THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF IOWA
CENTRAL DIVISION

ANDERS H. KNUDSEN (doing business as A & C KNUDSEN FARMS), Debtor CYNTHIA J. KNUDSEN, Joint Debtor	No. C07-3011MWB

BRIEF OF *AMICUS CURIAE*
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INTEREST OF AMICUS CURIAE

This Court has granted the request of Professor Jack Williams for leave to file a Brief of Amicus Curiae.[1] I am a Professor at Georgia State University College of Law in Atlanta, Georgia, since 1991. I have visited as a professor at Cardozo Law School, St. John's University where I established the Bankruptcy Taxation curriculum in the LL.M Program in Bankruptcy, New York Law School where I established the Bankruptcy Taxation curriculum in the LL.M Program in Taxation, and the University of Georgia School Of Law. I have practiced bankruptcy taxation since 1987 and have devoted substantial time and academic interest to researching bankruptcy taxation issues, co-authoring three books on bankruptcy, one two-volume treatise on bankruptcy taxation, chapters in two other books on bankruptcy or tax, and over 100 hundreds articles, columns, and monographs on related issues. I have had the honor to serve as the inaugural Robert M. Zinman American Bankruptcy Institute (ABI) Scholar in Residence (2001) and the Association of Insolvency and Restructuring Advisors (AIRA) Scholar in Residence (2004-Present). In those capacities, I have conducted extensive research on bankruptcy and bankruptcy tax issues and have prepared, drafted, and commented on various proposed bankruptcy and tax legislation, including the provision at issue in this appeal.

I had the honor to serve as the Tax Adviser to the National Bankruptcy Review Commission (NBRC) and as Chair of the Tax Advisory Committee to the NBRC. I served as Chair of the ABI Bankruptcy Taxation Committee, as Reporter (Taxation) for the ABI Bankruptcy Code Review Project, as Dean of the American Board of Certification, as a Commentator on the Republic of Croatia's and Bulgaria's Bankruptcy Codes, and as a Drafter of

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[1] In this Brief, I have employed the first person pronouns "I" and "Me." Initially, I used the term "Amicus" to refer to myself; that simply sounded too pretentious. I then tried, the royal "we" which smacked of even greater pretentiousness. I then returned to the first person singular; although somewhat informal, the choice is sincere and is not meant to offend.

the Russian Federation's Energy and Natural Resources Taxation Code. I am a member of the editorial boards of the ABI Law Review and the Journal of Corporate Renewal. I am a Fellow in the American College of Bankruptcy.

Since 1999, I have consulted on chapter 11 bankruptcy reorganizations, including chapter 11 bankruptcy taxation issues, with BDO Seidman, LLP, a public accounting and consulting firm. In that capacity, I have not been retained for compensation by any farmer or family farmer. By this Brief, I am appearing on my own behalf as a Professor of Law with a substantial interest in the issues in this Appeal.

Ms. Susan Seabury, who joined me in preparing this Brief, and I are unrelated to any parties on appeal, the bankruptcy trustee, and the attorneys of record. We have no financial interest in the outcome of the Appeal. We do know Attorney Joe Peiffer, attorney of record for the Debtors, and have served with him on various committees and have attended several bankruptcy conferences with him. I have also had interchanges with Mr. Peiffer both before and after enactment of the Bankruptcy Code section at issue in this Appeal. I have also served as an Adjunct Professor for the New York University School of Law/Continuing Professional Education Program. In that capacity, I have regularly taught bankruptcy taxation to the Internal Revenue Services Office of Chief Counsel and other federal and state government tax attorneys. I am compensated for those classes. No one has attempted to influence my positions in this Brief. Neither Ms. Seabury nor I have been compensated or reimbursed in any manner for work on this Brief.

NATURE OF THE CASE

Initially, all the questions presented in this appeal appear to center on the treatment of federal income taxes arising from the sale by Anders and Cynthia Knudsen d/b/a/ A&C Knudsen Farms (collectively, the "Knudsens" or "Debtors") of hogs raised for slaughter (a/k/a "fatted hogs" or "slaughter hogs"). Prior to the enactment of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA," "2005 Act," or "2005 Amendments"), the Debtors' tax liability arising from the sale of slaughter hogs was a priority claim pursuant to §507 of Title 11 of the United States Code (the "Bankruptcy Code"). However, among other goals, BAPCPA sought to provide more robust tax relief for family farmers in chapter 12 cases so that family farmers could keep their farms in the face of relatively large tax claims and added the section giving rise to many of the issues in this case, §1222(a)(2)(A).[2]

Notwithstanding the excellent briefs prepared by the parties on appeal, a closer inspection of §1222(a)(2)(A), however, leads to the inescapable conclusion that this provision is not a federal income tax provision at all; it is a governmental claims provision that fits comfortably within the Bankruptcy Code. Based on this observation, the questions of definition, application, calculation, and payment are answered by a holistic reading of the Bankruptcy Code and a deeper understanding of its policies and goals. In fact, each key term or phrase in §1222(a)(2)(A) may be found in the Bankruptcy Code, its policies, and its goals without the need to resort to any other statutory body of law, either federal or state.

[2] In its brief, the United States of America has correctly noted a timing twist in this case that makes this case an anomaly. *See* Brief of Appellee United States of America at 7, n.3. As the Government notes, virtually all of the amendments contained in BAPCPA took effect for bankruptcy petitions filed 180 days after the date of enactment, April 20, 2005. However, Congress did make several provisions, including §1222(a)(2)(A), effective as of the date of enactment. Because the Debtors commenced their case on July 1, 2005, §1222(a)(2)(A) is in effect; however, most other provisions of the 2005 Act are not. *See* BAPCPA, Pub. L. No. 109-8, §§1003(a), §1501, 119 Stat. 23, 216 (2005).

SUMMARY OF POSITION

"If the only tool you have is a hammer, you tend to see every problem as a nail."[3] The Internal Revenue Service (the "IRS" or the "Government") has a hammer – it is the Internal Revenue Code found in Title 26 of the United States Code (the "IRC"). Therefore, the IRS sees most issues as federal tax questions that should be addressed through the IRC lens. In bankruptcy, that approach is generally incorrect. For example, §1222(a)(2)(A) of the Bankruptcy Code is a priority provision relating to claims asserted by any governmental unit (federal, state, and local), not a tax provision,[4] and certainly not a federal income tax provision. That Section must be read in a manner consistent with the overall intent, purposes, and policies of the Bankruptcy Code, not necessarily with the provisions or policies of the IRC. To be sure, sound statutory construction of Bankruptcy Code provisions should consider the IRC when federal taxes are at issue; however, consideration of the IRC in addressing a Bankruptcy Code section is a far cry from abdicating the responsibility of construing the Bankruptcy Code provision within the context of bankruptcy law and policy in a forum of multiple stakeholders. This is especially the case, as here, where the provision at issue does not mention federal income taxes, nor, for that matter, taxes at all.

Section 507(a) of the Bankruptcy Code grants a priority to certain specific claims, among them, certain types of claims of governmental units. Section 1222(a)(2)(A) of the Bankruptcy Code simply eliminates that priority when certain conditions are met. While the priority in question may, or may not, pertain to a federal income tax, nothing in §1222(a)(2)(A) converts this priority-stripping provision into a tax provision. Therefore, the general policies of chapter

[3] *Abraham Maslow* (1908-70), American psychologist, founder humanistic psychology

[4] Chapter 12 does contain within it a section that specifically references "special taxes." *See* 11 U.S.C. §1231.

12, and the Bankruptcy Code as a whole, must be taken into account when interpreting any ambiguity in §1222(a)(2)(A) of the Bankruptcy Code. Looking to the IRC to interpret a provision of the Bankruptcy Code that governs all governmental units asserting a variety of tax and non-tax claims generally runs contrary to rules of statutory construction in general and to the Bankruptcy Code in particular.

In construing a potentially ambiguous provision like §1222(a)(2)(A) of the Bankruptcy Code, the initial step is to consider the purposes, policies, and intent of the Bankruptcy Code and Chapter 12. Fundamental goals of the Bankruptcy Code as applied to individuals[5] include allowing the honest but unfortunate debtor to have a fresh start while providing an equitable distribution of the debtor's non-exempt assets to pay creditors. Chapter 12 of the Bankruptcy Code extends these goals to preserving the family farm as a going concern due to the importance of the family farmer to our economy and in furtherance of the cheap food policy of the United States.

Recognizing that payments owed to governmental units are a necessity of providing services for the common good, the Bankruptcy Code has granted priority to certain of these claims. However, in the recently enacted BAPCPA, Congress rebalanced the need of governmental units to collect payments from family farmers and the ability of family farmers to reorganize, and gave precedence to the family farmer, provided certain conditions are met. The legislative history of §1222(a)(2)(A) shows that this rebalancing and shifting of precedence was not happenstance, but the intent of Congress.

The general rules of construction, particularly where they are applied to the Bankruptcy Code, require that the reader give the Bankruptcy Code a holistic reading such that the provisions are harmonized to reach the Bankruptcy Code's goals. Further, because granting priority to

[5] Including family farmers, as opposed to other types of businesses and corporate units.

certain claims runs contrary to the Bankruptcy Code's goal of treating similar claims similarly, provisions granting priority are strictly construed. Provisions removing priorities, however, must be construed somewhat more expansively because of their consistency with general Bankruptcy Code goals in the first instance.

In its thoughtful brief, the IRS essentially argues that a key component of §1222(a)(2)(A) is a direct reflection of a federal tax provision; therefore, the Court should look to similar, but not identical, language in the IRC to govern its interpretation of a Bankruptcy Code section. However, this assumes that all "claims of governmental units" in §1222(a)(2)(A) equates to "federal income tax claims," which it clearly does not. Many claims governed by this provision will be federal income tax claims, many will also be state and local income tax claims, some will be state and local sales and/or use tax claims, etc., and some claims may have nothing to do with sales or income taxes whatsoever. Consequently, the IRS's argument that the IRC should control the meaning of §1222(a)(2)(A) is unfounded. When Congress seeks to impose federal tax law on state and local sovereigns, it does so explicitly and not by innuendo. For example, Congress has imposed IRC §§108 and 1017 on the treatment of cancellation of indebtedness and basis reduction for state and local purposes. *See* 11 U.S.C. §346. Furthermore, when Congress seeks to treat a ***tax*** claim in a manner differently than a general unsecured claim, it does so explicitly. For example, Congress has deviated from the fundamental bankruptcy principle that equal claims are entitled to equal dignity by providing priority status for specific tax claims, *see* 11 U.S.C. §507(a)(8), or nondischargeable status for specific tax claims, *see* 11 U.S.C. §523(a)(1), but has refused to grant priority or nondischargeable status to all tax claims.

Therefore, if this Court does use the IRC as a source for definitions for a meaningful understanding of §1222(a)(2)(A), it either imposes the provisions of the IRC on a separate

sovereign, the state or local taxing authority, or treats substantially similar claims dramatically differently by looking, for example, to each sovereign's definition of "capital asset" in order to apply §1222(a)(2)(A). Neither of these outcomes is consistent with the provisions of the Bankruptcy Code. Rather, one should ascertain a uniform and functional understanding of §1222(a)(2)(A) of the Bankruptcy Code based on the language of that Section as understood within the context of the Bankruptcy Code, law, and policy and that would apply to the claims of all governmental units arising from the transfer of farm assets used in the debtor's farming operations – whether federal or state and local, or whether tax or non-tax – and leave undisturbed the uniformity requirement of the United States Constitution and the sovereignty of state and local governments. There are, as demonstrated below, ample bankruptcy sources to provide a meaningful understanding of §1222(a)(2)(A) without the unnecessary resort to federal tax law.

STATEMENT OF POSITIONS

Statement 1: As a bankruptcy provision designed to strip the priority status of certain claims of governmental units, §1222(a)(2)(A) should be construed in accordance with the Bankruptcy Code and bankruptcy policy to promote the effective reorganization of family farm operations.

This is a chapter 12 case involving an interpretation of a new chapter 12 Bankruptcy Code provision enacted as part of BAPCPA. That new provision is §1222(a)(2)(A).[6] That section provides:

> 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 operations 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 a manner only if the debtor receives a discharge…[7]

This amendment addresses, among others, a major problem faced by many family farmers filing under chapter 12: the sale of farm assets to make the farming operation economically viable triggered a 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 of the debtor's plan.[8] Section 1222(a)(2)(A) seeks to limit this veto power.

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[6] 11 U.S.C. §1222(a)(2)(A). That section became effective upon enactment of BAPCPA.
[7] 11 U.S.C. §1222(a)(2)(A).
[8] Contrary to the Government's assertion that the term "veto" to describe its power in chapter 12 borders on hyperbole; that term is regularly used in practice to describe a claimant's blocking power in a bankruptcy case. To be sure, as the Government has ably observed, holders of claims also have rights embodied in the Bankruptcy Code, including rights that may grant a functional veto over a chapter 12 plan; what the Government fails to disclose, however, is that it may waive all or part of these powers and protections to permit confirmation of an otherwise confirmable chapter 12 plan. *See* 11 U.S.C. §1222(a)(2)(B). That is a classic veto power.

Essentially, both the Knudsens and the IRS assert that §1222(a)(2)(A) is ambiguous on its face; thus, in drawing a proper understanding of the meaning of that section, one must consider Congressional intent, statutory purpose, and other relevant statutory provisions. Not surprisingly, the Debtors and the IRS disagree on those other sources of statutory construction. The Debtors argue that §1222(a)(2)(A) should be interpreted in the context of the remedial nature of chapter 12 of the Bankruptcy Code. Thus, a proper interpretation of that section must include a consideration of that section's language as understood in the Bankruptcy Code, intent, remedial purpose, and the overall policies embodied in the Bankruptcy Code in general and chapter 12 in particular. In contrast, the IRS argues that §1222(a)(2)(A) should be interpreted by reference to similar language used in the federal Internal Revenue Code, specifically IRC §1231. The bankruptcy court agreed with the IRS, limiting the meaning of §1222(a)(2)(A) by importing IRC §1231 and the case law thereunder.

It is my position that both parties have presented too narrow a view of the relevant provision in this case that may lead a court to interpret the provision erroneously. Contrary to the framing of the issues on appeal, this Court is not asked to interpret a federal income tax provision found in the Bankruptcy Code and certainly is not asked to interpret any provision of the Internal Revenue Code. Rather, this Court must confront as a matter of first impression a Bankruptcy Code governmental claims provision that purports to eliminate the priority and nondischargeable status of *any claim* by *any governmental unit* that arises as a result of sale, transfer, exchange, or other disposition of any farm asset used in the debtor's farming operation. To artificially impose a federal income tax meaning on a Bankruptcy Code section that deals with not only *all governmental tax claims* (federal, state, and local), but also *all governmental*

claims (non-tax and tax) that arise as a result of sale, transfer, exchange, or other disposition is improper.

1. Section 1222(a)(2)(A) is a governmental priority claims provision found in chapter 12 of the Bankruptcy Code whose application is not limited to federal income tax claims; thus, artificially imposing a reading of that Section driven by Internal Revenue Code definitions and policies is hostile to other relevant Bankruptcy Code provisions and bankruptcy policies.

By relying on the *federal* IRC, the Bankruptcy Court failed to appreciate that §1222(a)(2)(A) does not apply to federal income tax claims only. In fact, §1222(a)(2)(A) applies to any tax claim (not just federal income tax claims) of ***any governmental unit*** that arises as a result of sale, transfer, exchange, or other disposition of any farm asset used in the debtor's farming operations. Thus, tax claims of a state or local taxing authority – such as state and local income taxes, property taxes, sales and use taxes, and other excise taxes – may be eligible for treatment under §1222(a)(2)(A). Moreover, new §1222(a)(2)(A) is not limited to tax claims at all; rather, ***any claim*** of a governmental unit that arises as a result of sale, transfer, exchange, or other disposition of any farm asset used in the debtor's farming operations triggers §1222(a)(2)(A). Thus, for example, a postpetition transfer of farm land used in farming operations may generate a governmental claim arising from a Farm Service Agency ("FSA") shared appreciation agreement, a governmental Conservation Reserve Program ("CRP") claim, a governmental Direct and Countercyclical Program ("DCP") claim, or a special assessment triggered by a sale.[9] Consequently, the use of a federal income tax provision to constrain the meaning of a chapter 12 Bankruptcy Code provision fails to appreciate that new §1222(a)(2)(A) is a bankruptcy priority provision that regulates the priority and dischargeability of certain claims

[9] Each of these governmental claims that arise postpetition may constitute an administrative expense under §§503(b) and 507(a)(2) (prior to the 2005 amendments, §507(a)(1)).

of any governmental unit and is not simply a federal income tax provision embedded in the Bankruptcy Code.

2. Section 1222(a)(2)(A) is an integral part of Chapter 12 of the Bankruptcy Code and should be interpreted within the context of the Bankruptcy Code, bankruptcy law, and bankruptcy policy.

Chapter 12 is a Bankruptcy Code provision found in Title 11 of the United States Code. The Bankruptcy Code in general and chapter 12 in particular have certain well-understood purposes and policies that are frustrated in these circumstances by resort to the IRC and federal tax law with its own set of conflicting policies and interests. Reading §1222(a)(2)(A) to include any farm asset used by the debtor to further a chapter 12 reorganization of farming operations is consistent with the Bankruptcy Code, bankruptcy law, and bankruptcy policies. Moreover, such an approach to reading §1222(a)(2)(A) is also consistent with the Supreme Court's opinion in *United States v. Energy Resources Co., Inc.,* 495 U.S. 545, 110 S. Ct. 2139 (1990). In that case, the Supreme Court addressed a conflict between the Bankruptcy Code and well-established federal tax law. In *Energy Resources*, the bankruptcy court confirmed a chapter 11 plan of reorganization that purported to allocate plan payments to retire a federal tax trust fund liability before paying any other federal tax claims. In confirming the plan, the bankruptcy court found the plan payment allocation provisions were necessary for an effective reorganization.[10] In reaching the conclusion that a bankruptcy court could confirm such a plan, the Supreme Court rejected well-established federal tax collection law on the allocation of involuntary payments by a taxpayer. Under federal tax law, where a payment of a tax by a taxpayer is involuntary (for example, made under compulsion pursuant to a court order like a confirmed plan), then the IRS and not the taxpayer may direct the application of that payment toward a particular tax

[10] 495 U.S. at 547, 110 S. Ct. at 2141.

obligation. However, where the taxpayer voluntarily pays the tax, then the taxpayer and not the IRS may direct payment.[11]

In *Energy Resources*, the debtor corporation proposed a plan that would allocate payments to pay the trust fund portion of the tax claim first. That directed payment would reduce not only the claim against the bankruptcy estate, but also would reduce the trust fund liability of the non-debtor insiders of the debtor corporation.[12] The IRS argued that the allocation provision in the plan was inconsistent with applicable federal tax law that permitted the IRS to re-direct an involuntary payment; thus, with the allocation provision, the IRS argued, the plan should not be confirmed.[13] The Supreme Court held that federal tax law was largely irrelevant. Rather, the inquiry should be on whether the allocation provision was necessary to an effective reorganization.[14] The lower court had made such a finding in confirming the plan; thus, the plan could be confirmed even though it was inconsistent with federal tax law. Furthermore, the Supreme Court noted that nothing in the Bankruptcy Code guaranteed that the IRS would get paid in full if the plan failed.[15] According to the Supreme Court, if Congress wanted such a guarantee, it would have provided such protection in the Bankruptcy Code.[16] Thus, in resolving a conflict between a provision and policy within the Bankruptcy Code and a longstanding body of federal tax law on involuntary payments, the Bankruptcy Code prevailed where that conclusion furthered the reorganizational efforts of the debtor.

The Bankruptcy Code in general and chapter 12 in particular have certain well-understood purposes and policies that are clipped by resort to the application of IRC provisions

[11] 495 U.S. at 548, 110 S. Ct. 2141.
[12] 495 U.S. at 547-8, 110 S. Ct. at 2141.
[13] *Id.*
[14] 495 U.S. at 549, 110 S. Ct. at 2142.
[15] 495 U.S. at 550, 110 S. Ct. at 2142.
[16] 495 U.S. at 551, 110 S. Ct. at 2143.

such as IRC §1231. Initially, one should note that chapter 12 is a remedial and substantive chapter for relief under the Bankruptcy Code. As such, to understand properly its role, one must recognize that a chapter for bankruptcy relief, like chapter 12, is procedurally akin to a collective federal interpleader action. The debtor commences a case under the relevant chapter for relief (chapter 12 in this case) and then provides notice to all his creditors (stakeholders) of the filing. Upon the filing of the petition, the debtor's property is automatically transferred to the bankruptcy estate where it is protected by the automatic stay (like the *res* in a receivership case that is protected by the doctrine of *in custodia legis*) and used and administered in accordance with the Bankruptcy Code. Like any collective remedy, such as an interpleader action or receivership, the forum is inhabited by multiple parties making competing claims to assets. Like its federal receivership or interpleader counterpart, the bankruptcy forum cannot and does not limit its focus to a bilateral dispute; rather, the court must entertain simultaneous assertions of claims against the property of the estate in accordance with carefully crafted distributional schemes under the Bankruptcy Code.

Consistent with the Bankruptcy Code in general, chapter 12 bankruptcy policies include the preservation of the family farm and farm operations; the equal distribution of estate property in accordance with the bankruptcy distributional scheme; an inclusive definition of "claim" to ensure the participation in a bankruptcy case of a greater universe of those with an interest in the debtor or the debtor's assets; the fresh start embodied in the chapter 12 discharge; and family farmer debtor responsibility by delaying the chapter 12 discharge until full performance under the chapter 12 plan.

The Bankruptcy Code strikes a delicate balance between debtors and creditors; all creditors. Thus, one must be cautious in rushing to the IRC, a body of law that seeks bilateral

determinations between the government and a taxpayer, in order to understand provisions in the Bankruptcy Code, a body of law that seeks to resolve multilateral claims and rights in a context far different with far different policies than one would find under the IRC.

The present case introduces that concern. A fundamental tenet of bankruptcy law is that claims of equal dignity are to be treated equally. The definition of "claim" is found in §101(5) and includes "any right to payment . . . ." Although the definition is a federal question, courts regularly consult applicable nonbankruptcy law in an effort to understand better the existence of a claim. In this case, federal tax law provides that the IRS has a right to payment, that is, a claim, in this chapter 12 case. That IRS claim is presumptively a general unsecured claim, treated like any other unsecured claim under the chapter 12 plan, unless the IRS can prove that it is entitled to priority treatment under the Bankruptcy Code. Priority is a bankruptcy term of art; its meaning cannot be gleaned from any other source of law. Here, the federal income tax claim that arose from the sale of the slaughter hogs is a priority tax claim under §507(a) and would have been entitled to special priority treatment under the Bankruptcy Code prior to the 2005 Act. Under old chapter 12, that priority tax claim would have to have been paid in full over time with interest or the chapter 12 plan would not have been confirmed absent IRS consent. This was the case even though the general unsecured creditors were paid little and certainly less than the full value of their claims. In fact, that is the very nature of the priority claim; the priority claim is ensured full payment before any general unsecured creditors are paid at all. Essentially, for every dollar increase in a priority claim, we witness a corresponding dollar decrease in funds left for the general unsecured creditors. Thus, the priority tax claim diverts distributions from other general unsecured creditors, disturbing the fundamental policy of equal treatment, and because it must be paid in full (although over time), it renders many chapter 12 plans no longer feasible,

frustrating the policy of family farm preservation and family farmer discharge. But that was precisely the nature of chapter 12 as constructed by Congress prior to the 2005 Amendments to the Bankruptcy Code. It was this set of circumstances that Congress addressed in 2005 in enacting §1222(a)(2)(A).

The legislative history to §1222(a)(2)(A) is sparse but illuminating. One of the principal sponsors of the law was Senator Charles Grassley, the only United States Senator who is also a family farmer. In support of the bill, Senator Grassley observed:

> But Chapter 12 can be made even better. "Safety 2000" will make Chapter 12 better. The bill expands the definition of family farmer so that more farmers can use Chapter 12. Under current law, family farmers can't use Chapter 12 to save their farms if a farmer has more than $1.5 million in debt. This is too restrictive, and my bill would let farmers who have up to $3 million in debt use Chapter 12. "Safety 2000" also helps farmers to reorganize by keeping the tax collectors at bay. Under current law, farmers often face a crushing tax liability if they need to sell livestock or land in order to reorganize their business affairs. According to Joe Peiffer a bankruptcy lawyer from Hiawatha, Iowa, who represents many family farmers, high taxes have caused farmers to lose their farms. Under the Bankruptcy Code, the I.R.S. must be paid in full for any tax liabilities generated during a bankruptcy reorganization. If the farmer can't pay the I.R.S. in full, then he can't keep his farm. This isn't sound policy. Why should the I.R.S. be allowed to veto a farmer's reorganization plan? "Safety 2000" takes this power away from the I.R.S. by reducing the priority of taxes during proceedings. This will free up capital for investment in the farm, and help farmers stay in the business of farming.[17]

No longer happy with the results under prior bankruptcy law, Congress through the 2005 Amendments rolled back the priority treatment of certain specific governmental claims arising in chapter 12 cases. New §1222(a)(2)(A) does not reduce a governmental unit's claim, §101(5) still controls that determination and directs us to consider applicable nonbankruptcy law like the IRC; rather, §1222(a)(2)(A) strips priority treatment of certain claims of a governmental unit. Because §1222(a)(2)(A) is a priority-stripping provision, and priority is an exclusive bankruptcy

[17] 145 Cong. Rec. S750-02.

concept granted by the Bankruptcy Code and no other source of law, it is entirely logical to consider the Bankruptcy Code and its policies in interpreting that Section. By arguing that the IRC's restrictive definition of "capital asset"[18] should control the meaning and effect of §1222(a)(2)(A), the IRS is essentially urging a partial judicial repeal of that Section and a reshuffling of the bankruptcy deck at the expense of not only the debtor, but also the debtor's unsecured creditors.

The relevant facts in this case are not in dispute. The Knudsens own a hog farm in Iowa. Before the bankruptcy filing they bred, raised, and sold hogs for slaughter. In essence, they operated what is known as a "farrowing to finish" hog operation. Typically, the "breeding" hogs and the "slaughter" hogs are separated. The "farrowing to finish" operation was not profitable. In order to reorganize their farming operations, the Knudsens embraced and implemented a different business model under which they would only raise the hogs to finish, a "pig bed and breakfast," if you will. Because of disease concerns, the Knudsen's had to sell off all of their slaughter hogs before the integrator (the owner of the hogs) would allow them to convert to the "bed and breakfast" model. Prior to the bankruptcy filing, the Knudsens sold off their breeding hogs, equipment related to breeding, livestock trailer, and the hogs raised for slaughter. The relevant question is what priority treatment (priority v. general unsecured) is applied to the governmental tax claim arising from the sale of the slaughter hogs? That issue turns on how one defines the term ***"used in"*** in §1222(a)(2)(A). Does one look for assistance, as the IRS suggests, to the IRC, or does one look, as the Knudsens suggest, to the Bankruptcy Code?

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[18] I acknowledge that the Government has insisted that its use of the definition of "capital asset" in its Bankruptcy Court arguments was illustrative, *see* Brief of Appellee United States of America at 10; thus, although I use that term in my Brief to describe the Government's approach to reading §1222(a)(2)(A) of the Bankruptcy Code, the more appropriate characterization of the Government's illustration may be both defined (26 U.S.C. §1221(a)) and deemed (26 U.S.C. §§1231(b), 1245) capital assets, as that term is understood in tax practice.

The Bankruptcy Court answered that the term "used in" found in both §1222(a)(2)(A) and IRC §1231, should be given the same meaning in both the Bankruptcy Code and IRC sections. In doing so, as previously discussed, the Bankruptcy Court failed to appreciate that §1222(a)(2)(A) applies to all governmental claims that arise from the transfer of a farm asset used in farming operations pursuant to a chapter 12 plan; that Section is not limited to federal income tax claims by any fair reading. Moreover, the bankruptcy court failed to appreciate the context within which the issue was presented. This is a bankruptcy case wherein the debtor seeks to persuade a bankruptcy court to confirm a chapter 12 bankruptcy plan. Among other issues, the debtors must prove that the plan is feasible. Feasibility, in turn, rests in part in this case on the characterization of the IRS's tax claims. That determination turns, in part, on the meaning of §1222(a)(2)(A).

The treatment that §1222(a)(2)(A) provides to certain delineated claims of governmental units may be diagrammed. Not surprisingly, a chart that couples the phrases used in §1222(a)(2)(A) with the corresponding Bankruptcy Code definitions illustrates that resort to the IRC is not only incorrect for the reasons discussed above, but also unnecessary. The robust nature of the Bankruptcy Code and its construction as highlighted by the Supreme Court in *Energy Resources* answer the question of meaning without the need to consider any other source. Below is a chart that illustrates the meaning of §1222(a)(2)(A):

§1222(a)(2)(A)	**Bankruptcy Code Section Reference[19]**
Provide for the full payment	§1226 (payments made in a chapter 12 bankruptcy case)

[19] Note also that the case law regarding the specified provisions gives further assistance in the interpretation of that provision.

§1222(a)(2)(A)	Bankruptcy Code Section Reference[19]
in deferred cash payments	§511 (Bankruptcy case law unanimously reads the term "deferred cash payment" to require an interest component. Section 511 of the Bankruptcy Code as amended requires the use of state and federal interest rates, respectively, and not just one federal interest rate)
of all claims	§101(5) (defines "claim" as any right to payment, including tax obligations)
entitled to priority under section 507	§§507 & 503 (provides priority for claims incurred by the bankruptcy estate such as governmental claims based on taxes, DCP claims, CRP claims, and FSA shared appreciation claims; also provides for priority for certain enumerated tax claims by any governmental unit)
the claim is a claim	§101(5) (defined above)
Owed to a governmental unit	§101(27) (includes United States, a State, a Commonwealth, a District, a Territory, a Foreign State, a Municipality, etc.
that arises	§101(5) & case law that holds that "arises" is a term of art under bankruptcy law and not some state or other federal law source.
as a result of the sale, transfer, exchange, or other disposition	§101(54) (transfer is defined broadly to include any form of disposition of an interest in property)
of any farm asset	*cf.* §101(18) (generally understood to mean assets related to farming operations)
Used in	***§363* (governs the use, sale, or lease of property in any bankruptcy case and employs the phrase "use property of the estate in the ordinary course of business" to cover all the debtor's assets and not just deemed or defined capital assets)**
the debtor's	§101(13) (means person concerning which a bankruptcy case has been commenced)
Farming operations	§101(21) (means farming, tillage of the soil, dairy farming, ranching, production or raising of crops, poultry, or livestock, and production of poultry or livestock products in an unmanufactured state)
in which case the claim	§101(5) (defined above)

§1222(a)(2)(A)	Bankruptcy Code Section Reference[19]
Shall be treated	§1222 (provides for certain mandatory and permissive terms and conditions of a chapter 12 plan)
as an unsecured claim	§§501, 502, 726, & 1225(a)(4) (sets out the nature of unsecured claims, the claims process, and the distributional scheme)
that is not entitled to priority under section 507	§§507, 503, & 726 (sets out the priority and distribution schemes in bankruptcy)
but the debt	§101(12) (means liability on a claim)
Shall be treated in such a manner only if	§1222 (defined above)
the debtor	§101(13) (defined above)
receives a discharge	§1228 (chapter 12 discharge, unlike the chapter 7 discharge, is granted only after the debtor has fully performed under the chapter 12 plan; designed to impose discipline and responsibility on family farmer debtors to fulfill their promise of plan performance)

Thus, in a full consideration of the meaning of §1222(a)(2)(A), one must consult over twenty provisions found throughout the Bankruptcy Code. Now that we have properly framed §1222(a)(2)(A), we can confront the phrase that challenged the Bankruptcy Court. The relevant clause strips priority status from any claim of a governmental unit that arises from the transfer of: (1) "***any farm assets***" (2) ***"used in"*** (3) ***"the debtor's farm operations."***

Initially, one should begin with the first component – ***"(1) any farm assets."*** That phrase has significance all its own in bankruptcy. Section 541(a)(1) – (a)(7) establishes the contours of the estate in bankruptcy. Under Bankruptcy Code §541(a), property of the estate includes all of the debtor's legal or equitable interest in property at the time of the filing of the petition wherever located and by whomever held. This is a question of federal law; however, state law may be consulted to identify the indicia of property rights in the debtor. After the §541 rules have been applied, chapter-specific rules such as new §1115 for chapter 11 cases and §1306 for chapter 13 cases should be applied to determine the full extent of the property of the estate.

Property subject to exemption under §522 is included in the definition of property of the estate until it is, in fact, set aside as provided in that section. Further, anti-forfeiture, recapture, and exclusion provisions under §541(c) should also be applied to expand and contract, where appropriate, the contours of the bankruptcy estate. Moreover, all the interest of the debtor and the debtor's spouse in community property that is under the sole, equal, or joint management of the debtor is included in property of the estate. Furthermore, inheritances that come to the debtor within 180 days after the filing of the petition, an interest in property as a result of a divorce decree or property settlement agreement with the debtor's spouse, the proceeds of a life insurance policy or death benefit plan, and the proceeds, rents, and profits from property included in the estate are all included in the definition of property of the estate.[20] Additionally, in a chapter 12 case,[21] like in a chapter 13 case (and since 2005, like in a chapter 11 individual debtor case), postpetition income is included in the ambit of the estate and is usually used to fund, along with other financial sources, the chapter 12 farming operations plan. It is this property of the estate that is subject to administration under the Bankruptcy Code and is used to satisfy, among other things, allowed claims in accordance with the priority and distributional rules in bankruptcy.

As a functional point, the term "asset" is used interchangeably in the Bankruptcy Code and in bankruptcy practice with the term "property" as used in §§541(a) and 1207. For example, §101(18) uses the term "assets related to a farming operation" to determine family farmer eligibility.[22] Importantly, in order for all parties in interest in a bankruptcy case to determine the

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[20] *See* 11 U.S.C. §§541(a)(1)-541(a)(7) (2006).
[21] 11 U.S.C. §1207.
[22] *See also* 11 U.S.C. §§101(20), (21), (32) (insolvency is a functional comparison of assets and liabilities), (51B) (single asset real estate includes the property and income generated there from); §548(a)(1)(B)(II) (unreasonably small capital generally requires a comparison of current assets and current liabilities, among other assessments); §557 (grain assets); §727(a)(5) (discharge denied individual debtor unless debtor can explain loss of assets).

extent and value of the property of the estate, the individual debtor must file a "Schedule of Assets" under §522(a), a requirement that includes all of a debtor's assets and not just those assets that may qualify as a deemed or defined "capital asset" as that term is understood under the IRC. Thus, §1222(a)(2)(A)'s use of the term "any farm assets," like §522's use of the term "assets" and §§541(a) and 1207's use of the term "property," is all encompassing and broadly defined.[23] A broader definition of "assets" also leads to a greater universe of value for the creditors of the bankruptcy estate and protects more of the value from dissipation and unfair claims through a more expansive scope of the automatic stay under §362(a)(3).

The phrase "farm assets" also has a specific meaning under the Bankruptcy Code that properly limits the more expansive general meaning of "assets" under the Bankruptcy Code. That term, as used in §§101(18), (20), and (21), includes any asset ***related to*** farming operations, ***whether or not actually used*** in farming operations. That would include, among other things, capital assets under IRC §1231, other property that may receive favorable tax treatment under IRC §1232, and inventory items that would otherwise generate ordinary income under IRC §61. In this case, farm assets would include the Knudsen's breeding sows, the farm land, any farrowing or other farm equipment, the livestock trailers, and the hogs held for slaughter.

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[23] Sections 522 and 541 also reject the distinction urged by the Government in this appeal between "products" and "assets." *See* Brief of Appellee United States of America at 10 ("The slaughter hogs are better viewed as *products* of the debtor's farming operation primarily held by them for sale to customers in the ordinary course of business, not assets *used in* the farming operations." (Emphasis in original.)). A debtor that knowingly and willfully failed to include "products" on its §522 Schedule of Assets would find himself under investigation by the United States Trustee and the Department of Justice for filing false statements with the bankruptcy court. Moreover, a creditor that sought to repossess collateral that it maintained consisted of "products" and not "assets" would nonetheless find itself the target of possible sanctions for violating the automatic stay under §362(k). Finally, under §363, a debtor may use property in the ordinary course of business or outside the ordinary course of business with prior court approval, that property having been identified as assets under §522. Bankruptcy courts have never limited that use power to products and not assets. In other words, in bankruptcy the distinction between products and assets is meaningless. However, the use of that distinction in its argument tips the Government's approach to interpreting §1222(a)(2)(A). By employing a difference with a distinction in federal tax law, it seeks to create a difference with a distinction in bankruptcy law, a result that would not exist if the Bankruptcy Code were interpreted properly in these circumstances.

Turning to the second and third components of the phrase in §§1222(a)(2)(A) presently of interest, one can further limit the application of that Section through Bankruptcy Code definitions and policies. In fact, the second and third components are designed to winnow the expansive universe of ***any farm assets*** to those that are actually (2) ***"used in"*** (3) ***"the debtor's farm operations."*** The phrase "used in" is more restrictive than the phrase "related to" that is found in §§101(18), (20), and (21). Thus, it would appear that §1222(a)(2)(A) is more restrictive than §§101(18), (20), and (21), a reading that is consistent with the structure of bankruptcy law in that those latter sections establish debtor eligibility, criteria that are liberally construed under bankruptcy law.[24]

The term ***"used"*** is encountered throughout the Bankruptcy Code but may be found most prominently in §363. In that Section, the Bankruptcy Code regulates the authority of the debtor to use property of the estate both in the ordinary course of business or outside the ordinary course of business. Thus, under §§363(c)(1) and (b)(1), a chapter 12 debtor[25] may use estate assets in the ordinary course of business without court approval and may use estate assets outside the ordinary course of business with prior court approval. Here, the language of §363 is important to track because the actual language of §363 substantially mirrors §1222(a)(2)(A). Specifically, §363(c)(1) provides:

> If the business of the debtor is authorized to be operated under section . . . 1203 of this title and unless the court orders otherwise, the trustee may enter into transactions, including the sale or lease of property of the estate, in the ordinary course of business, without notice or a hearing, and may ***use property of the estate [assets] in the ordinary course of business*** without notice or a hearing.[26]

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[24] *In re Watford*, 898 F.2d 1525, 1527 (11th Cir. 1990)(liberal construction of farming operations effectuates Congressional intent to save family farm operations); *In re Koppes*, 2000 WL 150836 (Bankr. N.D. Iowa 2000)(farming operations liberally construed in order to further Congressional purpose of helping family farmers to continue farming).

[25] Under §1203, the debtor has all the powers of a trustee, including the power to use, sale, or lease property of the estate under §363.

[26] 11 U.S.C. §363(c)(1) (emphasis added).

Additionally, §363(b)(1) provides, in relevant part:

> The trustee, after notice and a hearing, may ***use***, sell, or lease, other than ***in the ordinary course of business***, ***property*** of the estate [assets] . . . .[27]

Section 1222(a)(2)(A) provides, in relevant part:

> [T]he 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 operations . . . .***[28]

One can see that the phrases are substantially similar across all three sections with the caveat that §1222(a)(2)(A) is farming specific, that is, the course of business that §363 refers to in a chapter 12 case where the debtor seeks the benefits of §1222(a)(2)(A) is generally farming operations. Notwithstanding these statutory similarities and a robust body of bankruptcy law interpreting the meaning of "use in the ordinary course of business" and "use . . . other than the ordinary course of business," the IRS persuaded the Bankruptcy Court that the proper meaning was to be found in the IRC. Thus, according to the IRS, the phrase "used in" as found in §1222(a)(2)(A) means farm assets that are either a deemed or defined capital asset.[29] The IRS's position is not only unpersuasive on its face and contrary to well-accepted canons of construction that seek to use bankruptcy definitions for bankruptcy statutes and key phrases, but also leads to absurd results. If the definition of capital asset is to be used for §1222(a)(2)(A), then why not also use that definition for §363(c)(1). Under the IRS reading of "used in the . . . business" in §363(c)(1), a debtor could never use inventory or the proceeds from inventory, *i.e.*, accounts receivable, because the debtor may only use assets used in a business, *i.e.*, a deemed or defined capital asset. Longstanding bankruptcy law and practice rejects the IRS's strained approach.

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[27] 11 U.S.C. §363(b)(1) (emphasis added).
[28] 11 U.S.C. §1222(a)(2)(A) (emphasis added).
[29] *See, e.g.,* 26 U.S.C.§1221(a) (defines capital asset); 26 U.S.C. §1231(b) ("property used in the trade or business").

Moreover, §1206 rejects the IRS's resort to the IRC to define what is already defined in the Bankruptcy Code. Section 1206 provides that the debtor may sell property free of any interests of a third party "if the property is farm land, farm equipment . . . ." Thus, when Congress wants to identify a debtor's rights and powers in deemed or defined capital assets only, such as farm land or farm equipment, it does so specifically. Congress does not define by wink. Rather, in §1222(a)(2)(A), Congress used the phrase any farm asset used in a debtor's farming operations consistent with the meaning of the word "use" under the Bankruptcy Code. That term is a functional action verb that links farm assets to farming operations.

Finally, the phrase ***"the debtor's farm operations"*** also has a significant meaning under the Bankruptcy Code and bankruptcy practice. Under Bankruptcy Code §§101(13) and §109, the debtor is defined as the person (including an individual) who has sought relief under the Bankruptcy Code. The Knudsens meet that requirement. The phrase "farming operation" has a specific meaning under §101(18), (20), (21), and 363 of the Bankruptcy Code independent of some tertiary meaning that may be constructed and conjoined out of the IRC. Under §101(21), the term farming operation "includes farming, tillage of the soil, dairy farming, ranching, production or raising of crops, poultry, or livestock, and production of poultry and livestock products in an unmanufactured state." Because the definition contains the term "includes," the definition of farming operation is illustrative and not limiting.[30]

In summary, the phrase "***any farm assets used in the debtor's farm operations"*** contains within it both an asset test and a use test, both of which must be satisfied in order for the chapter 12 debtor to apply the priority-stripping power found in §1222(a)(2)(A). The asset test asks whether the asset transferred by the debtor is presently a farm asset as defined by the Bankruptcy

[30] *See* 11 U.S.C. §102(3); *see also In re Koppes*, 2000 WL 150836 (Bankr. N.D. Iowa 2000)(farming operations liberally construed); *In re Bircher*, 241 B.R. 11, 14-16 (Bankr. S.D. Iowa 1999)(farming operations and farm income broadly construed; moreover, income tax declarations are not determinative of a debtor's status as a family farmer).

Code. In this case, farm assets include slaughter hogs, breeding hogs, farm equipment, and farm land. Even if the debtor intends to use a non-farm asset in the debtor's farming operations as contemplated by the chapter 12 plan, that would be insufficient to qualify for the special priority-stripping rule under §1222(a)(2)(A). The debtor would have failed to meet the asset test. Additionally, the use test asks whether the debtor in fact will use that farm asset in the debtor's farm operations as ultimately provided for in the chapter 12 plan.[31] In this case, the Debtors intended to use the sale of the slaughter hogs, breeding hogs, farm equipment, and farm land in the debtor's farm operations as contemplated in their business plan and as ultimately embodied in their chapter 12 plan. Even if the debtor intends to use a farm asset but in nonfarm business operations, that would be insufficient to trigger priority stripping under §1222(a)(2)(A). The debtor would have failed to meet the use test. Here, based on the record evidence, the Knudsens meet both the asset test and the use test under §1222(a)(2)(A).

3. In this case, nonpriority treatment of the income tax claim generated by the sale of slaughter hogs is necessary to an effective reorganization of the Debtor.

Notwithstanding the discussion above, this Court may characterize the issue of the meaning of "farm assets used in the debtor's farming operations" presented in this appeal in a narrower frame based on the facts in this case. From the undisputed record evidence, the Debtors sold their slaughter hogs to meet a precondition imposed by the pork integrator before the Debtors could transform their operations from a "farrowing to finish" farming operation to a "pig bed and breakfast" farming operation. Thus, the sale of the slaughter hogs on these facts

[31] The "full performance" requirement is implied by the additional requirement in §1222(a)(2)(A) that a discharge be granted before the priority status of the governmental claim is stripped. In chapter 12, a discharge is granted only after complete performance under the plan. This additional requirement of plan confirmation and full performance in order for §1222(a)(2)(A) to be triggered protects the governmental unit from a bad faith use of §1222(a)(2)(A).

was not replenished and was undertaken primarily to convert operations, a step necessary to effectuate the proposed chapter 12 plan of reorganization.

On the facts, the Knudsens intended to use, among other steps, the sale of their slaughter hogs to transform their farming operations from a hog farming operation that operated from farrowing to finish to a hog farming operation that ceased farrowing, located an integrator that supplied hogs for the Knudsens to finish, and created a functional pig "bed and breakfast." In order for the Knudsen's to accomplish the transformation and contract with the integrator, overcome serious undercapitalization issues, and reduce the overall risk of operations, thereby dramatically increasing the success of a successful plan of reorganization, the Knudsens had to sell off their slaughter hogs. If they failed to do so, the integrator would not contract with them, the transformation of the farming operations would not have been successful, and the farming operations would have failed. Thus, the Court is not faced with the broader question of whether the sale of slaughter hogs in any circumstance constitutes the sale of any farm asset used in the debtor's farming operations" as portrayed by the Bankruptcy Court and as urged on appeal before this Court by the government. Rather, the Court is confronting a much narrower question: ***whether, based on the undisputed facts in the record on appeal, any governmental claim arising from the sale of slaughter hogs owned by the debtors, such hogs being forbidden to be replenished, as required by an integrator as an absolute precondition for doing business with the debtor in a manner that would be necessary for an effective chapter 12 reorganization qualifies for special treatment under §1222(a)(2)(A)?*** The Bankruptcy Code answer is a resounding "yes" as demonstrated above. The slaughter hogs qualify as "any farm asset" and are, in fact, "used in the debtor's farming operations." In this case, their use is not primarily for generating income through the sale of inventory; rather, their use in the debtor's farming

operations is to remove an absolute obstacle to effectuating a chapter 12 plan of reorganization with a reasonable chance of success based on employing the benefits of a pork integrator.

Statement 2: The Debtors' marginal approach to determine the proper allocation of the tax claim of the IRS between priority taxes and unsecured taxes under §1222(a)(2)(A) ensures both that there is no reduction in the overall governmental claim and that there is no indirect effect from what is now a nonpriority general unsecured governmental claim.

Once this Court determines that §1222(a)(2)(A) applies,[32] the Court must then resolve a technical but important question of first impression left unanswered by that Section: how should the tax claim and priority status amounts be determined? The Debtors have suggested that the Court use what has been called the marginal approach. The IRS has suggested that the Court use what has been called the proportional approach.

In deciding which method is appropriate under §1222(a)(2)(A), this Court should be cognizant of two fundamental attributes of that Section. First, Congress did not intend that §1222(a)(2)(A) reduce the claim of any governmental unit. That Section is not a claims objection provision such as one might find in §502(b). Thus, any approach should retain the entire governmental claim under §101(5) without reduction. This principle is consistent with the meaning of a claim under §101(5) and the claims objection process under §502(b). Second, to the extent that §1222(a)(2)(A)'s priority-stripping treatment applies to an eligible governmental claim, any approach fashioned must remove both the direct and indirect affect of what was prior to the 2005 Amendments a priority claim. Thus, any approach should remove any priority taint that might have crept into a governmental unit's claim by reason of the progressive marginal nature of the federal income tax laws. This principle is consistent with the compelling body of law that strictly construes priority claims status in order to ensure a more equitable distribution

[32] It appears that the IRS has agreed that §1222(a)(2)(A) applies to the Debtors' sale of the breeding hogs and the farrowing farm equipment; thus, at some point, the issue of calculating the tax claims and identifying priority status must be addressed, regardless of this Court's ruling on the first issue on appeal.

of estate assets across a broader class of creditors.[33] Recall that bankruptcy law embraces the fundamental principle that claims of equal dignity should be treated equally and that priority status is the exception and not the rule.[34]

With these two attributes in mind, one would generally embrace an approach that would treat the §1222(a)(2)(A) unsecured claim as the "last dollars in." Of the methods presented to this Court, the method that more closely approximates this type of approach is the Debtors' marginal approach. Under the Debtors' approach, the marginal method allocates the §1222(a)(2)(A) tax as unsecured and dischargeable. The marginal method then utilizes a pro forma income tax return that eliminates the §1222(a)(2)(A) income to determine the amount of income taxes that are nonpriority and dischargeable when the Debtors' fully perform under their chapter 12 plan.[35] The marginal approach does this by eliminating that §1222(a)(2)(A) income from the pro forma return. Thus, the resulting tax shown on the pro forma return is the priority tax while the difference in the taxes shown on the traditional return and the pro forma return is the unsecured dischargeable claim.

Although the IRS's proportional approach generally preserves the entire claim, it allows, through the progressive marginal nature of federal tax law, some of the priority taint of the §1222(a)(2)(A) claim to remain. Thus, the IRS's proportional method, whereby the IRS prorated

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[33] *See, e.g., Stuart v. Carter (In re Larsen)*, 59 F.3rd 783, 786 (8th Cir. 1995)(because a priority claim represents an exception to the Bankruptcy Code's general policy of equality of distribution among all creditors, it must be strictly construed); *Northwest Financial Express, Inc. v. JWD, Inc. (In re Northwest Financial Express, Inc.)*, 950 F.2nd 561, 563 (8th Cir. 1991)("We think that as a matter of policy, statutory priorities should be strictly construed in the bankruptcy context and our construction for the purposes of this appeal fulfills this goal.").

[34] *Id.*

[35] I agree with the Government that the Debtors' marginal method is inconsistent with the IRS established practice in determining taxable income by looking to a single return, *see* Brief of Appellee United States of America at 15; however, I note that federal tax law already permits the consideration of more than one return in averaging farming income, for example. I also note that the use of a pro forma return is unusual; however, absent guidance from the IRS on this issue, debtors that employ the marginal method have no choice but to rely "on an unfilled 'pro-forma' return of their own design." *See* Brief of Appellee United States of America at 15. A greater concern undeveloped by the Government is the administrative problems that a marginal approach and §1222(a)(2)(A) will have on collections.

the tax on the return based on the percentages of income attributable to (1) §1222(a)(2)(A) priority-stripping treatment and (2) everything else, fails to square with the general policy requiring strict construction of priority claims provisions and with the policies embodied by §1222(a)(2)(A). Additionally, the IRS then applied credits based on what type of income earned the credit. The IRS applied all self-employment tax to priority treatment. The IRS prorated payments based on net tax due for each type of income. This proportional approach resulted in a higher priority tax balance because, among other things, the standard deduction and personal exemptions were spread among both types of income.[36]

Section 1222(a)(2)(A) is silent as to the proper allocation method for determining the extent of the priority and nonpriority tax claims when §1222(a)(2)(A) is triggered. Neither the Debtors' marginal approach nor the IRS's proportional approach is a panacea. Both approaches have identifiable strengths and weaknesses as already discussed in the parties' excellent appellate briefs. However, of the two, the Debtors' marginal approach ensures that §1222(a)(2)(A) claims do not directly or indirectly affect the extent of any priority claim. Thus, based on the body of law that priority claims provisions are strictly construed under the Bankruptcy Code and that the holder of an alleged priority claim has the burden to prove such claim by a preponderance of the evidence, the IRS's approach is less persuasive than the approach suggested by the Debtors.

Statement 3: Governmental claims arising from postpetition transfers triggering §1222(a)(2)(A) treatment may be paid by the bankruptcy estate.

When a debtor files for relief under chapter 12, a bankruptcy estate is created. The estate is a separate entity that may incur its own obligations that are generally treated as administrative expenses under §§503 and 507(a)(2) and paid out of property of the estate, including postpetition

[36] For a comparison of the difference in priority status as calculated by the two approaches, *compare* App. V. 2 at 351 *with* App. V. 3 at 20, lines 32 and 34.

income under §1207(a)(2). Generally, administrative expenses are obligations of the estate and not necessarily obligations of the debtor. What clouds the issues here is that the chapter 12 bankruptcy estate is treated under the IRC as a disregarded entity. *See* 26 U.S.C. §1399. In other words, unlike the bankruptcy case where an individual debtor files for relief under chapter 7 or 11, the filing of a chapter 12 petition does not create a separate taxable entity. The chapter 12 bankruptcy estate, unlike its chapter 7 or 11 counterpart, receives no new taxpayer identification number and has no duty to file returns.

The IRS asserts that postpetition sales fail to qualify for nonpriority treatment under §1222(a)(2)(A). That position would essentially eviscerate §1222(a)(2)(A) in that it would deny the priority-stripping power of that Section when it would be needed most, in the actual administration of the bankruptcy case after a chapter 12 petition in bankruptcy has been filed.

The Bankruptcy Court immediately recognized the import of the IRS's argument and, relying on well-established bankruptcy principles and the legislative goals of §1222(a)(2)(A). Based on a thoughtful and well-reasoned approach, the Bankruptcy Court found that postpetition sales of farm assets used in the debtor's farming operations qualify for nonpriority treatment. I would adopt the compelling reasoning of the Bankruptcy Judge for several reasons. First, as the Bankruptcy judge noted, confirmation of a chapter 12 plan does not mean that that bankruptcy estate ceases to exist; rather, §1227(b) is properly understood as a control issue. *See Security Bank of Marshalltown v. Neiman*, 1 F.3rd 687, 691 (8th Cir. 1993).

Second, the allocation or bifurcation approach, which bifurcated corporate tax years in the year of filing, as articulated by the Eighth Circuit in *Mo. Dep't of Rev. v. L.J. O'Neill Shoe Co. (In re L.J. O'Neill Shoe Co.)*, 64 F.3d 1146 (8th Cir. 1995), is controlling law in this

appeal.[37] In attempting to distinguish *L.J. O'Neill*, the IRS argues that chapter 11 cases are a poor model for understanding this issue. The IRS's attempt is unpersuasive. The law on bifurcating tax years is chapter agnostic. The logic and reasoning of *O'Neill* applies equally well across all substantive chapters for relief.

Finally, the legislative history, particularly the remarks by Senator Grassley, and the stated purpose of new chapter 12 to save family farms that may be lost because of relatively large governmental claims, strongly support the Bankruptcy Court's ruling on this issue. New chapter 12 policy and Senator Grassley's vision as embodied in §1222(a)(2)(A) would be greatly frustrated by adopting the IRS position. The IRS's position would resurrect priority treatment for claims that arise from the transfer of farm assets used in a debtor's farming operations if those transfers took place ***in bankruptcy***.

Additionally, I would suggest another ground in support of the Bankruptcy Court's opinion. In *In re Brensing*, 337 B.R. 376 (Bankr. D. Kan. 2006), the bankruptcy court addressed a related issue. That case provides sound reasoning to support the administrative expense position adopted by the Bankruptcy Court in this case. The *Brensing* court read §§1306(a)(2), 1327(b), and the language "vests all of the property of the estate in the debtor" to mean that the debtor does not have property apart from the bankruptcy estate until the chapter 13 plan is concluded. The chapter 13 logic, as conceded by the IRS, should generally flow to chapter 12 cases. Chapter 12 contains that chapter's counterparts to §§1306(a)(2) and 1327(b) – §§1207(a)(2) and 1227. Chapter 12 also contains the language "vests all of the property of the estate in the debtor" to mean that the debtor does not have property apart from the bankruptcy

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[37] As noted by the Government, the 2005 Amendments purported to reject the majority view that permitted bifurcation of certain tax claims, the so-called straddle tax year, through amendments to §507(a)(8)(A)(iii). It may appear that the language actually used by Congress fails to reach that result. Nonetheless, that new provision does not apply to this bankruptcy case. The new §507(a)(8) applies to cases commenced on or after October 17, 2005. BAPCPA §1501, 119 Stat. at 216.

estate until the chapter 12 plan is concluded. This approach recognizes the interplay among several sections in chapter 12, promotes the policy and purposes of chapter 12, and gives meaning to new §1222(a)(2)(A) as a tool to strip priority from claims of governmental units that arise from transfers (both pre- and post-petition) of farm assets used in farming operations so long as a chapter 12 discharge is granted upon full performance by the debtor.

CONCLUSION

Enacted by Congress in 1986, The Family Farmer Bankruptcy Act (presently, chapter 12 of the Bankruptcy Code) was designed to give family farmers facing dire financial distress a chance to reorganize their debts and keep their land.[38] It is the small family farm that Chapter 12 was designed to protect.[39] The focus is on the continuation of farming operations in order to save the family farm. Through the remedial nature of chapter 12, Congress sought to help family farmers continue farming operations.[40] However, over time, Congress recognized that an obstacle to the compassionate goals of chapter 12 was the claim of governmental units arising from the transfer of assets. As Senator Grassley noted, the assertion of that claim by the government frustrated chapter 12 family farm reorganizations, resulting in the loss of the family farm. So some twenty years after its original enactment, Congress reshuffled the relative rights, priorities, and treatments of certain governmental claims in chapter 12 cases in order to remove the taxing authority's "veto" over family farm plans of reorganization. The tool Congress employed was the enactment of a new chapter 12 provision without precedent in the Bankruptcy Code. That provision, §1222(a)(2)(A), strips priority status from any governmental claim that arose from the transfer of farm assets used in the debtor's farming operations if the debtor receives a discharge. The IRS and many commentators do not like this provision; it is an aberration under federal tax law and a peculiar provision under the Bankruptcy Code. Thus, the IRS seeks to limit is application and its efficacy. The IRS does so by resolving every perceived

[38] *In re Michels*, 2003 WL 1965849 (Bankr. N.D. Iowa).
[39] 132 Cong. Rec. Sess. 15076 (daily ed. Oct. 3, 1986)(statement of Sen. Charles Grassley).
[40] *In re Watford*, 898 F.2d 1525, 1527 (11th Cir. 1990)(liberal construction of farming operations effectuates Congressional intent to save family farm operations); *In re Koppes*, 2000 WL 150836 (Bankr. N.D. Iowa 2000)(farming operations liberally construed in order to further Congressional purpose of helping family farmers to continue farming).

ambiguity in §1222(a)(2)(A) against the family farmer who seeks to preserve and continue operating the farm. If §1222(a)(2)(A) where found in the IRC, I would likely support the IRS's position across the first two of the three issues on appeal; the IRS position on the first two issues has strong support under federal tax law. But §1222(a)(2)(A) is not an IRC provision; it is a Bankruptcy Code provision. And the read that the IRS suggests across all three issues on appeal cuts dramatically against a family farmer like the Knudsens and frustrates the Congressional purpose of protecting family farmers and small farms. In law and in fact, such a read restores the government's blocking power over many chapter 12 plans. In contrast, a read across all three issues that finds support in the Bankruptcy Code and bankruptcy law and policy furthers the specific enumerated goals of chapter 12, preserves the intent of Congress to remove the functional veto that governmental units had in chapter 12 cases, and preserves family farms.

Respectfully submitted this 15th day of June, 2007.

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CERTIFICATE OF SERVICE

I certify that on June 15, 2007, the **Brief of *Amicus Curiae*** was filed electronically with the Clerk of Court and was delivered by the Court's CM/ECF System to the following parties:

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