No. 10-875

In the Supreme Court of the United States

LYNWOOD D. HALL AND BRENDA A. HALL,
PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE UNITED STATES

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QUESTION PRESENTED

Whether 11 U.S.C. 1222(a)(2)(A) authorizes the bankruptcy court, in a case brought under Chapter 12 of the Bankruptcy Code, to treat as a dischargeable non-priority claim a federal tax debt arising out of the debtor's post-petition sale of a farm asset.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1-17) is reported at 617 F.3d 1161. The opinion of the district court (Pet. App. 18-33) is reported at 393 B.R. 857. The opinion of the bankruptcy court (Pet. App. 34-46) is reported at 376 B.R. 741.

JURISDICTION

The judgment of the court of appeals was entered on August 16, 2010. A petition for rehearing was denied on October 1, 2010 (Pet. App. 47). The petition for a writ of certiorari was filed on December 30, 2010. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. a. Chapter 12 of the Bankruptcy Code addresses debts of family farmers and fishermen. Pursuant to the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA), Pub. L. No. 109-8, 119 Stat. 23, Section 1222(a)(2)(A) of the Code permits family farmers to treat certain governmental claims resulting from the disposition of farm assets as general unsecured claims, which are not entitled to priority status and are dischargeable after less than full payment under the bankruptcy plan. Section 1222 provides in relevant part:

> § 1222. Contents of Plan
>
> (a) The plan shall—
>
> * * * * *
>
> (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.

11 U.S.C. 1222(a)(2)(A).

Section 507, in turn, accords priority status to enumerated categories of claims and expenses. In relevant part, Section 507 states that "[t]he following expenses and claims have priority in the following order: * * *

second, administrative expenses allowed under Section 503(b) of this title." 11 U.S.C. 507(a)(2). Section 503(b) includes in its enumeration of allowable administrative expenses "any tax * * * incurred by the estate." 11 U.S.C. 503(b)(1)(B)(i).[1]

b. Section 1399 of the Internal Revenue Code states that "[e]xcept in any case to which section 1398 applies, no separate taxable entity shall result from the commencement of a case under [the Bankruptcy Code]." 26 U.S.C. 1399. Section 1398 applies, with certain exceptions that are not relevant here, to "any case under chapter 7 (relating to liquidations) or chapter 11 (relating to reorganizations) of [the Bankruptcy Code] in which the debtor is an individual." 26 U.S.C. 1398(a).

2. a. On August 9, 2005, petitioners filed for Chapter 12 bankruptcy relief.[2] The bankruptcy court granted petitioners' motion to sell their 320-acre farm for $960,000, and the ensuing post-petition sale produced a capital-gains federal income tax liability in the amount of $29,000. As set forth in their first amended plan, petitioners proposed to treat the tax debt as a dischargeable unsecured liability. The United States objected to the proposed treatment of petitioners' post-petition tax debt. The government argued that, in part because a Chapter 12 bankruptcy estate does not constitute a sep-

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[1] Section 503(b) excepts taxes specified in Section 507(a)(8), which accords separate priority to certain pre-petition taxes. There is no dispute that the taxes at issue in this case arose after the filing of the bankruptcy petition, so Section 507(a)(8) is not at issue in this case.

[2] Although most of BAPCPA's amendments apply only to cases filed on or after October 17, 2005, Section 1222(a)(2)(A) became effective on the date of BAPCPA's enactment, April 20, 2005. Pub. L. No. 109-8, § 1003(c), 119 Stat. 23, 186. Accordingly, Section 1222(a)(2)(A) governs this case if it is otherwise applicable. Pet. App. 35 n.2.

arate taxable entity that can incur post-petition income tax liabilities, the debt was not dischargeable in bankruptcy but would instead remain the independent responsibility of petitioners. Pet. App. 35.

Petitioners argued that a Chapter 12 debtor can treat post-petition income taxes as administrative expenses of the bankruptcy estate under Section 503, and that such expenses are stripped of priority by Section 1222(a)(2)(A) and therefore may be discharged after less than full payment, even though a Chapter 12 estate is not a separate taxable entity. Pet. App. 36, 41 (citing *In re Knudsen*, 356 B.R. 480, 489-492 (Bankr. N.D. Iowa 2006), aff'd in part, rev'd in part, 389 B.R. 643 (N.D. Iowa 2008), aff'd, 581 F.3d 696 (8th Cir. 2009)). Petitioners noted that the bankruptcy court in *Knudsen* had accepted that contention, based on its view that Congress intended Section 1222(a)(2)(A) to lessen the burdens imposed by both pre-petition and post-petition taxes arising from the sale of farm assets. *Id.* at 45.

b. The bankruptcy court sustained the government's objection to petitioners' proposed Chapter 12 plan. Pet. App. 34-46. The court agreed with the government that the applicability of Section 1222(a)(2)(A) turned on whether the post-petition tax liability could be "incurred by the estate" pursuant to 11 U.S.C. 503(b)(1)(B). Pet. App. 37-39. The court explained that, given the interplay between the Bankruptcy Code and the Internal Revenue Code, Section 503(b)(1)(B)(i) must be read consistently with 26 U.S.C. 1398 and 1399. Sections 1398 and 1399 of the Internal Revenue Code establish that a Chapter 12 bankruptcy filing does not create a separate taxable entity. The bankruptcy court held that, in light of those provisions, "the capital gains tax arising from the postpetition sale of the farm land cannot be a

tax 'incurred' by the Chapter 12 Estate under § 503(b)(1)(B)(i)." Pet. App. 44; see *id.* at 42-44 (citing *In re Brown*, No. 05-41071, 2006 WL 3370867 (Bankr. D. Mass. Nov. 20, 2006) (finding that a Chapter 13 estate cannot be held liable for capital gains tax because it does not exist as a taxable entity)). The court observed that its ruling would not render Section 1222(a)(2)(A) superfluous because, "as written, § 1222(a)(2)(A) creates an exception for priority claims arising from the *prepetition* sale, transfer or exchange of farm assets." *Id.* at 45-46.

c. The district court reversed. Pet. App. 18-33. The district court agreed with the conclusion of the bankruptcy court in *In re Dawes*, 382 B.R. 509 (Bankr. D. Kan. 2008), aff'd, 415 B.R. 815 (D. Kan. 2009), appeal pending, No. 09-3129 (10th Cir.), which had rejected the government's argument that Section 503(b)(1)(B)(i) requires the existence of a separate taxable estate. Pet. App. 30. The district court quoted *Dawes* for the proposition that "[a]lthough IRC §§ 1398 and 1399 were in place at the time of BAPCPA, this court has been unable to find any Chapter 12, or even any Chapter 7 or Chapter 11 case, where those IRC provisions were held to be relevant to the construction of the definition of administrative claim in § 503(b)(1)(B)(i)." *Ibid.* (quoting 382 B.R. at 520). The court also agreed with the bankruptcy courts in *Knudsen* and in *In re Schilke*, 379 B.R. 899 (Bankr. D. Neb. 2007), aff'd, 2008 WL 4224279 (D. Neb. Sept. 9, 2008), aff'd, *sub nom. Knudsen* v. *IRS*, 581 F.3d 696 (8th Cir. 2009), both of which had relied in part on legislative history in concluding that 11 U.S.C. 1222(a)(2)(A) applies to post-petition as well as pre-petition taxes. Pet. App. 31.

3. The court of appeals reversed the district court's judgment. Pet. App. 1-17. The court explained that, because a Chapter 12 estate is not a separate taxable entity under Sections 1398 and 1399 of the Internal Revenue Code, "a chapter 12 estate cannot incur taxes." *Id.* at 6. The court relied in part on case law reaching the same conclusion for Chapter 13 estates. *Ibid.* (citations omitted). The court concluded that "[b]ecause a chapter 12 estate cannot 'incur' a tax," petitioners' post-petition tax liability does not constitute an "administrative expense" within the meaning of Section 503(b) (thereby entitled to priority treatment under Section 507(a)(2)), and petitioners therefore "cannot get the benefit of section 1222(a)(2)(A)." *Ibid*.

The court of appeals recognized that its conclusion was contrary to that reached by the Eighth Circuit in *Knudsen* v. *IRS*, 581 F.3d 696 (2009), but the court found the Eighth Circuit's reasoning unpersuasive. Pet. App. 8-13. In particular, the Ninth Circuit disagreed with the Eighth Circuit's refusal to look to the Internal Revenue Code when determining whether a post-petition tax debt was "incurred by the estate." *Id.* at 11-13. The Ninth Circuit noted that the Bankruptcy Code standing alone does not resolve whether a Chapter 12 estate can incur taxes, and that "Congress has indicated repeatedly that it is aware that the taxable entity provisions in the Internal Revenue Code are relevant to the Bankruptcy Code." *Id*. at 12.

The Ninth Circuit also noted that petitioners could not avoid the post-petition tax liability simply by including that liability in their plan, because "the Bankruptcy Code places limits on the liabilities a plan may address." Pet. App. 8 n.2. Citing Section 1227 of the Bankruptcy

Code, the court explained that a Chapter 12 plan generally is limited to pre-petition claims. *Ibid*.

Judge Paez dissented. Pet. App. 16-17. Based on his view that Congress intended Section 1222(a)(2)(A) to help family farmers, "regardless of whether they sold the assets before or after filing their Chapter 12 petition," he would have held that petitioners could "treat the capital gains taxes arising from the post-petition sale of their farm assets as an unsecured claim." *Id.* at 16.

ARGUMENT

The court of appeals correctly held that petitioners could not obtain a discharge, through their Chapter 12 bankruptcy plan, of a tax liability arising from their post-petition sale of a farm asset. In Chapter 12 (and Chapter 13) bankruptcy proceedings, the general rule is that liabilities incurred after the petition is filed are not dischargeable in bankruptcy. The provision of law on which petitioners rely, 11 U.S.C. 1222(a)(2)(A), does not establish an exception to that general rule, but rather applies only to claims that arise before the bankruptcy petition is filed.

Although the decision below is correct, another court of appeals, the Eighth Circuit, has resolved the question presented in a contrary manner, and the same issue is presented in several cases pending in the lower courts. In light of the square circuit conflict, and the importance of uniform administration of federal tax and bankruptcy laws, the petition for a writ of certiorari should be granted.

1. The court of appeals correctly held that petitioners could not include in the Chapter 12 plan and treat as

a dischargeable non-priority claim a tax liability arising from their sale of farm property.

a. The asset sale at issue took place, and petitioners thereby incurred liability for federal income tax on the resulting capital gain, after their Chapter 12 bankruptcy petition had been filed. Pet. App. 2. "As a general rule, bankruptcy proceedings do not address postpetition claims: 'The basic scheme of the Bankruptcy Code is to affect claims arising prior to the filing of the petition under title 11.'" *United States* v. *Ripley*, 926 F.2d 440, 443 (5th Cir. 1991) (quoting 5 Lawrence P. King, *Collier on Bankruptcy* ¶ 1305.01[1] (15th ed. 1988) (footnotes omitted)).

The specific provisions of Chapter 12 reinforce that general principle. A Chapter 12 plan does not bind holders of post-petition liabilities, but rather binds "creditors." See 11 U.S.C. 1227(a) ("the provisions of a confirmed plan bind the debtor, each creditor, each equity security holder, and each general partner in the debtor"); see also 11 U.S.C. 501(a) (stating that a "creditor" may file a "proof of claim"). As the court of appeals noted (Pet. App. 8 n.2), the Bankruptcy Code defines a "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), *i.e.*, a holder of a *pre*-petition claim.[3] Although the term "creditor" also includes holders of the few post-petition claims expressly designated in 11 U.S.C. 101(10)(B), the type of post-petition tax liability at issue in this case is not among them.

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[3] The commencement of a case, *i.e.*, the filing of the bankruptcy petition, constitutes the order for relief in a voluntary bankruptcy case. 11 U.S.C. 301.

Section 507(a)(8)(A) of the Bankruptcy Code designates certain *pre*-petition income tax debts as priority claims. 11 U.S.C. 507(a)(8)(A). Under Section 1222(a)(2), a Chapter 12 plan must "provide for the full payment, in deferred cash payments, of all claims entitled to priority under section 507." 11 U.S.C. 1222(a)(2). *Post*-petition income tax liabilities do not trigger that requirement—*i.e.*, a Chapter 12 plan does not provide for payment of such claims and such debts are not dischargeable in a Chapter 12 bankruptcy. Rather, they remain personal obligations of the individual debtor, subject to collection through such mechanisms as are otherwise available outside the framework of the bankruptcy case.

b. Section 1222(a)(2)(A) does not alter the established distinction between pre-petition and post-petition debts, nor does it bring within a Chapter 12 case debts that would otherwise be subject to collection outside the bankruptcy framework. The special relief offered by Section 1222(a)(2)(A) is an exception to Section 1222(a)(2)'s preexisting general rule that a Chapter 12 plan must provide for full payment of "claims entitled to priority under section 507." 11 U.S.C. 1222(a)(2). Section 1222(a)(2)(A) provides that certain debts resulting from the disposition of farm assets "shall be treated as * * * unsecured claim[s] that [are] not entitled to priority." 11 U.S.C. 1222(a)(2)(A). That provision allows the bankruptcy court to confirm a Chapter 12 plan even though it does not provide for full payment of claims that would otherwise be entitled to priority under Section 507, and it permits the eventual discharge of such claims after the debtor has made all payments required by the plan. See 11 U.S.C. 1228(a).

As an exception to Section 1222(a)(2), however, Section 1222(a)(2)(A) is necessarily limited to the types of claims that would otherwise be covered by a Chapter 12 plan. Section 1222(a)(2)(A) strips certain claims of priority status, and thus divests the creditor of his right to full payment, but it does not bring within the Chapter 12 case any claims that would otherwise be collected outside the bankruptcy framework. Although the Bankruptcy Code provides for payment of certain post-petition administrative expenses,[4] post-petition income taxes (like most other post-petition debts) remain the personal responsibility of individual Chapter 12 debtors. Section 1222(a)(2)(A) does not alter that pre-existing rule.

c. As set forth above (pp. 2-3, *supra*), Section 1222(a)(2)(A) applies to certain governmental claims that would otherwise constitute priority claims under Section 507. Section 507 enumerates ten categories of expenses and claims that are entitled to priority status, including two categories that address taxes: (1) claims for certain pre-petition taxes (11 U.S.C. 507(a)(8)), and (2) administrative expenses (11 U.S.C. 507(a)(2)), which include certain taxes (11 U.S.C. 503(b)(1)(B)). Because the tax at issue in this case arises out of a sale of land

[4] Chapter 12 establishes a special procedure for the payment of post-petition administrative expenses. Section 1226(b)(1) states that "[b]efore 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. 1226(b)(1). Section 1226(b)(1) thus ensures that holders of post-petition obligations of the kind specified in Section 507(a)(2)—*i.e.*, administrative expenses such as payments owed to bankruptcy professionals, see 11 U.S.C. 503(b)—are paid in full even though those obligations arise after the filing of the bankruptcy petition. Accordingly, the government's interpretation of Section 1222(a)(2)(A) is fully consistent with the Code's policy of providing for payment of post-petition administrative expenses.

after the filing of the Chapter 12 petition, Section 507(a)(8) does not apply. See note 1, *supra*. To trigger special treatment under Section 1222(a)(2)(A), therefore, the post-petition tax must fall under Section 507(a)(2), *i.e.*, qualify as an "administrative expense[] allowed under section 503(b)." 11 U.S.C. 507(a)(2). Section 503(b), in turn, covers in relevant part "any tax * * * incurred by the estate." 11 U.S.C. 503(b)(1)(B).

Assuming administrative expenses are covered by Section 1222(a)(2) at all, the question becomes whether the tax at issue was "incurred by the estate." That inquiry, which is informed by the Internal Revenue Code, depends on the chapter under which bankruptcy protection is sought and on the nature of the debtor. A bankruptcy filing generally does not create a separate taxable entity, 26 U.S.C. 1399, except in the instance of an individual debtor who files for Chapter 7 or Chapter 11 bankruptcy protection, 26 U.S.C. 1398. See p. 3, *supra*.[5] Because no separate taxable entity exists for an individual Chapter 12 debtor, and no other provision (in either the Bankruptcy Code or the Internal Revenue Code) imposes income tax liability on a Chapter 12 estate,[6] the court of appeals correctly concluded that any post-peti-

[5] The provisions of 26 U.S.C. 1398 and 1399 apply only to income taxes, and income taxes are at issue in this case. This case does not present the question whether other federal taxes may be incurred by the estate in a Chapter 12 case.

[6] Under 26 U.S.C. 6012(b)(3), a corporation's bankruptcy trustee is responsible for filing the debtor corporation's federal income tax returns. See also 11 U.S.C. 704(a)(8), 1106(a)(1), 1203. Under the Internal Revenue Code, the duty to make the tax return causes the estate to be liable for the federal income tax. See 26 U.S.C. 6151(a); *Holywell Corp.* v. *Smith*, 503 U.S. 47, 52 (1992); see also 28 U.S.C. 960. Thus, in the case of corporate debtors, federal income taxes are "incurred by the estate."

tion taxes arising out of petitioners' sale of farm assets could not have been "incurred by the estate." See Pet. App. 6a-7a. That conclusion is reinforced by case law establishing that a Chapter 13 estate, which is treated identically to a Chapter 12 estate by Sections 1398 and 1399, cannot incur taxes. See, *e.g.*, *In re Whall*, 391 B.R. 1, 5-6 (Bankr. D. Mass. 2008); *In re Brown*, No. 05-41071, 2006 WL 3370867, *3 (Bankr. D. Mass. Nov. 20, 2006); *In re Gyulafia*, 65 B.R. 913, 916 (Bankr. D. Kan. 1986).

Acceptance of petitioners' position would also create an unwarranted conflict between Sections 1222(a)(2) and 1226(b)(1) of the Bankruptcy Code. Section 1226(b)(1) provides that unpaid claims for administrative expenses must be paid "[b]efore or at the time of each payment to creditors under the plan," 11 U.S.C. 1226(b)(1); see note 4, *supra*, and it contains no exception for debts owed to governmental units arising from the sale of farm assets. If petitioners' post-petition tax debt is held (as petitioners urge) to be a claim for administrative expenses covered by Section 507(a)(2), then Section 1222(a)(2)(A) allows it to be treated as an unsecured non-priority claim (thereby rendering it dischargeable after less than full payment), while Section 1226(b)(1) requires it to be paid at or before the time payments are made to other creditors. If properly confined to pre-petition liabilities, by contrast, Section 1222(a)(2)(A) creates no such conflict, since pre-petition debts cannot qualify as administrative expenses.

2. Although the decision of the court of appeals is correct, the petition for a writ of certiorari should be granted to resolve a square circuit conflict on the question presented.

a. As petitioner explains (Pet. 7-10), the Ninth Circuit's decision below conflicts with that of the Eighth Circuit in *Knudsen* v. *IRS*, 581 F.3d 696 (2009). See Pet. App. 8-13. The Eighth Circuit concluded that Section 1222(a)(2)(A) applies to federal tax liabilities arising out of a Chapter 12 debtor's post-petition sale of a farm asset. *Knudsen*, 581 F.3d at 704-710. The Eighth Circuit rejected the argument (endorsed by the Ninth Circuit, Pet. App. 8 n.2) that the Bankruptcy Code limits the scope of the liabilities encompassed by a Chapter 12 plan to those arising before the petition is filed. The Eighth Circuit concluded that "nothing in [Section 1222(a)(2)(A)] restricts its application to only those dispositions that occur before the debtor files his bankruptcy petition." 581 F.3d at 706. The Eighth Circuit also rejected the argument (adopted by the Ninth Circuit, Pet. App. 6-7) that because 26 U.S.C. 1398 and 1399 establish that a Chapter 12 bankruptcy does not result in a separate taxable entity, the estate cannot incur taxes as needed to trigger Section 1222(a)(2)(A). 581 F.3d at 708-710. In rejecting that contention, the Eighth Circuit interpreted the phrase "incurred by the estate" in Section 503(b)(1)(B)(i) to mean simply "incurred post-petition." *Id.* at 708.

b. Although the Eighth and Ninth Circuits are the only two courts of appeals to have decided the question presented, the same question is presented in two cases pending in the Tenth Circuit,[7] and several similar cases are pending before various bankruptcy and district courts. The recent proliferation of these cases reflects the upward trend in Chapter 12 bankruptcy filings. See

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[7] *In re Dawes*, No. 09-3129 (10th Cir. argued Nov. 17, 2010); *Ficken* v. *IRS*, No. 10-1276 (10th Cir. oral argument unscheduled).

Pet. 16-17. In terms of its impact on the United States Treasury, the amount of tax liability at issue in any particular case of this nature is typically modest. There is, however, a significant governmental and public interest in the uniform administration of federal tax and bankruptcy laws. Accordingly, the United States agrees that this Court should grant review to resolve the conflict between the Eighth and Ninth Circuits regarding the proper treatment in Chapter 12 bankruptcy proceedings of post-petition tax liabilities resulting from the sale of farm assets.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

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