. Special provisions related to the treatment of State and local taxes

(a) Whenever the Internal Revenue Code of 1986 provides that a separate taxable estate or entity is created in a case concerning a debtor under this title, and the income, gain, loss, deductions, and credits of such estate shall be taxed to or claimed by the estate, a separate taxable estate is also created

for purposes of any State and local law imposing a tax on or measured by income and such income, gain, loss, deductions, and credits shall be taxed to or claimed by the estate and may not be taxed to or claimed by the debtor. The preceding sentence shall not apply if the case is dismissed. The trustee shall make tax returns of income required under any such State or local law.

(b) Whenever the Internal Revenue Code of 1986 provides that no separate taxable estate shall be created in a case concerning a debtor under this title, and the income, gain, loss, deductions, and credits of an estate shall be taxed to or claimed by the debtor, such income, gain, loss, deductions, and credits shall be taxed to or claimed by the debtor under a State or local law imposing a tax on or measured by income and may not be taxed to or claimed by the estate. The trustee shall make such tax returns of income of corporations and of partnerships as are required under any State or local law, but with respect to partnerships, shall make such returns only to the extent such returns are also required to be made under such Code. The estate shall be liable for any tax imposed on such corporation or partnership, but not for any tax imposed on partners or members.

(c) With respect to a partnership or any entity treated as a partnership under a State or local law imposing a tax on or measured by income that is a debtor in a case under this title, any gain or loss resulting from a distribution of property from such partnership, or any distributive share of any income, gain, loss, deduction, or credit of a partner or member

that is distributed, or considered distributed, from such partnership, after the commencement of the case, is gain, loss, income, deduction, or credit, as the case may be, of the partner or member, and if such partner or member is a debtor in a case under this title, shall be subject to tax in accordance with subsection (a) or (b).

(d) For purposes of any State or local law imposing a tax on or measured by income, the taxable period of a debtor in a case under this title shall terminate only if and to the extent that the taxable period of such debtor terminates under the Internal Revenue Code of 1986.

(e) The estate in any case described in subsection (a) shall use the same accounting method as the debtor used immediately before the commencement of the case, if such method of accounting complies with applicable nonbankruptcy tax law.

(f) For purposes of any State or local law imposing a tax on or measured by income, a transfer of property from the debtor to the estate or from the estate to the debtor shall not be treated as a disposition for purposes of any provision assigning tax consequences to a disposition, except to the extent that such transfer is treated as a disposition under the Internal Revenue Code of 1986.

(g) Whenever a tax is imposed pursuant to a State or local law imposing a tax on or measured by income pursuant to subsection (a) or (b), such tax shall be imposed at rates generally applicable to the same types of entities under such State or local law.

(h) The trustee shall withhold from any payment of claims for wages, salaries, commissions, dividends, interest, or other payments, or collect, any amount required to be withheld or collected under applicable State or local tax law, and shall pay such withheld or collected amount to the appropriate governmental unit at the time and in the manner required by such tax law, and with the same priority as the claim from which such amount was withheld or collected was paid.

(i) (1) To the extent that any State or local law imposing a tax on or measured by income provides for the carryover of any tax attribute from one taxable period to a subsequent taxable period, the estate shall succeed to such tax attribute in any case in which such estate is subject to tax under subsection (a).

(2) After such a case is closed or dismissed, the debtor shall succeed to any tax attribute to which the estate succeeded under paragraph (1) to the extent consistent with the Internal Revenue Code of 1986.

(3) The estate may carry back any loss or tax attribute to a taxable period of the debtor that ended before the date of the order for relief under this title to the extent that –

(A) applicable State or local tax law provides for a carryback in the case of the debtor; and

(B) the same or a similar tax attribute may be carried back by the estate to such a

taxable period of the debtor under the Internal Revenue Code of 1986.

(j) (1) For purposes of any State or local law imposing a tax on or measured by income, income is not realized by the estate, the debtor, or a successor to the debtor by reason of discharge of indebtedness in a case under this title, except to the extent, if any, that such income is subject to tax under the Internal Revenue Code of 1986.

(2) Whenever the Internal Revenue Code of 1986 provides that the amount excluded from gross income in respect of the discharge of indebtedness in a case under this title shall be applied to reduce the tax attributes of the debtor or the estate, a similar reduction shall be made under any State or local law imposing a tax on or measured by income to the extent such State or local law recognizes such attributes. Such State or local law may also provide for the reduction of other attributes to the extent that the full amount of income from the discharge of indebtedness has not been applied.

(k) (1) Except as provided in this section and section 505, the time and manner of filing tax returns and the items of income, gain, loss, deduction, and credit of any taxpayer shall be determined under applicable nonbankruptcy law.

(2) For Federal tax purposes, the provisions of this section are subject to the Internal Revenue Code of 1986 and other applicable Federal nonbankruptcy law.

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11 U.S.C. § 503. Allowance of administrative expenses

* * *

(b) After notice and a hearing, there shall be allowed administrative expenses, other than claims allowed under section 502(f) of this title, including –

(1) * * *

(B) any tax –

(i) incurred by the estate, whether secured or unsecured, including property taxes for which liability is in rem, in personam, or both, except a tax of a kind specified in section 507(a)(8) of this title; or

* * *

(C) any fine, penalty, or reduction in credit relating to a tax of a kind specified in subparagraph (B) of this paragraph; and

(D) notwithstanding the requirements of subsection (a), a governmental unit shall not be required to file a request for the payment of an expense described in subparagraph (B) or (C), as a condition of its being an allowed administrative expense;

* * *

11 U.S.C. § 507. Priorities

(a) The following expenses and claims have priority in the following order:

* * *

(2) Second, administrative expenses allowed under section 503(b) of this title, unsecured claims of any Federal reserve bank related to loans made through programs or facilities authorized under section 13(3) of the Federal Reserve Act (12 U.S.C. 343), and any fees and charges assessed against the estate under chapter 123 of title 28.

* * *

(8) Eighth, allowed unsecured claims of governmental units, only to the extent that such claims are for –

(A) a tax on or measured by income or gross receipts for a taxable year ending on or before the date of the filing of the petition –

(i) for which a return, if required, is last due, including extensions, after three years before the date of the filing of the petition;

(ii) assessed within 240 days before the date of the filing of the petition, exclusive of –

(I) any time during which an offer in compromise with respect to that tax was pending or in effect during that 240-day period, plus 30 days; and

(II) any time during which a stay of proceedings against collections was in effect in a prior case under this title during that 240-day period, plus 90 days; or

(iii) other than a tax of a kind specified in section 523(a)(1)(B) or 523(a)(1)(C) of this title, not assessed before, but assessable, under applicable law or by agreement, after, the commencement of the case;

* * *

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11 U.S.C. § 523. Exceptions to discharge

(a) A discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt –

(1) for a tax or a customs duty –

(A) of the kind and for the periods specified in section 507(a)(3) or 507(a)(8) of this title, whether or not a claim for such tax was filed or allowed;

* * *

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11 U.S.C. § 541. Property of the estate

(a) The commencement of a case under section 301, 302, or 303 of this title creates an estate. Such estate is comprised of all the following property, wherever located and by whomever held:

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

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

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

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

* * *

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

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

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11 U.S.C. § 1203. Rights and powers of debtor

Subject to such limitations as the court may prescribe, a debtor in possession shall have all the rights, other than the right to compensation under section 330, and powers, and shall perform all the functions and duties, except the duties specified in paragraphs (3) and (4) of section 1106(a), of a trustee

serving in a case under chapter 11, including operating the debtor's farm or commercial fishing operation.

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11 U.S.C. § 1207. Property of the estate

(a) Property of the estate includes, in addition to the property specified in section 541 of this title –

(1) all property of the kind specified in such section that the debtor acquires after the commencement of the case but before the case is closed, dismissed, or converted to a case under chapter 7 of this title, whichever occurs first; and

(2) earnings from services performed by the debtor after the commencement of the case but before the case is closed, dismissed, or converted to a case under chapter 7 of this title, whichever occurs first.

(b) Except as provided in section 1204, a confirmed plan, or an order confirming a plan, the debtor shall remain in possession of all property of the estate.

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11 U.S.C. § 1222. Contents of plan

(a) The plan shall –

(1) provide for the submission of all or such portion of future earnings or other future income of the debtor to the supervision and control of the trustee as is necessary for the execution of the plan;

(2) provide for the full payment, in deferred cash payments, of all claims entitled to priority under section 507, unless –

(A) the claim is a claim owed to a governmental unit that arises as a result of the sale, transfer, exchange, or other disposition of any farm asset used in the debtor's farming operation, in which case the claim shall be treated as an unsecured claim that is not entitled to priority under section 507, but the debt shall be treated in such manner only if the debtor receives a discharge; or

(B) the holder of a particular claim agrees to a different treatment of that claim;

* * *

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11 U.S.C. § 1225. Confirmation of plan

(a) Except as provided in subsection (b), the court shall confirm a plan if –

(1) the plan complies with the provisions of this chapter and with the other applicable provisions of this title

* * *

(b) (1) If the trustee or the holder of an allowed unsecured claim objects to the confirmation of the plan, then the court may not approve the plan unless, as of the effective date of the plan –

* * *

(B) the plan provides that all of the debtor's projected disposable income to be

received in the three-year period, or such longer period as the court may approve under section 1222(c), beginning on the date that the first payment is due under the plan will be applied to make payments under the plan; or

* * *

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11 U.S.C. § 1226. Payments

* * *

(b) Before or at the time of each payment to creditors under the plan, there shall be paid –

(1) any unpaid claim of the kind specified in section 507(a)(2) of this title; and

* * *

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11 U.S.C. § 1227. Effect of confirmation

(a) Except as provided in section 1228(a) of this title, the provisions of a confirmed plan bind the debtor, each creditor, each equity security holder, and each general partner in the debtor, whether or not the claim of such creditor, such equity security holder, or such general partner in the debtor is provided for by the plan, and whether or not such creditor, such equity security holder, or such general partner in the debtor has objected to, has accepted, or has rejected the plan.

(b) Except as otherwise provided in the plan or the order confirming the plan, the confirmation of a plan vests all of the property of the estate in the debtor.

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11 U.S.C. § 1228. Discharge

(a) Subject to subsection (d), as soon as practicable after completion by the debtor of all payments under the plan, and in the case of a debtor who is required by a judicial or administrative order, or by statute, to pay a domestic support obligation, after such debtor certifies that all amounts payable under such order or such statute that are due on or before the date of the certification (including amounts due before the petition was filed, but only to the extent provided for by the plan) have been paid, other than payments to holders of allowed claims provided for under section 1222(b)(5) or 1222(b)(9) of this title, unless the court approves a written waiver of discharge executed by the debtor after the order for relief under this chapter, the court shall grant the debtor a discharge of all debts provided for by the plan allowed under section 503 of this title or disallowed under section 502 of this title, except any debt –

(1) provided for under section 1222(b)(5) or 1222(b)(9) of this title; or

(2) of the kind specified in section 523(a) of this title.

* * *

(c) A discharge granted under subsection (b) of this section discharges the debtor from all unsecured debts provided for by the plan or disallowed under section 502 of this title, except any debt –

(1) provided for under section 1222(b)(5) or 1222(b)(9) of this title; or

(2) of a kind specified in section 523(a) of this title.

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11 U.S.C. § 1305. Filing and allowance of post-petition claims

(a) A proof of claim may be filed by any entity that holds a claim against the debtor –

(1) for taxes that become payable to a governmental unit while the case is pending; or

(2) that is a consumer debt, that arises after the date of the order for relief under this chapter, and that is for property or services necessary for the debtor's performance under the plan.

(b) Except as provided in subsection (c) of this section, a claim filed under subsection (a) of this section shall be allowed or disallowed under section 502 of this title, but shall be determined as of the date such claim arises, and shall be allowed under section 502(a), 502(b), or 502(c) of this title, or disallowed under section 502(d) or 502(e) of this title, the same as if such claim had arisen before the date of the filing of the petition.

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26 U.S.C. § 1398. Rules relating to individuals' title 11 cases

(a) Cases to which section applies – Except as provided in subsection (b), this section shall apply to any case under chapter 7 (relating to liquidations) or

chapter 11 (relating to reorganizations) of title 11 of the United States Code in which the debtor is an individual.

* * *

(d) Taxable year of debtors

(1) General rule – Except as provided in paragraph (2), the taxable year of the debtor shall be determined without regard to the case under title 11 of the United States Code to which this section applies.

(2) Election to terminate debtor's year when case commences.

(A) In general – Notwithstanding section 442, the debtor may (without the approval of the Secretary) elect to treat the debtor's taxable year which includes the commencement date as 2 taxable years –

(i) the first of which ends on the day before the commencement date, and

(ii) the second of which begins on the commencement date.

(B) Spouse may join in election – In the case of a married individual (within the meaning of section 7703), the spouse may elect to have the debtor's election under subparagraph (A) also apply to the spouse, but only if the debtor and the spouse file a joint return for the taxable year referred to in subparagraph (A)(i).

(C) No election where debtor has no assets – No election may be made under subparagraph (A) by a debtor who has no assets other than property which the debtor may treat as exempt property under section 522 of title 11 of the United States Code.

(D) Time for making election – An election under subparagraph (A) or (B) may be made only on or before the due date for filing the return for the taxable year referred to in subparagraph (A)(i). Any such election, once made, shall be irrevocable.

(E) Returns – A return shall be made for each of the taxable years specified in subparagraph (A).

(F) Annualization – For purposes of subsections (b), (c), and (d) of section 443, a return filed for either of the taxable years referred to in subparagraph (A) shall be treated as a return made under paragraph (1) of subsection (a) of section 443.

(3) Commencement date defined – For purposes of this subsection, the term "commencement date" means the day on which the case under title 11 of the United States Code to which this section applies commences.

(e) Treatment of income, deductions, and credits

(1) Estate's share of debtor's income. – The gross income of the estate for each taxable year shall include the gross income of the debtor to which the estate is entitled under title 11 of the United States

Code. The preceding sentence shall not apply to any amount received or accrued by the debtor before the commencement date (as defined in subsection (d)(3)).

(2) Debtor's share of debtor's income. – The gross income of the debtor for any taxable year shall not include any item to the extent that such item is included in the gross income of the estate by reason of paragraph (1).

(3) Rule for making determinations with respect to deductions, credits, and employment taxes – Except as otherwise provided in this section, the determination of whether or not any amount paid or incurred by the estate –

(A) is allowable as a deduction or credit under this chapter, or

(B) is wages for purposes of subtitle C, shall be made as if the amount were paid or incurred by the debtor and as if the debtor were still engaged in the trades and businesses, and in the activities, the debtor was engaged in before the commencement of the case.

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26 U.S.C. § 1399. No separate taxable entities for partnerships, corporations, etc

Except in any case to which section 1398 applies, no separate taxable entity shall result from the commencement of a case under title 11 of the United States Code.

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26 U.S.C. § 6012. Persons required to make returns of income

* * *

(b) Returns made by fiduciaries and receivers

* * *

(3) Receivers, trustees and assignees for corporations – In a case where a receiver, trustee in a case under title 11 of the United States Code, or assignee, by order of a court of competent jurisdiction, by operation of law or otherwise, has possession of or holds title to all or substantially all the property or business of a corporation, whether or not such property or business is being operated, such receiver, trustee, or assignee shall make the return of income for such corporation in the same manner and form as corporations are required to make such returns.

(4) Returns of estates and trusts – Returns of an estate, a trust, or an estate of an individual under chapter 7 or 11 of title 11 of the United States Code shall be made by the fiduciary thereof.

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26 U.S.C. § 6151. Time and place for paying tax shown on returns

(a) General rule – Except as otherwise provided in this subchapter, when a return of tax is required under this title or regulations, the person required to make such return shall, without assessment or notice and demand from the Secretary, pay such tax to the internal revenue officer with

whom the return is filed, and shall pay such tax at the time and place fixed for filing the return (determined without regard to any extension of time for filing the return).

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26 U.S.C. § 6658. Coordination with title 11

(a) Certain failures to pay tax – No addition to the tax shall be made under section 6651, 6654, or 6655 for failure to make timely payment of tax with respect to a period during which a case is pending under title 11 of the United States Code –

(1) if such tax was incurred by the estate and the failure occurred pursuant to an order of the court finding probable insufficiency of funds of the estate to pay administrative expenses, or

(2) if –

(A) such tax was incurred by the debtor before the earlier of the order for relief or (in the involuntary case) the appointment of a trustee, and

(B) (i) the petition was filed before the due date prescribed by law (including extensions) for filing a return of such tax, or

(ii) the date for making the addition to the tax occurs on or after the day on which the petition was filed.

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28 U.S.C. § 960. Tax liability

(a) Any officers and agents conducting any business under authority of a United States court shall be subject to all Federal, State and local taxes applicable to such business to the same extent as if it were conducted by an individual or corporation.

(b) A tax under subsection (a) shall be paid on or before the due date of the tax under applicable nonbankruptcy law, unless –

(1) the tax is a property tax secured by a lien against property that is abandoned under section 554 of title 11, within a reasonable period of time after the lien attaches, by the trustee in a case under title 11; or

(2) payment of the tax is excused under a specific provision of title 11.