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

REPLY BRIEF FOR PETITIONERS

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TABLE OF CONTENTS

TABLE OF AUTHORITIES

Page

FEDERAL CASES

TABLE OF AUTHORITIES – Continued

RULES, REGULATIONS AND STATUTES

UNITED STATES CODE:

TABLE OF AUTHORITIES – Continued

TABLE OF AUTHORITIES – Continued

TABLE OF AUTHORITIES – Continued

Page

OTHER AUTHORITIES

The Government does not dispute that the plain language of Bankruptcy Code 1222(a)(2)(A) applies it to "all claims entitled to priority under section 507," and that Congress "intended to incorporate the priority rules established by the various provisions of Section 507." Resp. 19. Section 507(a)(2) includes "administrative expenses allowed under section 503(b)," which in turn includes "any tax incurred by the estate" under Section 503(b)(1)(B). The plain language does not limit its scope to prepetition tax debts or narrow "any taxes" to just employment taxes as the Government urges. The Government does not question the historical treatment of taxes from postpetition asset sales as administrative expenses.

The Government also does not dispute that the purpose of Section 1222(a)(2)(A) is to demote the priority status of governmental claims resulting from the sale of farm assets and to allow their discharge without full payment. In other words, the Government acknowledges that Section 1222(a)(2)(A) was intended to eliminate priority treatment for *some* taxes, but it argues the range of tax debts included by Congress within Section 1222(a)(2)(A)'s exception is "somewhat smaller than it might otherwise be." Resp. 19. The scope of the priority exception would not just be "somewhat smaller," but nearly non-existent, if the Government prevails. As it concedes, under the 2005 amendments to Section 507(a)(8), all taxes incurred prepetition but during the year in which the bankruptcy case is filed are treated as Section 507(a)(2) priority administrative expense claims. The result is

that virtually no taxes due to farm sales would be covered if the Ninth Circuit is upheld, eviscerating the purpose of Section 1222(a)(2)(A).

The Government's primary argument is that Chapter 12 plans never include postpetition debts and such administrative expense claims cannot be discharged in Chapter 12 cases. If this were true, there would have been no need for Congress to engage in the tortured draftsmanship – using a separate provision of the I.R.C. relating to "separate taxable entities" not referenced in Section 1222(a)(2)(A) to remove administrative expense claims from its scope – that the Government also argues. And in fact, it is not true. Other provisions of the Bankruptcy Code and extensive case law confirm that Chapter 12 plans include postpetition debts, just like other reorganization plans.

The Government's secondary, and contradictory, argument that taxes resulting from sales of bankruptcy estate assets are administrative expense claims in corporate and LLC Chapter 12 cases, but not individual Chapter 12 cases where the debtor's estate is not a "separate taxable entity," is also incorrect. The Bankruptcy Code draws no such distinction, with administrative expense provisions equally applicable in all cases. The argument rests on an attempt to distinguish decades of decisions from this Court in single taxable entity cases through narrow attention to their facts; the holdings were not so limited. The I.R.C. provisions for a single taxable entity in some cases and separate taxable entity in others does not

alter these holdings, or the priority with which estate assets are distributed among different classes of claimants, or the requirement that discharge of debts be determined by Bankruptcy Code discharge provisions. Before enactment of Section 1222(a)(2)(A), the IRS repeatedly sought (and obtained) administrative expense treatment of taxes incurred due to transactions involving bankruptcy estate assets. While the IRS may no longer like the commonsensical understanding of the statutory scheme because of Section 1222(a)(2)(A), its change in course is untenable. Further, to hold that the meaning of administrative expense claims has changed, just to limit the scope of Section 1222(a)(2)(A), would have disruptive and detrimental effects on bankruptcy law and practice.

I. Administrative Expense Claims Are Treated in Chapter 12 Plans and Discharged.

The Government argues that administrative expense claims, including taxes, were not intended to be included in Chapter 12 plans or discharges. It asserts that Chapter 12 administrative expense claims are always treated outside a Chapter 12 plan as superpriority debts payable under Section 1226(b)(1), and as debts deducted in determining the debtor's disposable income used to make plan payments. The statutory language and its application in countless cases flatly contradict the Government's contentions.

A. The Bankruptcy Code Provides That Chapter 12 Plans and Discharges Encompass Administrative Expense Claims.

Section 1222(a) requires that a Chapter 12 plan "provide for the full payment, in deferred cash payments, of all claims entitled to priority under section 507" subject to the exception at issue here. While Section 1227(a) refers to binding each "creditor," Section 1228(a) provides for the "discharge of all debts provided for by the plan allowed under section 503 of this title" – expressly contemplating Section 503 administrative priority debts being "provided for by the plan" and discharged. If Congress wanted only prepetition debts to be discharged, it could have easily said that the discharge "discharges the debtor from all debts that arose before the date of the order for relief," as it did in Chapter 7. *See* 11 U.S.C. 727(b). The language in Sections 1227(a) and 1228(a) tracks their Chapter 11 counterparts: Section 1141(a) likewise provides for binding "any creditor," and Section 1141(d)(1)(A) "discharges the debtor from any debt that arose before the date of such [plan] confirmation." The Government has not questioned that administrative expense claims, including for taxes incurred during estate administration, must be provided for in Chapter 11 plans and are discharged. *See* Resp. 12, n.3.

Major bankruptcy treatises explain that all priority claims, including administrative expense claims, must be provided for in Chapter 12 plans (subject to the exception at issue here), and may be deferred

instead of paid in cash at confirmation as required in Chapter 11 cases. 8 Resnick & Sommer, COLLIER ON BANKRUPTCY ¶1222.02[2] (16th ed.); 7 NORTON BANKRUPTCY LAW & PRACTICE 133:6 (3d ed. 2010); C. Richard McQueen & Jack F. Williams, TAX ASPECTS OF BANKRUPTCY LAW AND PRACTICE 14.4 (3d ed. updated 2011) ("[A] Chapter 12 debtor may be required to pay in full, under the plan, a variety of tax claims that are entitled to priority under §507 of the Bankruptcy Code, including postpetition taxes entitled to administrative priority under §507(a)(1). . . .").

The Government contends that notwithstanding the express requirement in Section 1222(a) that plans "provide for the full payment" of administrative expense claims, Section 1226(b) means that all administrative expense claims are payable "outside the plan" with "super-priority status." Resp. 7, 15-17. Section 1226(b) actually directs that any unpaid administrative expense claim be paid "before *or at the time of* each payment to creditors under the plan." 11 U.S.C. 1226(b)(1) (emphasis added); *see In re Palombo*, 144 B.R. 516, 518-19 (Bankr. D. Colo. 1992) (Chapter 12 attorneys' fees need not be paid before other creditors under plan). These provisions have been construed extensively, and contrary to the Government's position.

The Bankruptcy Code expressly provides for the option of plan payments being made "outside the plan" directly to creditors, usually secured creditors whose claims will be paid over a period exceeding the three-to-five year plan. This means only that the payment is made directly by the debtor instead of

through the standing trustee, and requires a specific direction in the plan or confirmation order, because self-payment bears on plan feasibility and the trustee's fee is calculated as a percentage of plan payments, and will be reduced proportionately. *See* 11 U.S.C. 1226(c) (trustee shall pay creditors under plan unless plan or confirmation order provides otherwise); 1221(b)(9) (plan provision for secured claim payments over longer than plan term); 28 U.S.C. 586(e) (trustee's fees). Multiple courts have held that Chapter 12 administrative expense claims cannot be paid outside a plan for these reasons. *See In re Beard*, 45 F.3d 113, 116, 120 (6th Cir. 1995) (upholding order allowing direct payment to secured creditors, but requiring administrative expense claims and tax claims to be paid through trustee under plan); *In re Miller*, 288 B.R. 879, 883 (B.A.P. 10th Cir. 2003) (attorneys' fees must be paid as administrative expenses under plan); *In re Greseth*, 78 B.R. 936, 941 (D. Minn. 1987) (Sections 1222(a) and 1226(b)(1) mandate that administrative expense claims be paid under plan, with trustee's fees assessed on such payments); *In re Sorrell*, 286 B.R. 798, 806 (Bankr. D. Utah 2002) (confirmation of Chapter 12 plan denied because attorneys' fees to be paid directly outside the plan); *see also Haden v. Pelofsky*, 212 F.3d 466, 473 (8th Cir. 2000) (permitting direct payments to secured creditors under plans, avoiding trustee's fees); *In re Fulkrod*, 973 F.2d 801, 802-3 (9th Cir. 1992) (Chapter 12 debtor may not pay impaired secured claims outside plan); Keith M. Lundin & William H. Brown, CHAPTER 13 BANKRUPTCY §100.1, at ¶13 (4th ed.), Sec. Rev. June 24,

2010, www.Ch13online.com (Chapter 13 counterparts 1326(b)(1) and 1322(a)(2) overlap; payments of administrative expense priority claims are under plan).

B. Payment of Taxes and Other Administrative Expenses in Reorganization Cases Is Fundamental.

The Government is likewise simply incorrect in stating that the general structure of the Bankruptcy Code limits Chapter 12 reorganization plans to pre-petition debts. Resp. 7, 11-12. The Government cites dicta in a 1991 case, in turn citing a 1988 treatise discussing Section 1305. *In re Ripley*, 926 F.2d 440, 443 (5th Cir. 1991) (citing 5 Lawrence King, COLLIER ON BANKRUPTCY ¶1305.01[1] (15th ed. 1988)). Even in a Chapter 13 wage-earner case with no business operations, completion of a Chapter 13 plan entitles a debtor to a "discharge of all debts provided for by the plan or disallowed under section 502 of this title" with certain exceptions. 11 U.S.C. 1328(a). Those debts include, in a Chapter 13 case, all claims entitled to priority under Section 507, which a Chapter 13 plan is required to include and may pay with deferred cash payments. 11 U.S.C. 1322(a)(2). Chapter 13 plans that do not provide for payment of administrative expense claims will not be confirmed, and may result in case dismissal. *Id*.; 11 U.S.C. 1307(c)(5), 1325(a)(1).

The Government's premise largely applies to a Chapter 7 liquidation case, which involves liquidation of the debtor's assets as they exist on the petition

filing date, and discharges only debts existing on that date. 11 U.S.C. 727(b). The Chapter 7 trustee's administrative expenses are still paid first from bankruptcy estate assets, but the Chapter 7 debtor does not operate a business during case administration and is responsible for his own attorneys' fees. *See Lamie v. United States Trustee*, 540 U.S. 526, 542 (2004). Chapter 11 reorganizations, in contrast, entail operation of a business during administration of a bankruptcy case, while assets are sold, leases are assumed or rejected, and financing and plan terms are negotiated. Chapter 12 reorganizations likewise concern operating farm businesses, where the same types of issues arise. Bankruptcy estates are administered for months or years in both types of reorganization before plans are confirmed.

Taxes, along with other costs of doing business, are incurred and must be paid as administrative expenses during the administration period of a reorganization case, as a matter of long-standing bankruptcy law. Those not requiring court approval are paid in the ordinary course during the administration period pre-confirmation; the court is involved if its approval is needed or there is a dispute over payment.[1]

[1] The Government's statement that postpetition debts not qualifying as administrative expenses may be collected outside of bankruptcy conflicts with court's ability to disallow such claims. Section 503(b). Its statement that postpetition consumer expenditures do not qualify as allowable administrative expenses is irrelevant here, but Hall notes that if farmers cannot buy groceries, they cannot operate their farms. Resp. 15.

See 11 U.S.C. 521(j)(1) ("[I]f the debtor fails to file a tax return that becomes due after the commencement of the case, . . . the taxing authority may request that the court enter an order converting or dismissing the case"); 28 U.S.C. 960 (taxes must be paid in bankruptcy cases by due date under non-bankruptcy law, unless excused); I.R.C. 6151 (tax shall be paid when return filed); *Hartford Underwriters Ins. Co. v. UnionPlanters Bank*, 530 U.S. 1, 5, 12 (2000) (holders of "administrative claims" should insist on prompt payment); 4 COLLIER, *supra*, 503.03[5], at 503-17 ("Although courts deal gingerly with the payment of professionals, 'ordinary course of business' administrative expenses . . . generally are paid when due."); 15 COLLIER, *supra*, TX ¶1.05[5][a] ("BAPCPA amends section 507(a)(8) governing the priority of taxes to provide that income and gross receipts taxes for Straddle Years 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. . . .").

As this Court explained in *Nicholas*, interpreting the counterpart provisions of the Bankruptcy Act of 1898, in liquidation cases, there are two relevant periods – the "prepetition period, before the petition in bankruptcy was filed, and the post-petition period, during the bankruptcy liquidation." *Nicholas v. United States*, 384 U.S. 678, 685-86 (1966). In reorganization cases, there are three relevant periods – the pre-petition period, the reorganization period, and the liquidating bankruptcy period if the reorganization

does not succeed. *Id*. Taxes incurred in the prepetition period have priority under Section 507(a)(8) (with those during the filing year accorded administrative expense priority after 2005).[2] "On the other hand, taxes incurred during the arrangement [reorganization] period are expenses of the Chapter XI proceedings" with administrative expense priority, subordinated only to any administrative expenses of a superseding liquidation case. *Id*. at 687-88.

Contrary to the Government's inference, the Court's opinion in *Holywell* does not hold that administrative expense tax claims are excepted from reorganization plans and discharges. Indeed, *Holywell* held that taxes resulting from asset sales during reorganization cases of an individual and a corporation were payable by the debtors-in-possession and had to be paid by plan-created entities. *Holywell Corp. v. Smith*, 503 U.S. 47, 54-57 (1992). The Government's quote from that case suggests that a plan confirmation order may not "bind the United States or any other creditor with respect to *post-confirmation* claims." *Holywell*, 503 U.S. at 58-59 (emphasis added) (quoted at Resp. 13). As a general principle, the bankruptcy estate and administrative expense period end at plan confirmation. The caveat to that principle is that a plan can provide for the estate to continue, *e.g*., for an asset sale to occur, and for treatment of a tax claim based on that sale. 11 U.S.C. 1115(b), 1123(5)(D),

[2] *See* Pet. Br. 28-33 regarding 2005 amendments.

1141(b), 1222(b)(8), 1227(b); *see also* NORTON, *supra*, 130:8 (implementation of Section 1222(a)(2)(A) in a plan sale); *In re Hillis Motors*, 997 F.2d 581, 588 (9th Cir. 1993) (allowance of post-confirmation administrative expenses is unusual, except when an estate continues after confirmation pursuant to plan).[3] Also, some courts have held that the bankruptcy estate continues in a Chapter 12 or 13 case until the plan is completed or case dismissed, resulting in administrative expenses throughout that period. *See* Pet. Br. at 40-42.

C. Disposable Income Computations Concern Plan Implementation, Not Pre-Confirmation Administrative Expenses.

The Government argues that a Chapter 12 debtor's postpetition income taxes are expenses taken into account in determining whether a debtor will have sufficient disposable income to execute the plan, but their payment is not provided for by the plan. Resp. 17. It derives that conclusion from the debtor's obligation to list projected income and expenses including projected tax obligations on Schedules at the beginning of the case, and requirements that in

[3] The Government says taxes from a post-confirmation asset sale would not be incurred by the estate because plan confirmation vests all property of the estate in the debtor unless the plan provides otherwise. Resp. at 35, n.12, citing 11 U.S.C. 1227(b). A plan providing for an asset sale would also provide the asset remained in the estate until sold, with proceeds and resulting taxes treated under the plan.

some circumstances, a Chapter 12 plan must provide for application of all of the debtor's projected disposable income. *Id*. (citing, *e.g*., 11 U.S.C. 1225(b)(1)). Expected taxes during the plan implementation period are deducted in Chapter 13 projected disposable income computations. *See, e.g., In re Stimac*, 366 B.R. 889, 892-94 (Bankr. E.D. Wis. 2007). However, Chapter 12 disposable income determinations are not formula-driven like Chapter 13 cases. 11 U.S.C. 1225(b)(2); *cf. Ransom v. FIA Card Servs., N.A.*, 131 S.Ct. 716, 721-22 (2011). They take into account (A) maintenance or support of the debtor, debtor's dependents, or domestic support obligations, and (B) "expenditures necessary for the continuation, preservation and operation of the debtor's business," neither of which categories include capital gains taxes on a farm sale during bankruptcy case administration. 11 U.S.C. 1225(b)(2)(A), (B). Most importantly for this case, however, the computations are made as of the date that payments or distributions are made under the plan, not during the administration period. 11 U.S.C. 1225(b)(1)(B), (C). The administration period in this case has lasted for years past the October 6, 2005 farm sale generating the tax at issue; it is not a post-confirmation tax. Jt. App. 56. Further, whether or not post-confirmation income taxes are included in disposable income calculations does not undercut the fundamental principle that pre-confirmation administrative expenses, including taxes from estate asset sales, must be satisfied for a Chapter 12 reorganization plan to be confirmable, unless Section 1222(a)(2)(A) applies.

D. Section 1222(a)(2)(A) Includes Administrative As Well As Prepetition Priority Claims.

The Government's parsing of Bankruptcy Code provisions to argue that Section 1222(a)(2)(A) excludes administrative expense claims also fails. It says Section 1222(a)(2)(A) refers to "claims entitled to priority under section 507" and infers that Congress thereby intended to include only "claims" referenced in Section 507(a)(1) and (3)-(10) and to exclude "administrative expenses" in Section 507(a)(2). Resp. 13. The notion that Congress intended to refer to all these subsections of Section 507 and not refer to 507(a)(2) is implausible.

- Only Sections 507(a)(8) (taxes in the year before the bankruptcy filing) and 507(a)(2) (administrative expense claims for all taxes during the bankruptcy filing year and post-petition) concern taxes. Section 1222(a)(2)(A) is not limited to Section 507(a)(8) as the Government recognizes,[4] and administrative expense tax claims are the only other subsection the broad reference to "claims entitled to priority under section 507" could encompass.

- "Claim" includes administrative expenses by definition and by repeated usage of the term "claim" for "administrative expense"

[4] "Congress evidently intended to incorporate the priority rules established by the various provisions of Section 507." Resp. 19.

throughout the Code, including in Section 507(a)(2) itself. Pet. Br. 13-15.

- The Government is mistaken in stating that every Bankruptcy Code reference to administrative expenses as "claims" has a cross reference to Section 507(a)(2). Resp. 14. Section 1226(a)(1) addresses "any unpaid claim allowed under Section 503(b) of this title," *i.e.* administrative expense claims. 11 U.S.C. 1226(a)(1).

- The Government's notion that Congress should have added "claims of the kind specified in Section 507(a)(2)" to "claims entitled to priority under section 507" criticizes Congress for not being redundant. Resp. 14.

The Government also claims a "severe conflict" between Section 1226(b) requiring priority payment of administrative expense claims and Section 1222(a)(2)(A) providing for tax claims to receive unsecured claim treatment only if the debtor achieves a discharge. Resp. 16. The Halls explained in their Opening Brief how plans implement these provisions. Pet. Br. 51. A more detailed explanation is at NORTON, *supra*, 130:6-130:8.

The Government claims that under its constricted view of Section 1222(a)(2), that provision "provides meaningful relief to debtors," while admitting that taxes incurred due to farm asset sales within the entire year of a bankruptcy filing as well as all post-petition sales would not be covered under the 2005 amendments to Section 507(a)(8). Resp. 18-19. The practical effect is not just a "somewhat smaller" range

of tax debts entitled to the priority-stripping treatment. *Id*. at 19. The likelihood that farmers needing bankruptcy relief could strategically sell their assets and delay their bankruptcy filing by as much as a year is slim. It certainly was not an option for the Halls, who filed Chapter 12 to prevent a foreclosure sale and use their farm equity to pay the IRS and other creditors. Both the Tenth Circuit in *In re Dawes*, 652 F.3d 1236 (10th Cir. 2011), and the Ninth Circuit below apparently believed, erroneously, that their interpretation of Section 1222(a)(2)(A) would encompass a significant percentage of farm sales, ignoring Section 507(a)(8) amendments enacted contemporaneously.

E. Chapter 13 Provisions Are Not Dispositive.

The Government reasons that Chapter 12 was modeled on Chapter 13; that Chapter 13 includes Section 1305(a)(1) authorizing a proof of claim for taxes that become payable while the case is pending; that Section 1305(a)(1) would be unnecessary if Section 1322(a)(2) providing for full payment of claims entitled to priority already covered postpetition taxes; therefore, the Chapter 12 counterpart to Section 1322(a)(2), *i.e*. Section 1222(a)(2), does not cover postpetition tax claims. The Government cites no supporting authority. Resp. 20-21.

Chapter 12 farm businesses are more like typical Chapter 11 businesses than Chapter 13 wage-earners, and Chapter 11 postpetition taxes have administrative expense priority despite the lack of a Chapter 11

counterpart to Section 1305. Chapter 12 cases are not "typically confirmed quickly" like Chapter 13 as the Government assumes. Resp. 23-24; *see* Professors' Amicus Brief 32-34.[5] And, Chapter 13 statutory provisions and case law are not as simple as the Government suggests. The principal treatise on Chapter 13 includes lengthy descriptions of conflicts among courts over the nature and treatment of postpetition taxes, including the following:

> The definitions of allowable administrative expenses under §503(b) and of allowable postpetition claims under §1305(a)(1) and (2) are similar in many respects, but not exactly the same. For example, a postpetition debt for taxes that becomes payable to a governmental unit while the Chapter 13 case is pending can be an allowable postpetition claim under §1305(a)(1). A postpetition debt for taxes "incurred by the estate" is allowable as an administrative expense under §503(b)(1)(B). Some courts have concluded that because of the specific provision for postpetition taxes in §1305(a)(1), postpetition taxes cannot be administrative expenses under §503(b). Other courts have found that postpetition taxes can be administrative expenses in a Chapter 13 case. Still other courts have held that postpetition taxes travel

[5] *See* H.R. REP. NO. 99-764, at 48 (1986), *as reprinted in* 1986 U.S.C.C.A.N. 5227, 5249 (Chapter 12 necessary in part because deadlines for filing and confirming a plan were too short under Chapter 13).

> through §1305 to become priority claims entitled to full payment under §1322(a)(2).

Ch13Online.com, *supra*, 302.1 (citations omitted); *see also id*. 292.1 ("Depending on when the taxes arise, are incurred, are assessable, become payable and to what entity, activity or property the taxes relate, postpetition taxes may be priority claims under §507(a)(8), postpetition claims under §1305, administrative expenses under §§503(b)(1) and 507(a)(2) or something else altogether.").

The Government's syllogism is thus flawed, and by no means resolves this case. The bankruptcy court cases cited by the Government saying that Chapter 13 estates cannot incur income taxes so they are not administrative expenses (Resp. 37-38) are just a few of the myriad cases reaching conflicting conclusions. They are also distinguishable in Chapter 12 cases since they rely principally on Section 1305 which has no Chapter 12 counterpart. *In re Whall*, 391 B.R. 1, 6 (Bankr. D. Mass. 2008) (treating post-confirmation tax claim as administrative expense would render Section 1305 ineffectual); *In re Brown*, 2006 WL 3370867, *2 (Bankr. D. Mass. Nov. 20, 2006) ("First, the Court agrees with the analysis in *Gyulafia* that §1305, rather than §503(b), controls postpetition tax claims in Chapter 13."); *In re Gyulafia*, 65 B.R. 913, 915-16 (Bankr. D. Kan. 1986) (court rejects IRS's administrative expense claims; post-confirmation taxes not administrative since estate ended; pre-confirmation taxes "controlled by a very specific statute in Chapter 13, section 1305").

II. Taxes Incurred During Chapter 12 Cases Are Administrative Expenses, Except Under Section 1222(a)(2)(A).

A. "Incurred by the Estate" Means Incurred Postpetition-Preconfirmation, Payable With Estate Assets.

The Government says that whether an income tax is "incurred by the estate" depends on the nature of the debtor and the chapter of the Bankruptcy Code under which relief is sought. Resp. 22. When Congress enacted Section 503(b)(1)(B) with that term, however, administrative expense claims for federal taxes were payable by all debtors in all chapters, with no "separate taxable entity" status for some. The section concerns the priority of administrative expense claims over prepetition claims. The legislative history shows Congress simply focused on when a tax would be considered "before" versus "during" the administrative period of the case, warranting higher priority. It intended the term to be temporal: An income tax was "considered incurred on the last day of the taxable period" while sales and transaction taxes were "incurred on the last day of such transaction or event." *See In re Pacific-Atlantic*, 64 F.3d 1292, 1299-1300 (9th Cir. 1995). The portion of the 1977 House Report cited by the Government does not address Section 503(b)(1)(B) or administrative expenses or priority rights, but rather who bears the "administrative responsibility" for filing tax returns. *See* H.R. REP. NO. 95-595, at 277-78 (1977), *as reprinted in* 1978 U.S.C.C.A.N. 5963, 6234-35. Whether a debtor-in-possession or trustee files the tax return, the tax is

payable from estate assets with administrative priority, a point this note of history does not concern.

The Halls' interpretation of the Bankruptcy Code is consistent with the I.R.C., as well as venerable bankruptcy law. The I.R.C. ties the duty to pay federal income taxes to the duty to file a tax return. *Holywell*, 503 U.S. at 52. The Government says a corporate Chapter 11 or 12 debtor is liable for such taxes despite the lack of a separate taxable entity because the I.R.C. requires a corporation's trustee to file tax returns. Resp. 26, citing I.R.C. 6012(b)(3). But in nearly all such cases, the individual debtor is a debtor-in-possession with no trustee, just like individual reorganization cases. The person in control of the bankruptcy case and estate must file the tax return and is responsible for ensuring taxes are paid, with no limitation to corporate cases. *See* 28 U.S.C. 960 (persons conducting business under federal court authority taxed as if conducting a private business); *Nicholas*, 384 U.S. 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.").

That does not mean the personal money of the individual filing that return is used for payment, in the absence of "responsible person" liability under I.R.C. 6672. Bankruptcy estate funds are used, with taxes incurred in estate administration paid before lower-priority charges. *See, e.g., Nicholas*, 384 U.S. at 699 (administrative expense tax claims "payable only if there are sufficient assets to pay prior expenses"); *In re Samuel Chapman, Inc.*, 394 F.2d 340, 341-42 (2d

Cir. 1968) (estate funds for postpetition taxes during debtor-in-possession and trustee administrative periods); *Ill. Dep't of Revenue v. Schechter*, 195 B.R. 380, 384-85 (Bankr. N.D. Ill. 1996) (Chapter 11 trustee not personally liable for failure to pay postpetition taxes when insufficient estate funds); *see also* 11 U.S.C. 524(a)(1) (discharge under Chapter 12 and other chapters voids "personal liability of the debtor with respect to any debt discharged"); I.R.C. 6903(a) (person's fiduciary assumes powers and rights in respect of such person's taxes "except that the tax shall be collected from the estate of such other person").

The Government is mistaken in advocating that postpetition employment taxes are treated differently under the Bankruptcy Code than a debtor's income taxes based on income earned by use or sale of bankruptcy estate assets. Resp. 27-30. Both are "costs ordinarily incident to operation of a business" and thus accorded administrative expense status under longstanding bankruptcy law. *See Reading Co. v. Brown*, 391 U.S. 471, 483-84 (1968) (taxes and all other operating costs); *In re Luster*, 981 F.2d 277, 280-81 (7th Cir. 1992) ("taxes on gains realized on sales of property during the administration of the estate" are "costs and expenses of administration" under the 1898 Bankruptcy Act). Section 503(b)(1)(B) applies to "*any tax* incurred by the estate . . . including property taxes." (emphasis added). *Holywell* concerned income taxes from sales of bankruptcy estate assets. *Holywell*, 503 U.S. at 50-51; *see also Boteler v. Ingels*, 308 U.S. 57, 61 (1939) (automobile license taxes); *Nicholas*, 384 U.S. at 679-80 (excise and employment

taxes); *Palmer v. Webster & Atlas Bank*, 312 U.S. 156, 163 (1941) ("What Congress intended was that a business in receivership, or conducted under court order, should be subject to the same tax liability as the owner would have been if in possession and operating the enterprise.") As shown by the cases and IRS position statements cited in the Opening Brief, this is a point the IRS has repeatedly supported, advocating for administrative expense priority treatment of postpetition tax claims. Pet. Br. 48-49. While some cases concerned employment taxes, others concerned income taxes on bankruptcy estate asset sales. *Holywell*, 503 U.S. at 50-51. The IRS memoranda cited by the Government stating that there is no Chapter 12 provision for filing postpetition proofs of claim, unlike Section 1305, is both accurate and irrelevant to seeking and enjoying administrative expense treatment for postpetition tax claims that require no such filing. Resp. 24-25; 11 U.S.C. 503(b)(1)(B).

B. Bankruptcy Code Legislative History Supports the Halls.

The legislative history of Sections 507(a) and 503(b)(1)(B) regarding administrative priority of "any tax incurred by the estate" and including capital gains taxes from estate asset sales does indeed precede the enactment of I.R.C. provisions for some bankruptcy estates being separate taxable entities. Resp. 39-40. This shows Congress intended administrative priority treatment for such taxes in all cases for all debtors. The Government cites nothing in the history of the

I.R.C. provisions showing any intent to alter that payment source, payment priority, or long-standing bankruptcy law. To the contrary, the legislative history of I.R.C. 6658 shows that when Congress enacted I.R.C. 1398 and 1399 it considered taxes "incurred by the estate" and "administrative expenses" to be interchangeable concepts without nuanced distinctions between types of cases and debtors. Pet. Br. 20-21.

The legislative history of Section 1222(a)(2)(A) shows that the lead sponsor of that provision (and BAPCPA generally) explained to his colleagues in Congress – including when they first passed it in 2000 – that (i) it applied to capital gains taxes "generated during a bankruptcy reorganization," and (ii) without it, such taxes would have to be paid as priority claims, and the applicable taxing authority could block any farmer's reorganization plan that did not do so. *See* 145 CONG. REC. S727, S764 (1999) (statement of Sen. Charles Grassley) and Pet. Br. 22-28. *See also* NORTON, *supra*, 130:6 (prior to 2005 enactment, capital gains taxes from sale or deed-back of collateral to a secured creditor had to be paid in full, causing many family farmer plans to be denied confirmation, citing *inter alia In re Sprecht*, copied in Professors' Amicus Brief).

The Government repeatedly cites to portions of the Bankruptcy Code legislative history on Section 346 concerning state and local taxation. Resp. 22, 23, 31, 34-36. The Government implies that certain language related to Section 503 on administrative priority. Resp. 22. The cited text concerns only Section 346. The discrepancy between responsibility to file a

return and arrange for payment referenced there, and the source of funds to pay and priority rights to such funds over other creditors, is brought home by the 1978 version of Section 346(e) and its legislative history. That subsection read:

> (e) *A claim allowed under section* 502(f) or *503 of this title, other than a claim for a tax that is not otherwise deductible* or a capital expenditure that is not otherwise deductible, *is deductible by the entity to which income of the estate is taxed* unless such claim was deducted by another entity, and a deduction for such claim is deemed to be a deduction attributable to a business.

Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, ch. 3, §346(e), 92 Stat. 2549, 2566 (1978) (emphasis added). In more common language, the legislative history explained the tax reference as follows:

> It is important to point out that there are *two kinds of administrative expenses that are not deductible* under section 346(e) of title 11. First, a claim for a tax that is not otherwise deductible, such as State tax on a State tax return or *Federal tax on a Federal tax return*, is excluded when appropriate.

H.R. REP. NO. 95-595, at 278 (1977), *as reprinted in* 1978 U.S.C.C.A.N. 5963, at 6235. The "entity to which income of the estate is taxed," be it a separate entity in certain individual cases for state and local tax purposes, or the single entity of a corporate or individual debtor in other cases, could deduct some Section 503 administrative expenses on its tax returns. But tax

payments are one kind of administrative expense that cannot be deducted on tax returns. Tax payments must be administrative expenses in the first place or the exclusionary language in Section 346(e) would have been unnecessary. Subsection (e) was removed from Section 346 in 2005, but similar language remains in I.R.C. 1398(h)(1). *See* William Tatlock, *Discharge of Indebtedness, Bankruptcy and Insolvency*, TAX MANAGEMENT 540-3RD, at A54 (2009) (comparing former 346(e) to I.R.C. 1398(h)(1)); *id.* at A53 ("[F]ederal income taxes are not deductible (disallowed under [I.R.C.] §275), even though taxes are allowable as administrative expenses."). Single taxable entities consisting of the debtor-in-possession and his/its estate are taxed during estate administration, and pay the taxes from estate assets on an administrative priority basis.

III. The Halls' Interpretation is Consistent With Bankruptcy Law.

The Halls agree with the Government that when interpreting BAPCPA, the Court "will not read the Bankruptcy Code to erode past bankruptcy practice absent a clear indication that Congress intended such a departure." *Hamilton v. Lanning*, 130 S.Ct. 2464, 2473 (2010) (quoting *Travelers Cas. & Surety Co. of Am. v. Pac. Gas & Elec. Co.*, 549 U.S. 443, 454 (2007)); Resp. at 19. There is no such indication in the BAPCPA provisions at issue here. Under long-standing bankruptcy practice, taxes from bankruptcy asset sales and other debts incurred during administration of a reorganization hold high priority entitlement

to payment from the bankruptcy estate *res*. Such expenses are payable by the debtor-in-possession or trustee in the ordinary course without court approval, and if still unpaid when a plan is confirmed, must be satisfied as priority claims under the plan. The debtor-in-possession is discharged from all such debts addressed in the plan upon confirmation in Chapter 11 cases and plan completion in Chapter 12 and 13 cases. The debtor-in-possession is not personally liable for such debts any more than a trustee, except to the extent they are non-dischargeable and not satisfied under the plan.

These are fundamental principles of bankruptcy, and Congress did not intend to alter them when enacting I.R.C. 1398, 1399 creating separate taxable entities in some cases, and retaining single taxable entity status in others. Interpreting Section 507(a)(2) as not including postpetition income taxes would mean a substantial Treasury loss in large and extended Chapter 11 cases, and in most liquidating Chapter 11 and Chapter 7 cases where there is no ongoing debtor to pay taxes. *See* Dawes Amicus Brief. Section 507(a)(2) applies to all bankruptcy debtors and chapters. Disrupting all bankruptcy cases to advance a narrow IRS focus on limiting the effect of Section 1222(a)(2)(A) is hazardous.

Congress understood that capital gains taxes from sales of family farms shortly before and during a bankruptcy case would result in priority claims that had to be paid in full to confirm a Chapter 12 plan, in accordance with time-honored law, Bankruptcy Code

provisions and IRS advocacy in the courts, and with no distinction among farmers operating as sole proprietors, partnerships, corporations or LLCs. Section 1222(a)(2)(A) was written broadly to provide an exception to all priority taxes from farm asset sales 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. It does not reference I.R.C. "taxable entities," and the I.R.C. should not prevent implementation of Congressional intent to help distressed family farmers.

Respectfully submitted,

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