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Chapter 12 Bankruptcy Taxation: Did BAPCPA Really Change Tax Claims to Unsecured General Creditor Status?

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Overview

The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA)[1] is the most farreaching revision of bankruptcy law since 1978. With respect to agriculture, the changes are principally in two areas – (1) amendments to the eligibility requirements for Chapter 12 filing; and (2) modification of the income tax treatment of gains on property liquidated in connection with a Chapter 12 bankruptcy reorganization. Also, effective July 1, 2005, BAPCPA makes Chapter 12 a permanent part of the bankruptcy code.

Income Tax Issues For Debtors in Chapter 12 Bankruptcy

For gain or loss triggered on sale or other turnover of assets to creditors, there is no exception to the rule of income recognition. That can cause problems for a farm debtor that has filed Chapter 12 bankruptcy and is proposing to downsize the farming operation as a means of reorganizing debts, paying off creditors and continuing the farming operation.

Confirmation of the Chapter 12 Plan – The Issue of Feasibility

Tax liability of a Chapter 12 debtor can play a significant role in getting a Chapter 12 plan confirmed. Unless the time limit is extended by the court, the confirmation hearing is to be concluded not later than 45 days after the plan is filed. The court is required to confirm a plan if:

1. The plan conforms to all bankruptcy provisions;
2. All required fees have been paid;
3. The plan proposal was made in good faith without violating any law;
4. Unsecured creditors receive not less than the amount the unsecured creditors would receive in a Chapter 7 liquidation;
5. Each secured creditor either accepts the plan, retains the lien securing the claim (with the value of the property to be distributed for the allowed amount of the claim, as of the effective date of the plan, to equal not less than the allowed amount of the claim), or the creditor receives the property; and
6. The debtor will be able to make all payments under the plan and to comply with the plan.

If the court determines that the debtor will be unable to make all payments as required by the plan, the court may require the debtor to modify the plan, convert the case to a Chapter 7, or request the court to dismiss the case.

As noted above, one of the requirements for confirmation is that the debtor "be able to make all payments under the plan and to comply with the plan." This feasibility standard requires the bankruptcy court to determine whether the plan offers a reasonable prospect of success and is workable. The debtor bears the burden of proof in meeting the feasibility requirement. The court considers the farm's earning power, capital structure, economic conditions, managerial efficiency and whether the same management will continue operations. In addition, the debtor's income and expense projections may be considered in conjunction with their actual past performance to determine feasibility of the proposed plan.

Pre-BAPCPA Tax Treatment

Before amendment by BAPCPA, the deed-back of collateral to a secured creditor as well as asset sales conducted in an attempt to downsize a farming operation, carried with it tax consequences to the debtor that could negatively impact the feasibility of the debtor's reorganization plan. Such taxes were a priority claim in the bankruptcy estate and had to be paid in full on a deferred basis.[2] Thus, if as part of a proposed reorganization plan the debtor proposed to downsize the farming operation by selling assets or turning them back over to secured creditors, the tax liability triggered by such sales and other transfers often impacted significantly the feasibility of the debtor's plan if the debtor did not have the means to pay the taxes (which was likely). The result was likely to be that the debtor's reorganization plan would not be confirmed.[3]

BAPCPA Chapter 12 Tax Provision

Under BAPCPA, a Chapter 12 debtor can treat claims arising out of "claims owed to a governmental unit" as a result of "sale, transfer, exchange, or other disposition of any farm asset used in the debtor's farming operation" as an unsecured claim that is *not entitled to priority* under Section 507(a) of the Bankruptcy Code, provided the debtor receives a discharge.[4] The provision became effective upon enactment – April 20, 2005. The amended statutory language specifies that a Chapter 12 plan must:

(1) 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;…[5]

From a policy standpoint, the Congress has chosen to recognize the uncollectability of the majority of the income taxes occasioned by the sale of a farm debtor's assets used in the farming operation. The impact of the revision is to provide financially strapped family farmers the opportunity to downsize and restructure their farming operations without the necessity of paying taxes in full. It is also important to note that the provision only applies to farm assets and does not apply to assets used in a commercial fishing operation.

The amendment was designed to address a major problem faced by many family farmers filing Chapter 12 bankruptcy – the sale of farm assets to make the farming operation economically viable triggered taxable gain which, as a priority claim, had to be paid in full to confirm a Chapter 12 plan. Even though the priority tax claims could be paid in full in deferred payments under prior law, in many instances the debtor still could not meet this requirement, thus giving the IRS a virtual veto power of the debtor's plan. The Congress, with passage of 11 U.S.C. §1222(a)(2)(A) sought to limit this veto power.[6]

Unfortunately, the new statutory provision does not detail the procedure a debtor is to follow to take advantage of the non-priority claim treatment. One possible approach, for debtors that liquidate assets used in the farming operation within the tax year of filing or liquidate assets used in the farming operation after the filing as a part of the Chapter 12 plan and depreciation recapture and capital gains taxes are incurred, is to provide in the reorganization plan that there shall be no payments to unsecured creditors until the amount of the tax owed to governmental bodies for the sale of assets used in the farming operation is ascertained. Then, the 11 U.S.C. §1222(a)(2) claims would be added to the pre-petition unsecured claims to determine the percentage distribution to be made to the prepetition unsecured claims as well as the claims of the governmental units that are being treated as unsecured creditors not entitled to priority. Thus, all claims that 11 U.S.C. §1222(a)(2) requires to be treated the same[7] are treated equitably.

Similarly, if the debtor determines post-confirmation that in order to ensure financial viability, assets used in the farming operation must be liquidated, the Chapter 12 plan could be modified to allow the sale of the assets as long as the modified plan made provision to make payment to the taxing bodies in an amount that would pay the appropriate dividend. Then, upon entry of the

Chapter 12 discharge, the governmental taxing body's post-petition claim for taxes on the sale of assets used in the debtor's farming operation would also be discharged.

The *Knudsen*[8] Case

In late 2006, the bankruptcy court for the Northern District of Iowa rendered an opinion in the first Chapter 12 case involving the application of 11 U.S.C. §1222(a)(2) as amended by BAPCPA. Under the facts of the case, the debtors (a married couple) had been farming since 1983. They had always utilized the cash method of accounting for the farming business. The debtors owned 160 acres with two large hog finishing setups on them. For many years, the debtors operated a farrow-to-finish operation, but had changed the business to a contract hog operation pursuant to a contract with a supplier, Squealers Pork, Inc., under which they were paid $14,000 per month. When hogs are in the buildings, the debtors care for the hogs according to Squealers' protocol. Squealers provides the feed, veterinary care and marketing for its pigs.

The debtors also farmed cropland in conjunction with the husband's father and brother, and shared machinery and labor. The debtors grew corn and soybeans on the portion of their property not occupied by hog buildings, and rented two additional farms consisting of approximately 300 acres for crop production.

In the late 1990s, the debtors' hog herd suffered from significant outbreaks of disease, and the husband was injured in a farm accident that immobilized him for several months. Consequently, the debtors' bank started pushing them to cease operations. Over the years, the debtors had also amassed significant debt with their feed suppliers, but were able to restructure most of that indebtedness.

2003-2004 change in operations. The debtors made a fundamental change in their farming operation beginning in 2003. In an attempt to derive steady income from the farming operations, they located a swine integrator to provide pigs for their nursery buildings and pigs for their finishing houses for them to care for on a custom basis. As a result, they sold their sows, discontinued farrowing, and also sold all of their fat hogs. The wind-down of the farrow-to-finish operation began in late 2003 and was completed in September of 2004 when the last of the fat hogs were sold. The contract-feeding arrangement began in May of 2004 in the nursery buildings and went into full swing in the finishing buildings in July of 2004. During 2004, the debtors sold their entire hog herd, including $339,487 worth of fat hogs, as well as some of their farming equipment so they could begin the contract feeding arrangement.[9]

Bankruptcy filing and the proposed reorganization plan. A creditor was unwilling to renegotiate a slow repayment of a $70,000 obligation that was not secured by a mortgage on the debtors' real estate, and began litigation against the debtors. Given their financial situation and the pending lawsuit against them by the creditor (that was scheduled to go to trial in early July, 2005), the debtors filed Chapter 12 bankruptcy on July 1, 2005, after the BAPCPA Chapter 12 tax provisions had become effective.

The debtors' reorganization plan proposed the sale of 120 acres and the concentration of efforts on the contract feeding arrangement in an attempt to dramatically reduce indebtedness and increase the debtors' probability of long term success. At the time the reorganization plan was filed, the debtors' income tax basis in the 120 acres was $1,000 per acre and they projected a selling price of $4,000 per acre. At that selling price, the sale of the land would trigger $360,000 of long term capital gain.

The debtors also proposed selling the husband's remainder interest in other real estate to ensure payment to the unsecured creditors of at least as much as the unsecured creditors would be entitled to receive under a chapter 7 liquidation. At the time of filing the reorganization plan, the husband's income tax basis in the remainder was $43,250, with the fair market value pegged at $150,000. Thus, a sale of the remainder interest at its fair market value would trigger long term capital gains of $106,750. The net available to pay unsecured creditors without regard to the payment of income taxes would be $104,806 after deducting the sum owed to the debtors' bank.

The positions of IRS and the debtors in the bankruptcy court. The primary question facing the bankruptcy court was how much of the debtors' tax liability could be treated as an unsecured claim pursuant to 11 U.S.C. §1222(a)(2)(A). As illustrated above, that tax liability had been triggered by the sale of numerous assets including raised sows, a livestock trailer, farrowing equipment, other raised livestock and grain sales.

"Farm assets." IRS took the position that only the sale of *capital assets* qualifies for treatment under 11 U.S.C. §1222(a)(2)(A). Thus, not qualified for non-priority treatment were asset sales the income from which would be reported on Schedule F. Accordingly, the debtors' sale of breeding stock, farrowing equipment and livestock trailer, according to the IRS approach, would be entitled to non-priority treatment under the amended statute, but the sale of their hog inventory in order to facilitate a change in their farming operation would remain a priority claim.

The debtors maintained that the IRS position was contrary to Congressional intent, overly limiting and would render the statute a nullity. The debtors maintained that the legislative history behind the statutory provision illustrates that the Congress contemplated the scaling down of a farming operation to make the operation viable and not have the tax liability impact the feasibility of the debtor's reorganization plan. In addition, the statute was clear in that it did not specifically limit governmental claims to only those taxes resulting from the sale of capital assets.

Pre-petition taxes. While IRS took the position that the amended statute applied to pre-petition taxes, IRS also maintained that the taxes generated by the pre-petition sale of farm assets used in a debtors' farming operation remained collectible after the entry of the Order of Discharge in the Chapter 12 proceeding. IRS based its argument on the rationale that taxes arising from a debtor's prepetition sale of farm assets used in the farming operation are priority taxes. Thus, if any portion of the priority tax is not paid, it is fully collectible together with penalty and interest when the Chapter 12 discharge is entered. IRS maintained that the benefit to farm debtors of the BAPCPA amendment is to merely delay payment of an otherwise priority tax that debtors would have had to pay in the plan under the prior version of Chapter 12. Thus, debtors might be able to make a lower payment and make an otherwise unconfirmable plan confirmable.

Taxes on post-petition asset sales. As for the proposed sale of the 120 acres, IRS took the position that the amended statute did not apply to post-petition taxes. Thus, a debtor would remain liable for the full amount of tax triggered by a sale or other disposition of farm assets utilized in the debtor's farming operation after bankruptcy filing. With respect to the debtors' proposed sale of the remainder interest, the position of the IRS was not clear before the bankruptcy court. The primary issues related to the sale of the remainder interest involve whether the resulting taxes qualified for tax treatment under 11 U.S.C. §1222(a)(2)(A), or whether it is to be treated as a traditional long term capital gain with income taxes due in the year of sale. A related question is whether the sale of the remainder interest constitutes the sale of a "farm asset" used in the debtors' farming operation.

The debtors claimed that the statutory language clearly applied to *all* priority claims under 11U.S.C. §507, including taxes generated by post-petition sales of assets used in the farming operation. In addition, the debtors argued that, under BAPCPA, Chapter 12 filers are given flexibility in making decisions regarding downsizing the farming operation both before and after filing the Chapter 12 petition. The debtors argued that nothing in the legislation limits the timing of the farm debtor's decision as to when the assets used in the farming operation should be disposed, whether pre-petition, post-petition or post confirmation. What is certain is that, irrespective of the timing of the sale of the assets used in the farming operation, the taxing bodies must receive as large a dividend as they would have received if the tax claims arising from the disposition of the assets used in the farming operation were treated as prepetition unsecured claims.

The bankruptcy court's ruling. The bankruptcy court held that the debtors were *not* entitled to favorable tax treatment under the amended statutory language because the statute did not apply to income from the sale of *all* farm assets. Instead, the court agreed with the I.R.S. argument that the statute was limited to sales of farm assets used in the debtor's farming operation within the meaning of I.R.C. §1231(b)(3). As such, the court held that the term "used" in the phrase "…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…" limited the favorable bankruptcy treatment tax treatment afforded Chapter 12 filers in 11 U.S.C. to the sale of capital assets.

However, the court did hold that post-petition sales of farm assets used in the debtors' farming operation qualified for non-priority treatment, and that the debtors could pay *as an administrative expense* the income taxes they incurred during the pendency of the case. So, the debtors could treat a portion of the taxes as non-priority unsecured claims under the plan. Such non-priority unsecured taxes incurred post petition, the court reasoned, could be discharged with the pre-petition unsecured debt after completion of the plan.

Ultimately, the court denied confirmation of the debtors' plan. The debtors appealed the court's decision to the Federal District Court for the Northern District of Iowa.

Primary issues before the District Court.
On appeal, the primary issue involved the construction of a *governmental claims provision* that purports to eliminate the priority and non-dischargeable status of *any claim* by *any governmental unit* that arises as the result of sale, transfer, exchange, or other disposition of any farm asset used in the debtor's farming operation. In *Knudsen*, the specific question was the proper treatment in the context of Chapter 12 of federal income taxes arising from the sale by the debtors of hogs raised for slaughter – in essence, whether 11 U.S.C. §1222(a)(2)(A) is a federal income tax provision (the meaning of which is to be determined consistent with the existing tax code and regulations) or whether it is a governmental claims provision (applicable to both tax and non-tax claims) to be defined in accordance with the Bankruptcy Code.

I.R.S. took the position in the bankruptcy court that the provision is to be defined in accordance with the Tax Code, and the bankruptcy court agreed. However, while Chapter 12 does include a section that specifically references "special taxes,"[10] 11 U.S.C. §1222(a)(2)(A) is not contained within that section. On its face, 11 U.S.C. §1222(a)(2)(A) purports to be a priority provision relating to claims asserted by *any governmental unit* (federal, state and local), not just simply a tax provision, and certainly not a federal income tax provision. Clearly, the Internal Revenue Code should be considered when a Bankruptcy Code provision involves federal taxation, but it is not the only consideration when a Bankruptcy Code provision involves both tax and non-tax creditors, and does not even mention "taxes" in the text of the statute. Looking solely to the Internal Revenue Code to interpret a provision of the Bankruptcy Code (as did the bankruptcy court) that governs *all governmental units asserting a wide variety of tax and non-tax claims* generally runs contrary to rules of statutory construction in general, and the Bankruptcy Code in particular.[11]

The district court was faced with the argument that there are sufficient sources within the Bankruptcy Code to provide a meaningful understanding of 11 U.S.C.§1222(a)(2)(A) without resorting solely (or even at all) to the Internal Revenue Code. Indeed, the phrase "farm assets" has a more expansive definition of the Bankruptcy Code than it does under the Internal Revenue Code. As such, the term would include not only capital assets under I.R.C. §1231, other property that may receive favorable tax treatment and inventory items that would otherwise generate ordinary income under I.R.C. §61. In the *Knudsen* case, the Bankruptcy Code definition of "farm assets" would therefore include the debtors' breeding sows, farm land, any farrowing or other farm equipment, livestock trailers and hogs held for slaughter. Likewise, the phrase "used in the farming business" contained in 11 U.S.C. §1222(a)(2)(A) mirrors similar terminology in 11 U.S.C. §363 involving the use of assets "in the ordinary course of business."[12]

Upon review, the district court held that a "farm asset" that is eligible for non-priority status is not limited to assets used in the taxpayer's trade or business, which are eligible for capital gain treatment under I.R.C. §1231 and §1221. Thus, the debtors' taxes triggered by the sale of slaughter hogs and grain were eligible for non-priority treatment.[13]

The district court was also faced with the question of how the tax claim and priority status amounts are to be determined.[14] In the bankruptcy court, the debtors proposed a marginal approach – the use a pro-forma tax return that excludes income from the sale of the debtor's farm assets used in the debtor's farming operation and then subtracting the resulting tax from the income tax due as shown on the debtors' actual return. The difference is the priority claim that must paid be in full. The tax shown on the *pro forma* return is the tax subject to treatment under 11 U.S.C. §1222 (a)(2)(A). The I.R.S., however, proposed a proportional approach – a proration of the income tax between the ordinary income and the gain triggered by asset sales.[15] So, the district court had to determine which of the proposed approaches was correct, or establish the correct approach on its own – the statute is silent as to the proper allocation method for determining the extent of the priority and non-priority tax claims.

On this point, an overriding principle is that the Congress, in enacting 11 U.S.C. §1222(a)(2)(A) did not intend to reduce the claim of any governmental unit. So, the proper approach should retain the entire governmental claim under 11 U.S.C. §101(5) without reduction. In addition, the proper approach should remove any priority taint that might have crept into a federal tax claim due to the progressivity of the federal income tax laws.[16] While the proposed I.R.S. approach generally preserves the entire claim, it allows, through the progressive nature of federal tax law, some of the priority taint of the 11 U.S.C. §1222(a)(2)(A) claim to remain. Under the IRS approach, credits are applied based on the type of income earned and the type of the credit, all self-employment tax was applied to priority treatment, and the IRS pro-rated payments based on the net tax due for each type of income. Consequently, the IRS approach results in a higher priority tax balance due, at least in part, to the standard deduction and personal exemptions being spread among both types of income.

On appeal, the district court reversed the bankruptcy court and held that in allocating tax claims between those attributable to the sale of farm assets eligible for non-priority treatment (allowing possible discharge) and those taxes that remain in priority status, the appropriate method is the "marginal" approach, rather than a prorated approach.[17]

The district court also had to determine whether the bankruptcy court was correct in concluding that taxes triggered by post-petition asset sales qualify for non-priority treatment under 11 U.S.C. §1222(a)(2)(A). On that point, the filing of Chapter 12 bankruptcy creates a bankruptcy estate which may incur its own obligations that are generally treated as administrative expenses and are paid out of property of the estate, including post-petition income.[18] While administrative expenses are typically obligations of the estate rather than the debtor, a Chapter 12 bankruptcy estate is treated under the Internal Revenue Code as a disregarded entity – no separate taxable entity is created. Accordingly, if post-petition sales fail to qualify for non-priority treatment under 11 U.S.C. §1222(a)(2)(A), the intent and effect of the statute would be negated.

Indeed, on review, the district court affirmed the bankruptcy court and held that the BAPCPA provision applies to taxes generated by post-petition transfers even though a separate estate from the debtor is not created. The court held that such claims can be treated as administrative expenses (i.e., handled as an unsecured claim).[19]

Note: The district court also held that 11U.S.C. §1222(a)(2)(A) applies to taxes generated by pre-petition transfers, affirming the bankruptcy court.[20]

Eighth Circuit Opinion. On September 16, 2009, the U.S. Court of Appeals for the Eighth Circuit filed its opinion in the case.[21] The court held that, indeed, a Chapter 12 debtor may treat post-petition income taxes that are imposed on the debtor's income that is earned during pendency of the bankruptcy case as an administrative expense under 11 U.S.C. §503. On that point the court concluded that the plain language of 11 U.S.C. §1222(a)(2)(A) did not restrict its application to pre-petition sales, and that post-petition sales can be treated as an administrative expense. The court rejected the IRS argument that post-petition taxes would be treated as a priority claim because there is no separate bankruptcy estate created in a Chapter 12 and, thus, the taxes are not "incurred by the estate" as required by 11 U.S.C. §503(b)(1)(B),[22] and that it is the Internal Revenue Code rather than the Bankruptcy Code that creates a "separate taxable entity" upon the filing of a Chapter 7 petition (as opposed to a Chapter 11 or 12 case). The court also noted that the vast majority of courts that have considered the issue have also reached the same conclusion.
As for the Knudsen's pre-petition sale of their slaughter hogs, the court held that the sale constituted the sale of a "farm asset" that was "used in the debtor's farming operation" in accordance with 11 U.S.C. §1222(a)(2)(A). The court cited a bankruptcy treatise to support their position that language in the Bankruptcy Code should be construed by considering its "context, object and policy." The sticking point was with the statutory

phrase "used in." To be eligible for non-priority treatment, the farm assets must be "used in" the debtor's farming operation. Arguably, the slaughter hogs were not "used in" the debtor's farming operation – they were sold as a commodity. The court determined that the Knudsen's "use" of their slaughter hogs was the sale of them to further the reorganization of their farming business into a contract operation. The court believed this interpretation also furthered the overall policy of the bankruptcy code – to assist poor, but honest, debtors.[23]

Note: On this point, however, one judge dissented, noting that the plain language of the statute refers to claims arising as a result of the sale of an asset that was *already used* in the farming operation. As such, the sale of the asset itself cannot satisfy the requirement that the asset be "used" in the debtor's farming operation.

Caution: The majority's opinion on this issue results in 11 U.S.C. §1222(a)(2)(A) being available to discharge taxes resulting from the sale or other disposition of "other property that may receive favorable tax treatment under I.R.C. §1232, and inventory items that would otherwise generate ordinary income under I.R.C. §61" [see page 25 of the opinion where the court references this language from a treatise on bankruptcy tax law]. The problem with that line of reasoning is that any Chapter 12 debtor with unpaid taxes for either pre-petition or post-petition years could discharge unpaid taxes that are the result of general operations (unrelated to reorganization of the farming business or from the forced liquidation of the business). While there is scant legislative history behind 11 U.S.C. §1222(a)(2)(A), it is highly unlikely that the Congress intended a construction of 11 U.S.C. §1222(a)(2)(A) that would allow farmers to use pre-petition tax money to pay creditors of the farming operation followed by a Chapter 12 filing which would, in essence, let the IRS pay, at least partially, the creditors of the farming operation. The Eighth Circuit's broad language on this point is not well thought out, is subject to attack, and could trigger congressional action.

The court also determined that the Knudsen's proposed "marginal method" was the correct method for determining the allocation of taxes between priority and non-priority claims. While the court noted that the statute was silent (and, therefore, ambiguous) concerning how to allocate a debtor's tax liability between non-priority and priority claims, the court cited policy reasons for using an allocational approach favorable to the debtors.[24] The court also noted that IRS did not always apply the proportional method.[25]

Note: A dissenting judge pointed out that the U.S. Supreme Court, in *Florida Department of Revenue v. Picadilly Cafeterias, Inc., 128 S. Ct. 2326 (2008),* rejected the Eleventh Circuit's claim that the Bankruptcy Code is a "remedial statute" that should be construed "liberally" in favor of debtors. The dissent also noted that the 8th Circuit had previously ruled that the Congress did not intend to depart from the "general purposes of bankruptcy law when creating an expeditious avenue for farm reorganizations" in Chapter 12.[26]

In re Brown[27]

On the same day that the bankruptcy court decided *Knudsen*, another bankruptcy court rendered a decision in *In re Brown*.[28] *Brown* involved a Chapter 13 case in which the debtor filed a motion for order directing the trustee to reserve funds in accordance with 11 U.S.C. §105(a) to have the Chapter 13 estate pay capital gains taxes triggered by the debtor's post-petition sale of the debtor's interest in rental property. The trustee and a creditor objected. The debtor's reorganization plan had already been approved, and specified (among other things) that the creditors would receive 100 percent of the proceeds of the sale of the rental property. The sale resulted in $70,894.78 being tendered to the bankruptcy trustee. The debtor estimated that capital gains taxes would be $17,936. Consequently, the trustee did not have enough funds to pay the capital gains taxes and make full payment to the creditors. So, the question was whether the obligation for the capital gains taxes belonged to the bankruptcy estate or the debtor.

The debtor's argument. The debtor argued that it would be unfair to burden him with the capital gains tax and requested the court (pursuant to 11 U.S.C. §105(a)) to require the trustee to reserve the estimated taxes and either pay the taxes directly or release the funds to the debtor for payment of the tax. The debtor also argued that the taxes should be treated as an administrative claim in accordance with 11 U.S.C. §503(b) and, therefore, are a liability of the estate. The debtor also claimed that 11 U.S.C. §346(d), when read together with 11U.S.C. §1305, established the debtor's responsibility to file the tax returns, but places liability for post-petition taxes that are "incurred by the estate" on the estate.[29]

The creditor's argument. The creditor's principal argument was that 11 U.S.C. §1305 allows a creditor to seek recovery from the debtor after the case is closed.

The court's analysis. While the debtor filed bankruptcy before the pertinent provisions of the BAPCPA became effective, the court noted that both 11 U.S.C. §346(d) (the pre-BAPCPA version) and 11 U.S.C. §346(b) (the BAPCPA version) state that the debtor is responsible for the payment of *state* taxes because the Internal Revenue Code[30] expressly provides that a Chapter 13 filing does not create a separate taxable estate. While 11 U.S.C. §346 did not address the issue of liability for federal taxes, the court reasoned that the administrative claim treatment of 11 U.S.C. §503(b)(1)(B) for "any tax incurred by the estate" has no application in the Chapter 13 context, because a separate bankruptcy estate is not created.[31]

***In re Hall* [32]**

Facts and the position of the parties. Another court opinion involving the BAPCPA amendments in the context of Chapter 12 bankruptcy is *In re Hall*.[33] The debtors filed for Chapter 12 relief on August 9, 2005, and sold their farm for $960,000 on September 22, 2005, generating capital gains tax of approximately $29,000. The debtor's amended plan proposed, based on the BAPCPA-amended 11 U.S.C. §1222(a)(2)(A), to treat the capital gains tax liability as an unsecured claim which would be paid in full if funds were available, and pro rata with other like claims if funds were insufficient, with the remaining balance discharged. The IRS objected on the basis that a Chapter 12 bankruptcy estate is not a separate taxable entity. Thus, IRS argued, the tax liability that resulted from the debtor's post-petition sale was not incurred by the estate, and remained the debtor's responsibility. The debtor's disagreed, citing *Knudsen*.[34]

The bankruptcy court's holding and rationale. The court faced the specific question of whether capital gains taxes arising from the post-petition sale of farmland are a priority claim under 11 U.S.C. §507 which can be denied full payment under a Chapter 12 plan and treated as an unsecured claim not entitled to priority under 11 U.S.C. §1222(a)(2)(A). The court noted that to qualify as an unsecured claim, the claim must be within a priority category of 11U.S.C. §507– either be an administrative expense or an allowed, *pre petition* unsecured claim of a governmental unit.[35] But, the court noted, "priority administrative expenses" are those allowed under 11 U.S.C. §503(b), which includes any tax *incurred by the bankruptcy estate*. The court agreed with *In re Brown* and held that because there is no separate taxable entity created in a Chapter 12 bankruptcy, the debtor's post-petition sale of farmland could not generate a tax "incurred" by a bankruptcy estate. So, because the capital gains taxes were incurred post-petition and because no separate taxable entity exists in the context of Chapter 12 bankruptcy, they did not fall within the exception of 11 U.S.C. §1222(a)(2)(A). As such, the court noted that 11 U.S.C. §1222(a)(2)(A) only treats as an unsecured non-priority claim taxes arising from pre-petition sale, transfer or exchange of farm assets.

The district court's opinion. On appeal, the Federal District Court for the District of Arizona reversed the bankruptcy court and held that 11 U.S.C. §1222(a)(2)(A) applies to taxes arising post-petition.[36]

The Ninth Circuit's opinion. On further review, the United States Court of Appeals for the Ninth Circuit reversed.[37] The court noted that, by its terms, 11 U.S.C. §1222(a)(2)(A) applies only to "claims entitled to priority under section 507." Section 507 lists two categories that include taxes – 507(a)(8) (which involves pre-petition taxes) and 507(a)(2) (which involves administrative expenses that are allowed under section 503(b)). So, to be within the scope of section 503(b), the debtors' post-petition sale of land had to be "incurred by the estate." But, that wasn't possible, the court noted, because I.R.C. §1399 specifies that a Chapter 12 estate cannot incur taxes. Thus, because a Chapter 12 estate cannot incur a tax, it cannot benefit from 11 U.S.C. §1222(a)(2)(A). The court found the rationale of *Knudsen*[38] entirely unpersuasive. The court noted that the *Knudsen* opinion failed to cite even a single provision in Chapter 12 stating that a bankruptcy estate can incur taxes. In addition, the court reasoned that the ability to retain property does not mean the ability to incur tax. The court noted that the Internal Revenue Code clearly states that I.R.C. §§1398 and 1399 specify that a Chapter 12 bankruptcy estate cannot incur taxes, and that the Congress had repeatedly indicated (whether correct or not) that it is aware that the taxable entity provisions of the Internal Revenue Code are relevant to the Bankruptcy Code.[39] Thus, the court determined that it was clearly justified in relying on I.R.C. §§1398 and 1399 to interpret the application of 11 U.S.C. §1222(a)(2)(A) to taxes arising post-petition in a Chapter 12 bankruptcy. The court also refused the debtors' reliance on legislative history, noting that the Senate report referenced by the debtors (and which was relied on by Knudsen) involved language in an unenacted version of 11 U.S.C. §1222(a)(2)(A) (which didn't become law) that was proposed six years before the section was actually enacted with different language. In addition, the court noted that the reference in the Senate report language referred to taxes that "trustee" incurs which means taxes that the "estate" incurs (because the trustee acts on behalf of the bankruptcy estate). Because, a Chapter 12 estate cannot incur a tax, the language was not helpful to the debtors' post-petition tax argument. While the court noted that the Congressional intent of 11 U.S.C. §1222(a)(2)(A) may have indeed been as the debtors' proposed, the text of the statute was different and the court was bound by what the Congress wrote, not what it intended.

In re Schilke[40]

Under the facts of *In re Schilke,*[41] the debtor filed Chapter 12 in late 2006 and proposed to sell farm real estate and breeding livestock as part of the Chapter 12 plan. The debtor estimated that the sale would trigger capital gain of $33,108. Accordingly, the debtor's reorganization plan provided for the tax to be treated as an unsecured debt not entitled to priority. Both the debtor and the government agreed that the assets were farm assets used in the debtor's farming operation, so the only question before the court was whether the taxes should be treated as an unsecured, non-priority claim. The bankruptcy court agreed with *Knudsen*[42] on the basis that *Knudsen* carried out the intent of the statute – to help farmers reorganize.

The bankruptcy court cited the legislative history behind the provision to bolster its point. In addition, the court noted that while Chapter 12 did not create a bankruptcy estate that is a separate taxable entity from the debtor, an estate does exists that contains the debtor's property that is acquired after commencement of the case and all earnings the debtor earns from services performed after Chapter 12 is filed. The court did not believe that 11 U.S.C. §503(b)(1)(B) regarding any tax "incurred by the estate" was intended to apply only to those situations where the estate itself is a separate taxable entity.

On appeal, the Federal District Court for the District of Nebraska affirmed.[43] To hold otherwise, the court noted, would render the BAPCPA provision meaningless.

Eighth Circuit Opinion. As noted above, the U.S. Court of Appeals for the 8th Circuit consolidated *Schilke* with *Knudsen* and issued its opinion on September 16, 2009.[44] The Eighth Circuit affirmed *Schilke* on all points.

In re Dawes[45]

In *In re Dawes,*[46] the debtors, a married couple, were part of the tax protestor movement and had been criminally convicted of tax fraud and sentenced to prison in the late 1980s.[47] In 1985 and 1986, the debtors established fraudulent trusts to hold their real estate and serve as a means of funneling farm income to them on a tax-free basis. They also didn't pay federal income taxes for 1984, 1986-1988 and 1990. Their primary creditor was the IRS, which held a judgment against them for $1,541,604.08, plus interest for their 1982 through 1990 income taxes.[48] The debtors filed bankruptcy in 2006, and IRS received relief from the automatic stay as to eight parcels of the debtors' real estate (which had been placed in a fraudulent trust). The debtors' Chapter 12 plan proposed to surrender the parcels to the IRS for payment of the IRS' claim. The parcels were sold with the sales proceeds exceeding $900,000. The sale of the parcels also triggered capital gains tax, and the debtors' reorganization plan proposed to treat the IRS claim and state tax claims as general unsecured claims not entitled to priority in accordance with 11 U.S.C. §1222(a)(2)(A). The debtors filed a motion for partial summary judgment on the basis that they could provide in their reorganization plan that the post-petition capital gains tax resulting from the IRS' forced sale of the parcels was an unsecured claim. IRS opposed the motion and also moved for summary judgment on the issue.

The precise issue before the bankruptcy court was whether the claim for capital gains taxes arising from the post petition sale of real property is a priority claim under 11 U.S.C. §507, which is to be treated as an unsecured claim not entitled to priority in accordance with 11 U.S.C. §1222(a)(2)(A). The court first noted that one category of priority claims under 11 U.S.C. §507 is for administrative expenses that are allowed under 11 U.S.C. §503(b). Such administrative expenses include tax claims that are incurred by the estate, and are not a prepetition liability that becomes a tax claim after the petition is filed. IRS agreed that the capital gains taxes were not a prepetition liability that became a tax claim after the debtors filed their petition, so the only issue was whether the taxes were "incurred by the estate."

The debtors pointed to the *Knudsen*[49] opinion, where the court held the BAPCPA relief applicable to capital gains taxes arising from the post-petition sale of farm assets on the basis that the claim could be treated as an administrative expense. The court also noted that the *Knudsen* position on post-petition tax claims had also been followed by *Schilke*.[50] Those courts reached that outcome even though Chapter 12 does not create a separate taxable entity from the debtor. The court believed that the phrase "incurred by the estate" in 11 U.S.C. §503(b)(1)(B)(i) was ambiguous. The court noted that while a bankruptcy estate is created when a Chapter 12 petition is filed, the phrase "incurred by the estate" could refer to the *time* tax liability accrues or could refer to the entity liable for the tax. So, given the ambiguous nature of the statute, the court turned to legislative history to determine Congressional intent. That legislative history indicated that 11 U.S.C. §503(b)(1)(B)(i) indicated that the Congress intended "incurred by the estate" to refer to the time the tax liability was incurred, not to the entity liable for the tax.

Note: The court's characterization that the phrase "incurred by the estate" is ambiguous was rejected in *In re Whall*.[51] The *Whall* court noted that the language, on its face, clearly refers to a liability accrued against a bankruptcy estate. The court stated that, "the statutory text contains no temporal adjectives and it strains credibility to assume that Congress would have used such language if it simply meant "incurred during the estate" or "incurred post-petition." The court also noted that the snippet of legislative history cited by the *Dawes* court did not require the interpretation the court gave it. The *Dawes* court, the *Whall* court noted, ignored the language in the Senate Report referring to taxes that the "trustee incurs" and sale of property "by the trustee." Thus, the court reasoned, the Congress was concerned with taxes *incurred by the trustee* during the administration of the estate.

The court also noted that other courts have held capital gains taxes arising from post-petition sales to be administrative expenses.[52] In addition (and key to the court's analysis), the court noted that in prior Chapter 12 cases (pre-BAPCPA cases) IRS had taken the position that a claim arising from the debtor's failure to pay post-petition employment taxes as they became due was an administrative expense subject to 11 U.S.C. §1222(a)(2). The court also noted that the debtors' position promoted the congressional intent of allowing farmers to put together a feasible reorganization plan without the complication of having to pay tax claims in full as a result of asset sales designed to further the existence of the farming business. In addition, the court declined to follow *Brown*,[53] a Chapter 13 case.

On appeal, the district court affirmed the bankruptcy court.[54] In May of 2009, an appeal was filed with the U.S. Circuit Court of Appeals for the Tenth Circuit.

***In re Rickert*[55]**

Facts. The Chapter 12 debtors filed bankruptcy in 2006 after selling their breeding livestock and farm equipment. The sale resulted in $88,511 of capital gain. Even though the assets were sold before the debtors filed bankruptcy, the debtors and the government agreed that the taxes were post-petition because the tax came due at the end of the 2006 tax year. That's been the IRS position in the Chapter 12 tax cases to date, and the debtors agreed to it in this case. The debtors' Chapter 12 plan contained a provision that specified that any claim currently owing or becoming due and owing to IRS because of the asset sale would be treated as a general unsecured claim, consistent with the 2005 BAPCPA provision. The IRS objected, but agreed that the debtors' Chapter 12 plan could be confirmed upon removal of the language treating the taxes as a general unsecured claim and replacing it with language that gave the debtors the right to later file a motion to modify the reorganization plan that would again attempt to treat the taxes as an unsecured claim. The plan was confirmed and, in early 2008, the debtors filed their motion to modify their Chapter 12 plan to include language that would treat the capital gain taxes as a general unsecured claim upon their receipt of a discharge.

Bankruptcy court opinion. Two issues faced the bankruptcy court: (1) whether 11 U.S.C. §1222(a)(2)(A) allowed the debtors to treat the capital gain taxes as a general unsecured claim that is not entitled to priority; and (2) if the taxes are entitled to non-priority treatment, what is the appropriate method for calculating the amount of the non-priority claim? The IRS conceded that the court had already ruled on the first issue in *Schilke*,[56] holding that post-petition taxes are eligible for unsecured claims that are not entitled to priority. Indeed, all of the courts that have considered the issue have also reached that same result. Accordingly, the bankruptcy court held that the capital gain taxes were not entitled to priority. Thus, the court focused on the second issue – how to determine the amount of taxes entitled to priority and non-priority treatment.

On that second issue, the court noted that the statute (11 U.S.C. §1222(a)(2)(A)) is silent as to the proper allocation of taxes entitled to priority and non-priority treatment. As it had done in *Knudsen*,[57] the IRS argued for the proportional method. Under the proportional method, all income, items of deduction, exemptions and credits are recognized in computing tax. The tax is then allocated according to the percentage of each type of income. Conversely, the debtors argued for use of the marginal method - calculate tax on a return under the normal rules and then prepare a "pro forma" return removing all income from the sale of qualified farm assets which removes the income from those asset sales and results in non-qualifying income likely being taxed at lower marginal income tax rates (effectively allocating the highest marginal tax rate to the taxes qualifying for non-priority treatment under the BAPCPA provision). On this issue, the court disagreed with the district court's opinion in *Knudsen*[58] and held that, while the statute was silent on the issue, utilizing the proportional method provided the simplest and fairest method because it treats every taxable dollar of income as equal to the extent that the Internal Revenue Code does. In addition, the court noted that the 11 U.S.C. §1222(a)(2)(A) does not allow courts to utilize an allocational approach that maximizes the taxes to which the beneficial, non-priority treatment applies (the provision also doesn't say that it prevents courts from utilizing such approach either).

The result of utilizing the proportional method for tax allocation was that, of the debtors' post-petition tax liability of $7,797.00, $7,128.00 was entitled to non-priority treatment. Utilization of the marginal approach, as the debtors' proposed, would have entitled the entire $7,797.00 tax liability to non-priority treatment.

In re Uhrenholdt[59]

Facts: The debtors, a married couple, filed Chapter 12 on July 3, 2006. Both before and after filing, the debtors sold corn that was raised as part of their 2005 crop. The tax return for the 2006 crop sales came due after the debtors filed bankruptcy, so the taxes were treated as post-petition. While the IRS argued that 11 U.S.C. §1222(a)(2)(A) did not apply to post-petition taxes, the bankruptcy court disagreed. The court noted that it had already ruled that the provision *did apply* to post-petition taxes in *Schilke*,[60] *Gartner*,[61] and *Rickert*.[62] The court also noted that its opinion was consistent with the District Court opinion in *Knudsen*[63] and that the established precedent would be followed in this case.

The primary issue in the case, however, was whether the debtors' sale of corn was a sale of a farm asset that was "used in the debtor's farming operation" as required by 11 U.S.C.

§1222(a)(2)(A). The District Court in *Knudsen*[64] interpreted the phrase broadly to include all farm assets sold for some purpose of the reorganization plan. IRS, however, asserted that the phrase meant exactly what it states – that the provision applies only to those assets that are "used" in the debtor's farming operation. As such, products of the farming operation that are sold to third party buyers are not "used" in the farming operation and the taxes generated by the sale of such assets do not qualify for non-priority treatment. However, the court noted that it did not have to determine whether *Knudsen's*[65] expansive definition was correct. Here, the debtors sold the corn to a family cattle feeding operation that the husband had an ownership interest in. Accordingly, the debtors were "using" the corn as feed in the debtors' own feeding operation and the taxes were entitled to non-priority treatment under the reorganization plan.

In re Ficken[66]

Facts: The debtors were cattle farmers that filed Chapter 12 in late 2005. They amended their reorganization plan in early 2006 to specify that they planned to sell all of their cattle no later than the end of 2006 and pay the net proceeds to a bank. They did sell their cattle in 2006 for $139,522 which included $62,429 from the sale of 88 calves (their calf inventory) and $77,093 from the sale of 73 cows and 2 bulls (their breeding livestock). They used the marginal approach to compute the amount of the tax claim resulting from the sale of the breeding livestock and calf inventory to be treated as an unsecured claim. IRS challenged the debtors' tax treatment, claiming that 11 U.S.C. §1222(a)(2)(A) did not apply to the post-petition asset sales and, if it did apply, that the marginal approach was the incorrect approach to use in computing the amount of tax entitled to non-priority treatment.

The court noted that all of the cases involving the issue have ultimately concluded that 11 U.S.C. §1222(a)(2)(A) applies to post-petition taxes, and declined to hold otherwise. In so holding, the court reasoned that non-priority treatment applies to both pre-petition and post-petition tax claims based on the language of the statute and that the purpose of the non-priority provision was to help farmers reorganize their operations. In so holding, the court noted that the use of the word "claim" in 11 U.S.C. §1222(a)(2)(A) did not preclude administrative expenses under 11 U.S.C. §507(a), and that the fact that there is no bankruptcy estate created in a Chapter 12 that is separate from the debtor does not prevent post-petition taxes from qualifying as administrative expenses. While the statute was ambiguous on this point, the court noted that the legislative history behind the provision indicated that it included taxes which the trustee incurs in administering the debtor's estate.

The court also held that the taxes triggered by the sales of both the calf inventory and the breeding livestock qualified for non-priority treatment. The IRS, as it had attempted in *Knudsen*, tried to limit the scope of the non-priority provision to the sale of "capital assets," and argued that the calf inventory was not a capital asset because the calf inventory was not used in the debtors' farming operation. But, the court noted that the 11 U.S.C. §1222(a)(2)(A) did not refer to "capital asset" and the court would not read it into the provision, and refused to use the Internal Revenue Code to determine the phrase "used in" in 11 U.S.C. §1222(a)(2)(A), a debt relief provision.

As for the procedure to use in determining the amount of tax entitled to non-priority treatment, the court reasoned that the marginal approach was the most appropriate approach because it more closely carried out the intent of the Congress in providing relief to farmers filing Chapter 12. Under the marginal approach, the court noted, would provide the debtors the greatest benefit. That squared with the overall policy of Chapter 12 – to not have taxes incurred by reason of asset sales in an attempt to reorganize the farming business not inhibit reorganization. Consequently, $38,965 of tax was treated as unsecured.

On appeal, the Bankruptcy Appellate Panel for the 10th Circuit affirmed on all points.[67]

Present Status of the Law

The various opinions by the lower courts have been clarified somewhat by the Eighth Circuit's opinion in *Knudsen, et al*,[68] and the Ninth Circuit's opinion in *Hall*.[69] There is a split of authority on the application of 11 U.S.C. §1222(a)(2)(A) to post-petition taxes. The Eighth Circuit and the Tenth Circuit hold that it applies to post-petition taxes, while the Ninth Circuit holds that it does not.

That will have to be clarified by the Supreme Court or the Congress.

The Eighth, Ninth and Tenth Circuits agree, however, that 11 U.S.C. §1222(a)(2)(A) applies to taxes arising from the *pre-petition* sale of assets used in the farming business. *Dawes*[70] didn't address the issue. The bankruptcy court in *Ficken*[71] did not limit the provision to "capital assets." Neither *Dawes*[72] nor *Hall*[73] address the issue. Only *Ficken*[74] addresses how the tax claim and priority status amounts are to be determined.

Perhaps an issue that could be addressed on any eventual appeal is that the capital gains tax in *Dawes*[75] resulted from the sale of real estate to pay tax debt the debtors incurred as a result of criminal tax fraud. While the capital gains tax liability at issue in *Dawes* was a post-petition claim, the conduct giving rise to the sale of the real estate which triggered the claim was not associated with a farm operation nor was the land disposed of as part of the debtor's reorganization plan. Instead, the sale of the tracts resulted from criminal conduct occurring more than two decades before filing of the bankruptcy petition and via a judgment entered against the debtors two years before they filed bankruptcy. Permitting such debtors to benefit from the amended statute would seem to run counter to the underlying purpose of bankruptcy law to aid poor but honest debtors. It also runs counter to Congressional history concerning the rationale for the BAPCPA amendment to 11 U.S.C. §1222 (a)(2)(A).

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[1] S. 256, Pub. L. No. 109-31, signed into law on April 20, 2005.

[2] Under 11 U.S.C. §507(a) the taxes are priority taxes. Under the pre-BAPCPA version of 11 U.S.C. §1222(a)(2), these priority taxes had to be paid in full on a deferred basis. Also, in a farm bankruptcy, assets other than land may be disposed of as part of the reorganization plan. As a result, it is possible that, in addition to capital gains, recapture of depreciation could also be triggered. Before amendment by BAPCPA, that tax obligation was also a priority claim in the bankruptcy estate that had to be paid in full.

[3] *See, e.g.*, In re Specht, No. 96-21022KD (Bankr. N.D. Iowa Apr. 9, 1997)(Chapter 12 plan denied confirmation, at least in part, because the plan made no provision to pay the significant capital gains taxes triggered by the proposed deed-back of collateral to secured creditor).

[4] BAPCPA, §1003, *amending* 11 U.S.C. §1222(a)(2) by the addition of subsection (A).

[5] Id.

[6] One of the chief sponsors of the Chapter 12 amendments to BAPCPA was Iowa Senator Charles Grassley. When Senator Grassley introduced the language changing Chapter 12 in S.260, introduced in 1999 as "Safety 2000," he stated, "Under the Bankruptcy Code, the I.R.S. must be paid in full for any tax liabilities generated during 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." 145 Cong. Rec. S.750-02.

[7] These claims include the 11 U.S.C. §1222(a)(2) tax claims as well as the unsecured claims without priority.

[8] 356 B.R. 480 (Bankr. N.D. Iowa 2006).

[9] For the typical farmer, the year of liquidation of an enterprise customarily results in dramatically higher income taxes. This was certainly true in *Knudsen.* The 2004 asset sales were coupled with lower deductible expenses. In 2004, the debtors' feed purchases were lower, as were their semen purchases and other supply purchases. In addition, many other expenses were lower than they would have been in a traditional year when they would have been feeding sows, breeding the sows and preparing for additional farrowing and finishing throughout the year. Thus, with fewer expenses in 2004, the debtors' tax liability increased by $55,280 from the 2003 level.

[10] See 11 U.S.C. §1231.

[11] Before the bankruptcy court, IRS argued that the bankruptcy court should look to similar, but not identical, language in the Internal Revenue Code to govern the interpretation of 11 U.S.C. §1222(a)(2)(A). IRS assumed that "claims of governmental units" in 11 U.S.C. §1222(a)(2)(A) equates to "federal income tax claims," which it clearly does not.

[12] A key point in *Knudsen* is that the debtors were required to sell their slaughter hogs to enter into a contract with the integrator and increase their chances of putting a successful reorganization plan together.

[13] In re Knudsen, 389 B.R. 643 (N.D. Iowa 2008).

[14] In the bankruptcy court, IRS agreed that 11 U.S.C. §1222(a)(2)(A) applied to the debtors' sale of breeding hogs and farrowing equipment. So, the issue of calculating the tax claims and identifying priority status must be addressed by the district court irrespective of how the court rules on the proper interpretation of 11 U.S.C. §1222(a)(2)(A).

[15] This approach guarantees that some of the resulting income tax obligation will be taxed at each rate attributable to the debtor.
[16] A fundamental principle of bankruptcy law is that claims of equal dignity should be treated equally and that priority status is the exception and not the rule. *See, e.g.*,In re Larson, 59 F.3d 783 (8th Cir. 1995).
[17] In re Knudsen, 389 B.R. 643 (N.D. Iowa 2008).
[18] Administrative expenses are treated as an above-the line deduction in arriving at adjusted gross income. AM 2007-010, Jun. 30, 2006.
[19] In re Knudsen, 389 B.R. 643 (N.D. Iowa 2008).
[20] *Id.*
[21] Knudsen, *et al.* v. IRS, 581 F.3d 696 (8th Cir. 2009). Actually, the *Knudsen* case was consolidated with the *Schilke* case from Nebraska – No. 4:07 CV 3283, 2008 U.S. Dist. LEXIS 68176 (D. Neb. Sept. 9, 2008), *aff'g*, 379 B.R. 899 (Bankr. D. Neb. 2007).
[22] On this point, the court noted that it had previously ruled that "incurred by the estate" means "incurred post-petition." See In re O'Neill Shoe Company, 64 F.3d 1146 (8th Cir. 1995)(Chapter 11 case, but no separate taxable entity is created in either a Chapter 11 or a Chapter 12).
[23]The court's position does have some theoretical support. The debtors' sale of slaughter hogs was the result of the change in their farming operation in an attempt to reorganize the business, and was not simply the sale of agricultural produce or inventory in the normal course of business.
[24] The court noted that Chapter 12 was enacted as a temporary measure to address financial problems that farmers were encountering in the 1980s and, as such, ambiguous provisions should be construed favorably to farm debtors. However, the court failed to note that the Congress, in 2005, made Chapter 12 a permanent part of the bankruptcy code.
[25] On this point, the court cited an unpublished Chapter 12 bankruptcy court opinion from Colorado where the court utilized the marginal method, and noted that the marginal method is used in the context of special use valuation elections under I.R.C. §2032A for determining estate taxes and stated (incorrectly) that the estate tax, like the income tax, is a graduated tax.
[26] See Rowley v. Yarnall, 22 F.3d 190 (8th Cir. 1994).
[27] No. 05-41071, 2006 Bankr. LEXIS 3156 (Bankr. D. Mass. Nov. 20, 2006).
[28] *Id.*
[29] The trustee agreed that the taxes were an administrative claim, but argued that the debtor should be required to file an amended plan providing for 100 percent distribution to the creditors.
[30] I.R.C. §§1398; 1399.
[31] The court noted, in dicta, that it would have reached the same result had the case been filed post-BAPCPA.
[32] 376 B.R. 741 (Bankr. D. Ariz. 2007)
[33] *Id.*
[34] 356 B.R. 480 (Bankr. N.D. Iowa 2006)
[35] See 11 U.S.C. §§507(a)(2); 507(a)(8).
[36] 393 B.R. 857 (D. Ariz. 2008).
[37] United States v. Hall, No. 08-17267, 2010 U.S. App. LEXIS 17082 (9th Cir. Aug. 16, 2010).
[38] 581 F.3d 696 (8th Cir. 2009).
[39] On this point the court noted that at the same time the Congress enacted 11 U.S.C. §503(b), it also enacted I.R.C. §346 (concerning the relationship between the Internal Revenue Code's taxable entity provisions and state and local taxes. In addition, the court noted, at the same time the Congress enacted 11 U.S.C. §1222(a)(2)(A), it also amended I.R.C. §346.
[40] 379 B.R. 899 (Bankr. D. Neb. 2007)
[41] *Id.*
[42] 356 B.R. 480 (Bankr. N.D. Iowa 2006)
[43] In re Schilke, No. 4:07 CV 3283, 2008 U.S. Dist. LEXIS 68176 (D. Neb. Sept. 9, 2008).
[44] Knudsen, *et al.* v. IRS, 581 F3d 696 (8th Cir. 2009).
[45] 382 B.R. 509 (Bankr. D. Kan. 2008).
[46] *Id.*
[47] See United States v. Dawes, 874 F.2d 746 (10th Cir. 1989)(guilty plea entered as to willful failure to file income taxes for tax years 1982 and 1983).
[48] See United States v. Dawes, 344 F. Supp. 2d 715 (D. Kan. 2004), *aff'd*, 161 Fed. Appx. 742 (10th Cir. 2005).
[49] 356 B.R. 480 (Bankr. N.D. Iowa 2006).
[50] 379 B.R. 899 (Bankr. D. Neb. 2007).
[51] 391 B.R. 1 (Bankr. D. Mass. 2008).
[52] In re Goffena, 175 B.R. 386 (Bankr. D. Mont. 1994)(Chapter 7 case); In re Swann, 149 B.R. 137 (Bankr. D. S.D. 1993)(Chapter 7 case); In re Scott Cable Communications, 227 B.R. 596 (Bankr. D. Conn. 1998)(Chapter 11 case).
[53] No. 05-41071, 2006 Bankr. LEXIS 3156 (Bankr. D. Mass. Nov. 20, 2006).
[54] In re Dawes, 415 B.R. 815 (D. Kan. 2009). In early 2010, the Kansas District Court refused to confirm the debtors' third amended Chapter 12 plan because the effective date did not conform to the Bankruptcy Code. The plan was filed on June 5, 2009, but had an effective date of January 20, 2007. The court noted that 11 U.S.C. §1227 provides that the parties are not bound by a plan until it is confirmed, and that the proposed plan would conflict with this section because it would treat the initial proposed plan (and perhaps others) as if they were binding on the debtors and creditors. A plan cannot be confirmed any earlier than the date of the confirmation hearing. In re Dawes, 423 B.R. 550(D. Kan. 2010).
[55] No. BK06-40253-TLS, 2009 Bankr. LEXIS 17 (Bankr. D. Neb. Jan. 9, 2009).
[56] 379 B.R. 899 (Bankr. D. Neb. 2007), *aff'd*, No. 4:07 CV 3283, 2008 U.S. Dist. LEXIS 68176 (D. Neb. Sept. 9, 2008). See also In re Gartner, No. BK06-40422, 2008 Bankr. LEXIS 3525 (Bankr. D. Neb. Dec. 29, 2008).
[57] 389 B.R. 643 (N.D. Iowa 2008).
[58] *Id.*
[59] No. BK06-40787-TLS, 2009 Bankr. LEXIS 144 (Bankr. D. Neb. Jan. 26, 2009).

[60] 379 B.R. 899 (Bankr. D. Neb. 2007).
[61] No. BK06-40422, 2008 Bankr. LEXIS 3525 (Bankr. D. Neb. Dec. 29, 2008).
[62] No. BK06-40253, 2009 Bankr. LEXIS 17 (Bankr. D. Neb. Jan. 9, 2009).
[63] 389 B.R. 643 (N.D. Iowa 2008).
[64] 389 B.R. 643 (N.D. Iowa 2008).
[65] *Id.*
[66] No. 05-52940-HRT, 2009 Bankr. LEXIS 3008 (Bankr. D. Colo. Jul. 30, 2009).
[67] In re Ficken, No. CO-09-042, 2010 Bankr. LEXIS 1325 (B.A.P. 10th Cir. May 7, 2010)(11 U.S.C. §1222(a)(2)(A) applies to taxes generated by post-petition sale of farm assets; debtor's calf inventory constituted a "farm asset" used in the debtor's farming operation for purposes of 11 U.S.C. Sec. 1222(a)(2)(A); debtor's "marginal method" of computing the amount of tax to be treated as a non-priority claim under 11 U.S.C. §122(a)(2)(A) is correct).
[68] Knudsen, *et al.* v. IRS, 581 F3d 696 (8th Cir. 2009).
[69] United States v. Hall, No. 08-17267, 2010 U.S. App. LEXIS 17082 (9th Cir. Aug. 16, 2010).
[70] 382 B.R. 509(Bankr. D. Kan. 2008).
[71] No. 05-52940-HRT, 2009 Bankr. LEXIS 3008(Bankr. Colo. Jul 30, 2009).
[72] 382 B.R. 509 (Bankr. D. Kan. 2008).
[73] 393 B.R. 857 (D. Ariz. 2008).
[74] No. 05-52940-HRT, 2009 Bankr. LEXIS 3008 (Bankr. D. Colo. Jul. 30, 2009).
[75] 382 B.R. 509 (Bankr. D. Kan. 2008).