IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE

In re:	:	Chapter 11
GUE Liquidation Companies, Inc.[1]	:	Case No. 19-11240 (LSS)
Post-Effective Date Debtor.	:	(Jointly Administered)
	:	**Re: Docket Nos. 1476, 1491, 1497**

NOTICE OF SUBMISSION OF AUTHORITY IN SUPPORT OF THE DEBTOR LIQUIDATION TRUST'S MOTION FOR AN ORDER PURSUANT TO SECTION 505 OF THE BANKRUPTCY CODE GRANTING THE DEBTOR LIQUIDATION TRUST'S RIGHTS TO TAX REFUNDS

PLEASE TAKE NOTICE that, on September 10, 2021, the Debtor Liquidation Trust established pursuant to the *First Amended Joint Plan of Liquidation for the Debtors* [D.I. 1005] (the "Plan"),[2] filed the *Motion for Debtor Liquidation Trust for an Order Pursuant to Section 505 of the Bankruptcy Code Granting the Debtor Liquidation Trust's Rights to Tax Refunds* [D.I. 1476] (the "Motion")[3] with the United States Bankruptcy Court for the District of Delaware (the "Court").

PLEASE TAKE FURTHER NOTICE that, on October 18, 2021, the Internal Revenue Service of the United States of America filed an objection to the Motion [D.I. 1491] ("Objection").

[1] The Post-Effective Date Debtor is and the last four digits of its taxpayer identification number are GUE Liquidation Companies, Inc. (5852). The address of the Post-Effective Date Debtor is: GUE Liquidation Companies, Inc., c/o Howley Law PLLC, Pennzoil Place – South Tower, 711 Louisiana Street, Suite 1850, Houston, Texas 77002.

[2] Capitalized terms used but not otherwise defined herein shall have the meanings ascribed to them in the Plan.

[3] Capitalized terms used but not otherwise defined herein shall have the meanings ascribed to them in the Motion.

PLEASE TAKE FURTHER NOTICE that, on November 1, 2021, the Court held a hearing (the "Hearing") to consider the relief requested in the Motion.

PLEASE TAKE FURTHER NOTICE that, on the record at the Hearing, the Court requested the Debtor Liquidation Trust submit the relevant portion of the following treatise cited in its reply to the Objection [D.I. 1497]: Stuart J. Goldring, Gordon D. Henderson, *Bankruptcy Court Jurisdiction Over Debtor's Tax Liability,* TAX PLANNING FOR TROUBLED CORPORATIONS: BANKRUPTCY AND NONBANKRUPTCY RESTRUCTURINGS, (2021 ed.).

PLEASE TAKE FURTHER NOTICE that, in accordance with the Court's direction at the Hearing, attached hereto is section 1013 of the above cited treatise as **Exhibit A**.

Dated: November 2, 2021
Wilmington, Delaware

Respectfully submitted,

/s/ Brett M. Haywood

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ATTORNEYS FOR THE DEBTOR
LIQUIDATION TRUST

Exhibit A

Tax Planning for Troubled Corporations

Bankruptcy and Nonbankruptcy Restructurings

2021 Edition

Gordon D. Henderson
Weil, Gotshal & Manges LLP

Stuart J. Goldring
Weil, Gotshal & Manges LLP

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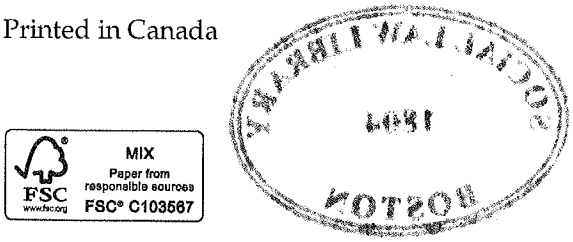

allowed in accordance with the plan, the debtors were barred under the principles of *res judicata* from pursuing the tax refunds.[46]

§1013 BANKRUPTCY COURT JURISDICTION OVER DEBTOR'S TAX LIABILITY

A bankruptcy court has as its central purpose the successful financial rehabilitation of the debtor corporation. The bankruptcy court will also be familiar with the affairs of the debtor and with the plan for its rehabilitation. As a result, a debtor corporation may find the bankruptcy court a better place than any other court in which to resolve tax disputes.

Pursuant to Bankruptcy Code section 505(a), the bankruptcy court may determine the amount or legality of any tax claim against the debtor (including any addition to tax, fine, or penalty relating to a tax), whether incurred prepetition or postpetition and whether or not previously assessed or paid.[1] A decision by the bankruptcy court as to the debtor corporation's tax liability is fully binding on the debtor corporation and cannot thereafter be relitigated in any tribunal.[2]

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[46] *Consider also Johnston v. Commissioner*, 461 F.3d 1162, 2006-2 U.S.T.C. ¶50,538 (9th Cir. 2006) (taxpayer could not apply NOLs from other audit years to reduce a tax liability agreed to in a settlement agreement with the IRS where such use of the NOLs was not preserved in the agreement).

[1] **§1013** 11 U.S.C. §505(a)(1). *See, e.g., United States v. Smith* (*In re Smith*), 158 B.R. 813, 93-2 U.S.T.C. ¶50,656 (Bankr. 9th Cir. 1993) (motion for order requiring State Lottery Commission to remit lottery winnings without reduction for applicable federal withholding taxes was not a proceeding "to determine the amount or legality of any tax"); *see also IRS v. Sulmeyer* (*In re Grand Chevrolet, Inc.*), 153 B.R. 296 (C.D. Cal. 1993), and *Inter Urban Broadcasting of Cincinnati, Inc. v. Lewis* (*In re Inter Urban Broadcasting of Cincinnati, Inc.*), 180 B.R. 153 (Bankr. E.D. La. 1995), discussed *infra* §1013.3.

As the use of the word "may" indicates, it is generally within the bankruptcy court's discretion to abstain from determining the merits of any tax claim. *See* discussion at §1013.1; *also consider In re Franklin*, 78 B.R. 118 (Bankr. E.D. Va. 1987) (court declined to consider allegation of faulty assessment where debtor had opportunity to file in Tax Court and did not raise request in its complaint to the bankruptcy court).

For a discussion of the ability (or inability) of a debtor to obtain relief from interest and penalties, *see* §§1006.1.2 (prepetition taxes), 1006.2.1 (postpetition taxes) and 1006.3.1 (trust fund taxes).

[2] S. Rep. No. 833, 96th Cong., 2d Sess. 48 (1980); *see, e.g., Florida Peach Corp. v. Commissioner*, 90 T.C. 678, Dec. 44,689 (1988) (bankruptcy court tax decision binding even though Chapter 11 case subsequently dismissed); *Samuel Leroy Bostian*, 62 T.C.M. 1337, Dec. 47,775(M), T.C. Memo. 1991-589 (same); *In re Pine Knob Investment*, 20 B.R. 714 (Bankr. E.D. Mich. 1982). A bankruptcy court order upholding (or "allowing") an IRS proof of claim constitutes a final and appealable judgment. *See, e.g.*, Circuit Court cases discussed at end of §1010.3 above, and *Samuel Leroy Bostian*, 62 T.C.M. 1337, *supra*. For a brief discussion of the binding effect of a court approved settlement agreement, *see* discussion *infra* at notes 82-91; *see also Schwab v. United States* (*In re Shop N' Go Partnership*), 261 B.R. 810 (Bankr. M.D. Pa. 2001) (concluding that "a settlement agreement entered into as part of a Chapter 11 plan proceeding and affirmed through a court order has a similar effect as a confirmed plan"; thus, in absence of any objection or timely appeal of the affirming order or of fraud in the procurement of the order, the debtor's settlement agreement with the IRS was binding even though the payment provisions were arguably inconsistent with the prioritization of claims in the Bankruptcy Code and the Plan).

In general, a bankruptcy court's declared findings of facts in an order confirming a debtor corporation's Chapter 11 plan are not determinative of such facts in a later IRS tax dispute that was not before the court at the time. *See, e.g., Dycoal Inc. v. IRS* (*In re Dycoal Inc.*), 327 B.R. 220, 2005-2

In general, this broad grant of authority means that the bankruptcy court may rule on a debtor's challenge to a previously assessed (but unpaid) tax liability even if the time period for challenging the assessment has expired under applicable nonbankruptcy law. Inevitably, though, this concept proves to be the rare exception, rather than the rule.[3]

As discussed below, the bankruptcy court may not rule on a tax claim that has been previously adjudicated in a contested proceeding before a judicial or administrative tribunal of competent jurisdiction before the commencement of the bankruptcy case.[4] Nor, in bankruptcy cases commenced on or after October 17, 2005, may

(Footnote Continued)

U.S.T.C. ¶50,554 (Bankr. W.D. Pa. 2005) *aff'd*, 2006 U.S. Dist. LEXIS 25078 (W.D. Pa. 2006) (IRS not bound by findings of facts in confirmation order purporting to establish factual predicates for Code §29 tax credits for preconfirmation periods), discussed at § 1014.3.4 below.

[3] Such belated challenges were relatively common in the local property tax area, but (as discussed in the text below) are no longer possible in the property tax context for bankruptcy cases commenced on or after October 17, 2005. *See, e.g., New Haven Projects L.L.C. v. City of New Haven (In re New Haven Projects L.L.C.)*, 225 F.3d 283 (2d Cir. 2000) (recognized broad grant of jurisdiction, but upheld bankruptcy court's right to abstain from redetermining two-year to six-year-old property tax assessments where reduction would result in a "windfall" to the debtor and an insider secured creditor to the prejudice of the city and the tax lien purchasers, and the amount of unsecured debt was *de minimis*), *cert. denied*, 121 S. Ct. 1093 (2001); *In re AWB Associates, G.P.*, 144 B.R. 270 (Bankr. E.D. Pa. 1992) (upheld jurisdiction to redetermine seven-year-old property taxes previously unchallenged by the debtor; acknowledged that at some point the staleness of the tax years may become relevant); and other authorities cited *infra* note 8 (which contrast the treatment of unpaid taxes with that of tax refunds); *In re WUS Corporation*, 1998 U.S. Dist. LEXIS 13754 (D.N.J. 1998) (debtor may challenge property tax assessments that were the basis for creditor's secured claim, but were assessed prior to debtor's ownership of the property); *Eddyville Corp. v. Ulster County*, 1998 U.S. Dist. LEXIS 2735 (S.D.N.Y. 1998) (upheld bankruptcy court's denial of debtor's motion to redetermine six years of unpaid property taxes assumed by debtor in connection with the debtor's recent purchase of the property from a bankrupt affiliate while the property was pending foreclosure); *Allison v. United States (In re Allison)*, 232 B.R. 195, 99-1 U.S.T.C. ¶50,285 (Bankr. D. Mont. 1998) (refusing to entertain debtor's action with respect to propriety of IRS levies where underlying tax assessments were over a decade old, the IRS levies were themselves several years old and no claim for refund had been filed; as one of several reasons given for its refusal, the court asserted that section 505(a) "must be read in light of the federal statutes granting appeal rights of tax assessments to taxpayers;" additional reasons given included laches by estoppel, efficient administration of the bankruptcy estate and fairness to the creditors and the bankruptcy trustee), *aff'd*, 242 B.R. 705, 99-1 U.S.T.C. ¶50,522 (D. Mont. 1999) (sanctions allowed), *judgment vac'd*, 2000-2 U.S.T.C. ¶50,768 (9th Cir. 2000) (vacated district court judgment due to untimely appeal).

[4] 11 U.S.C. §505(a)(2)(A); *see* discussion accompanying notes 25-31 below, and authorities *infra* at §1102.11 note 145. For other case discussions, *see In re TMI Growth Properties*, 109 B.R. 403 (Bankr. N.D. Cal. 1990) (upheld reconsideration of a debtor's property tax assessment, despite an earlier *postpetition* determination by the assessment appeals board; restriction in Bankruptcy Code section 505(a)(2)(A) only applies to prepetition determinations; moreover, the debtor was acting in good faith and presented evidence of an unduly high tax assessment that "outweigh[ed] the court's desire to honor the county's assessment acs a matter of comity"); *Mantz v. Calif. State Board of Equal. (In re Mantz)*, 343 F.3d 1207 (9th Cir. 2003) (concluding that the doctrine of *res judicata* does *not* preclude a bankruptcy court from redetermining a debtor's tax liability that was the subject of an adjudication that became final postpetition, at least where the matter was not pending appeal or in the appeal filing period at the time of the bankruptcy petition); *Bunyan v. United States (In re Bunyan)*, 354 F.3d 1149, 2004-1 U.S.T.C. ¶50,128 (9th Cir. 2004) (claim was previously adjudicated even though the tax matter at issue was not raised and determined in the prior proceeding *until* the Court of Appeals level). Although Bankruptcy Code section 505(a)(2)(A) is often said to be "jurisdictional in nature," it

the bankruptcy court rule on an *ad valorem* tax claim relating to real or personal property if the statutory period for contesting or redetermining the tax under nonbankruptcy law has expired.[5] In addition, a bankruptcy court may not disregard a time limit that relates to the grant of a statutory privilege, such as a charitable tax exemption which is conditioned upon the making of a timely application.[6]

A bankruptcy court also may not rule on a claim for refund unless (1) a refund claim has been properly filed with the IRS and the necessary waiting period for filing the refund suit has expired (*see also* §1012.2) or (2) the refund claim has been disallowed by the IRS.[7] Although the limitation on suits for refund appears relatively straightforward, the treatment of tax refunds has engendered considerable confusion in the case law. Nevertheless, except in certain limited circumstances, it is clear that the timely filing of a refund claim with the IRS is a precondition to a bankruptcy court determination of the refund.[8] Most courts have treated a request for a tax

(Footnote Continued)

is also well recognized as embodying the common law concepts of *res judicata*. Accordingly, like the defense of *res judicata*, some courts view such provision as an affirmative defense that may be lost if not timely raised. *See, e.g., In re El Tropicano, Inc.*, 128 B.R. 153, 156-157 (Bankr. W.D. Tex. 1991). *But see infra* note 13 and accompanying text, considering the same issue in the context of the limitation on the court's jurisdiction under Bankruptcy Code section 505(a)(2)(B).

[5] 11 U.S.C. 505(a)(2)(C). This effectively reverses the case law discussed in note 3, *supra*. Moreover, the reference to "nonbankruptcy" law has been held to preclude any extension of time under Bankruptcy Code section 108 (see discussions at §§1012.2 and 1102.11). *See, e.g., Dubov v. Read (In re Read)*, 692 F.3d 1185 (11th Cir. 2012); *In re Village at Oakwell Farms, Ltd.*, 428 B.R. 372 (Bankr. W.D. Tex. 2010).

[6] *See, e.g., Metropolitan Dade County v. Kapila (In re Home and Housing of Dade County, Inc.)*, 220 B.R. 492 (S.D. Fla. 1997) (involving use tax; distinguishes a procedural statute of limitations relating to the amount of an assessment from a time limit relating to a substantive entitlement).

[7] 11 U.S.C. §505(a)(2)(B). *See also* Code §7422(a) (quoted in full in the preceding section). It may therefore be relevant in a given case whether the monies remitted were in fact tax "payments" or simply "deposits" intended to preclude the accrual of interest and penalties. *See, e.g., IRS v. Pransky*, 261 B.R. 380, 2001-1 U.S.T.C. ¶50,440 (D.N.J. 2001), *aff'd* and *rem'd*, 318 F.3d 536, 2003-1 U.S.T.C. ¶50,216 (3d Cir. 2003). *See also* Rev. Proc. 2005-18, 2005-13 I.R.B. 798 (setting forth procedures for making, withdrawing or identifying deposits to suspend the running of interest on potential underpayments).

[8] *See also* discussion at §1012.2 above (discussing statute of limitations and interaction of the Bankruptcy Code); *City of Jersey City v. Mocco (In re Mocco)*, 2002 U.S. Dist. LEXIS 18592 (D.N.J. 2002) (only "requires the debtor to *properly request a refund*, not to *properly prosecute*" such claim).

Most of the law in this area, and the genesis of considerable confusion, involves property tax abatements (in bankruptcy cases pre-dating the 2005 statutory change in the Bankruptcy Court's jurisdiction for *ad valorem* claims) and stems from Judge Queenan's decision in *Ledgemere Land Corp.*, which he subsequently refuted in *Cumberland Farms*. Compare, *e.g., City of Perth Amboy v. Custom Distribution Services, Inc. (In re Custom Distribution Services, Inc.)*, 224 F.3d 235, 243-44 (3rd Cir. 2000) (involved New Jersey property tax; court did not have jurisdiction to refund excess payments since tax had not been contested in accordance with state law); *In re Venture Stores, Inc.*, 2002 U.S. App. LEXIS 25242 (3d Cir. 2002) (involved Texas property taxes; same); *In re Farmland Indus., Inc.*, 336 B.R. 415 (Bankr. W.D. Mo. 2005) (citing as comparative support the Eighth Circuit decision in *Kearns, infra* note 13); *Constable Terminal Corp. v. City of Bayonne, New Jersey (In re Constable Terminal Corp.)*, 222 B.R. 734 (Bankr. D. N.J. 1998) (to same effect; follows *Cumberland Farms*), *aff'd*, 246 B.R. 181 (D. N.J. 2000), *aff'd, without op.*, 281 F.3d 220 (3rd Cir. 2001); *Cumberland Farms, Inc. v. Town of Barnstable, et al. (In re Cumberland Farms, Inc.)*, 175 B.R. 138 (Bankr. D. Mass. 1994) (after considering legislative history, Judge Queenan reversed his original position in *Ledgemere Land Corp.*, in respect of property taxes); *In re St. John's Nursing Home, Inc.*, 169 B.R. 795 (D. Mass. 1994) (ruled contrary to *Ledgemere Land Corp.*

"credit" in the same manner.[9] As discussed at § 1012, many courts have held that the need to first file a claim for refund is dispensed with where the refund arises by way of offset or counterclaim.[10] Nevertheless, some courts (including the Third Circuit) have held that the offset or counterclaim must still be asserted within the applicable statute of limitations for claims for refund,[11] whereas others have held that a refund

(Footnote Continued)

with respect to property taxes and required timely filing; discussing authorities, including Third Circuit's unpublished opinion in *Continental Airlines, infra*), *with In re Ledgemere Land Corp.*, 135 B.R. 193 (Bankr. D. Mass. 1991) (Queenan, J.) (contrasting the treatment of federal income tax refunds with property tax abatements, and upholding jurisdiction over property tax abatements despite absence of timely filing).

See also In re Continental Airlines, Inc., 8 F.3d 811 (3d Cir. 1993) (unpublished opinion) (involving Denver sales and use tax), *cert. denied*, 114 S. Ct. 1297 (1994), *rev'g in part and aff'g in part* 149 B.R. 76, 80-81, 89 (D. Del. 1993) (although the district court ultimately upheld the need for timely filing, as to claims for refund as well as tax credit, it did so not so much on jurisdictional grounds but, rather, as a matter of substantive compliance with the time limitations of state law), *aff'g* 138 B.R. 430, 433-434 (Bankr. D. Del. 1992); *In re Qual Krom South, Inc.*, 119 B.R. 327 (Bankr. S.D. Fla. 1990), discussed below. The bankruptcy court decision in *Qual Krom South* has been often cited and highly criticized for its rather unusual reasoning. Although upholding the federal statute of limitations on refund claims, the court did so based on a narrow construction of the court's general grant of authority under Bankruptcy Code section 505(a), rather than on the more specific rule for refunds in Bankruptcy Code section 505(a)(2)(B). Under the bankruptcy court's reasoning, the bankruptcy court's jurisdiction would be subject to all types of statutes of limitation, whether relating to unpaid taxes or refund claims. Such a pervasive limitation, however, was clearly not intended. *See, for example, Roberts v. Sullivan County* (*In re Penking Trust*), 196 B.R. 389, 395-398 (Bankr. E.D. Tenn. 1996) (involving property taxes; also discusses the status of tax payments "under protest"); *see also supra* note 3.

In contrast, consider *In re Swan*, 152 B.R. 28 (Bankr. W.D.N.Y. 1992), implying that the bankruptcy court may have it within its equitable discretion to consider a refund suit despite an improperly filed refund claim. Similarly, consider *Schroeder v. United States* (*In re Van Dyke*), 275 B.R. 854, 2002-1 U.S.T.C. ¶ 50,270 (Bankr. C.D. Ill. 2002) (permitting suit for refund in a non-offset situation under alternative theories, including a broad reading of the *Kearns* decision, discussed *infra* note 11).

[9] *See, e.g., In re Dunhill Medical, Inc.*, 96-1 U.S.T.C. ¶ 50,276 (Bankr. D.N.J. 1996) (credit and refund treated alike for purposes of Bankruptcy Code section 505(a)(2)(B)); *In re Continental Airlines, Inc., supra* note 8; *Constable Terminal Corp. v. City of Bayonne* (*In re Constable Terminal Corp.*), *supra* note 8 (both bankruptcy and district courts).

[10] *See supra* § 1012 note 31.

[11] *See, e.g., City of Perth Amboy v. Custom Distribution Services, Inc.* (*In re Custom Distribution Services, Inc.*) (3d Cir.), *supra* note 8; *In re Rodriguez*, 387 B.R. 76 (Bankr. E.D. N.Y. 2008) (must assert within limitations period); *In re Dunhill Medical, Inc., supra* note 9 (*see* sections "III" and "IV" of decision); *In re Bowen*, 1994 Bankr. LEXIS 1604 (Bankr. S.D. Ga.). *Cf. In re Nottingham*, 2005-2 U.S.T.C. ¶ 50,479 (Bankr. C.D. Ill. 2005) (no amount legally subject to setoff by debtor where period to claim refund or credit had expired); *Constable Terminal Corp. v. City of Bayonne* (*In re Constable Terminal Corp.*), *supra* note 8; *In re Gibson*, 176 B.R. 910 (Bankr. Or. 1994) (statute of limitations barred setoff of contract damage claim against tax debt).

But see United States v. Kearns, 177 F.3d 706, 99-1 U.S.T.C. ¶ 50,573 (8th Cir. 1999) (allowed offset even though no claim for refund had been filed and statutory period for doing so had passed, where the IRS claimed additional taxes based on previously unreported income for monies embezzled by the debtor, and the offset—principally the debtor's tax savings from deducting his restitution payments—also arose out of the embezzlement; the court carefully avoided addressing whether the prior passage of the statutory period for filing a refund claim could, on other facts, impede a debtor's ability to offset previously unclaimed tax savings for taxable years not covered by the proof of claim), *rev'g*, 219 B.R. 823 (Bankr. 8th Cir. 1998); *United States v. Henderson* (*In re Guardian Trust Co.*), 260 B.R. 404, 2000-2 U.S.T.C. ¶ 50,777 (S.D. Miss. 2000) (upheld bankruptcy court's jurisdiction over trustee's claim for an offset arising out of an asserted NOL carryback from one of the same taxable years for

claim must be filed at least prior to the court "determining" the offset or counterclaim.[12] One possible exception to the need for a timely filed claim for refund is where a prepetition tax was (with court permission) paid postpetition. In such event, some courts have viewed a debtor's later action to reduce the tax to be part of the normal claims adjustment process, rather than in the nature of a refund claim, and therefore not subject to the same preconditions as a claim for refund or credit.[13] In another instance, a debtor objected to an IRS tax claim asserting as an offset certain prior-year tax overpayments that the debtor believed had not been properly credited.[14] In the bankruptcy court's view, the nature of the asserted offset did not require "the determination of a tax, a fine or penalty relating to a tax, or an addition to tax" and, thus, was not prohibited by the Bankruptcy Code condition requiring a prior claim for refund. Although not entirely clear, it appears that the absence of a timely filed claim for refund or tax credit (where otherwise required) is a jurisdictional bar which can be raised as a defense at any time during the proceeding or on appeal, rather than a procedural or affirmative defense that may be lost if not timely raised.[15]

(Footnote Continued)

which the IRS had filed a claim for tax deficiencies, even though an administrative claim for refund would not have been timely; the district court, relying on the Eighth Circuit's decision in *Kearns*, held that jurisdiction was justified since the IRS had already committed itself to expending resources for the tax years at issue, and, thus, no additional litigation burden would be imposed).

[12] *See United States v. Bond*, 2012-2 U.S.T.C. ¶50,567 (E.D. N.Y. 2012), *rev'g, sub nom. In re PT-1 Communications, Inc.*, 403 B.R. 250 (Bankr. E.D. N.Y. 2009) (held that a properly filed refund claim is required, expressly rejecting the line of cases to the contrary; however, it was sufficient that the refund claim was filed after the counterclaim was brought, and then plead by way of an amendment or supplement to the original pleading; on the facts, the court also considered this the equitable result), *rev'd on other grounds*, 762 F.3d 255, 2014-2 U.S.T.C. ¶50,406 (2d Cir. 2014) (the Second Circuit reversed because the refund action was brought by a liquidating trustee appointed pursuant to the debtor's Chapter 11 plan without the debtor itself having first filed the claim for refund; the liquidating trustee's filing of the claim for refund was not sufficient; the court expressly did not address the situation of a counterclaim filed in response to a prepetition proof of claim).

[13] *See, e.g., MCorp Financial, Inc. v. Harris County (In re MCorp Financial, Inc.)*, 216 B.R. 596 (Bankr. S.D. Tex. 1996) (involved real estate taxes); *150 North Street Assoc. Ltd. L.P. v. City of Pittsfield*, 184 B.R. 1 (Bankr. D. Mass. 1995) (same).

[14] *Mahon v. IRS (In re Mahon)*, 2017 Bankr. LEXIS 419 (Bankr. D. Mass. 2017).

[15] *See, e.g., United States v. Bond* (2d Cir.), *supra* note 12 (jurisdictional); *City of Perth Amboy v. Custom Distribution Services, Inc. (In re Custom Distribution Services, Inc.)*, *supra* note 8 (jurisdictional; Third Circuit reversed district court holding to the contrary); *Graham v. United States (In re Graham)*, 981 F.2d 1135, 1138, 93-1 U.S.T.C. ¶50,255 (10th Cir. 1992) (held that bankruptcy court erred in awarding tax refund because Bankruptcy Code section 505(a)(2)(B) and Code §7422(a) "are nonwaivable jurisdictional requirements," and stated that, until a timely claim for refund is filed, the government has not waived its sovereign immunity). *Cf. United States v. Kearns (In re Kearns)*, 219 B.R. 823, 98-1 U.S.T.C. ¶50,315 (Bankr. 8th Cir. 1998) (involves individual debtor; viewed Bankruptcy Code section 505(a)(2)(B) as a jurisdictional bar; similarly considered the filing of a timely claim as a precondition to waiving sovereign immunity; lack of subject matter jurisdiction may be raised at any stage of proceeding), *rev'd*, 177 F.3d 706, 99-1 U.S.T.C. ¶50,573 (8th Cir. 1999) (Eighth Circuit disagreed with Appellate Panel as to the need for a timely filed claim in certain cases of offset, *see supra* note 11). Consider also the following cases discussing whether the timely filing requirement is jurisdictional or procedural, but did not involve an untimely defense. *Compare United States v. Ryan (In re Ryan)*, 64 F.3d 1516, 1520-1521, 95-2 U.S.T.C. ¶50,519 (11th Cir. 1995) (discussing jurisdictional significance of a timely filed claim in the bankruptcy context); *In re Dunhill Medical, Inc. supra* note 9 (same); *In re Qual*

Once the refund claim is timely filed and the requisite waiting period is satisfied, the case law developed in the state and local property tax area (pre-dating the 2005 statutory change in the bankruptcy court's jurisdiction) generally supports the ability of the bankruptcy court to rule on the refund claim irrespective of any generally applicable statute of limitations for suits for refund, in view of the bankruptcy court's broad grant under Bankruptcy Code section 505(a) to determine any tax liability of the debtor "whether or not paid."[16] Nevertheless, such courts generally have considered the relative equities in determining whether to entertain actions brought several years after the original tax assessment and payment.[17] Moreover, it is uncertain whether the reasoning of such cases properly extends to federal tax refunds. For example, in *In re Pransky*,[18] the Third Circuit applied the normal two-year statute of limitations on refund suits in Code §6532 without any discussion of any potential Bankruptcy Code interplay.

Another potential limitation on the bankruptcy court's jurisdiction in tax refund actions is whether the debtor's suit for refund is a "core" or "non-core" proceeding under 28 U.S.C. §157(a). As discussed further at §1013.2 below, a bankruptcy court has general jurisdiction over any civil proceeding that is at least "related to" the bankruptcy case. However, unless the proceeding constitutes a "core" proceeding or the parties otherwise consent, the bankruptcy court's power to dispose of the proceeding is limited to hearing the case and submitting proposed findings of fact and conclusions of law to the district court for *de novo* review. A "core" proceeding generally includes matters concerning the allowance or disallowance of prepetition claims or otherwise affecting the adjustment of the debtor-creditor relationship. Thus, most (if not all) proceedings involving prepetition tax claims are "core" proceedings. In contrast, a suit for tax refund may not involve an offsetting claim against the

(Footnote Continued)

Krom South, Inc., supra note 8; *with* district court decision in *In re Continental Airlines, Inc., supra* note 8. *But cf. In re El Tropicano, Inc., supra* note 4 (Bankruptcy Code section 505(a)(2)(A) is not a jurisdictional bar, but rather an affirmative defense that may be lost if not timely raised).

[16] *See, e.g., In re Poiroux*, 167 B.R. 980 (Bankr. S.D. Ala. 1994), and the case law referenced *supra* at note 3, which—as relates to bankruptcy cases commenced before October 17, 2005—generally holds that the lapse of the debtor's right to protest or appeal an outstanding state or local tax assessment is not binding on the bankruptcy court. *But see CGE Shattuck LLC v. Town of Jaffrey (In re CGE Shattuck LLC)*, 272 B.R. 514 (Bankr. D. N.H. 2001) (debtor did not "properly request" a tax refund where it failed to appeal a decision of the town selectmen and the statute of limitations for doing so had expired). *Also consider* 11 U.S.C. §106(a)(5), discussed *supra* at §1005.1 (stating that the waiver of sovereign immunity contained in that section does not "create any substantive claim for relief or cause of action not otherwise existing" under the Bankruptcy Code or applicable nonbankruptcy law).

[17] *See, e.g., Delafield 246 Corp. v. The City of New York (In re Delafield 246 Corp.)*, 368 B.R. 285 (Bankr. S.D. N.Y. 2007) (under appropriate circumstances, abstention can be proper even where an alternative remedy is no longer available); Report of the American Bar Association Task Force Concerning the Tax Recommendation of the National Bankruptcy Review Commission (April 15, 1997), p. 132, *reprinted at* 97 TNT 90-22 ("The Bankruptcy Courts have in the past . . . exercised appropriate discretion in determining which tax issues need be resolved to provide an orderly completion of the pending [bankruptcy] case"). *Cf.* cases cited *supra* note 3.

[18] *IRS v. Pransky (In re Pransky)*, 318 F.3d 536, 2003-1 U.S.T.C. ¶50,216 (3d Cir. 2003); *see also In re Smythe*, 306 B.R. 218, 2004-1 U.S.T.C. ¶50,180 (Bankr. N.D. Ohio 2004), *citing Pransky*.

debtor for unpaid taxes and, even when it does, might *not* be considered a "core" proceeding.

For example, in an unusual procedural set of facts, the individual debtor, in *Dunmore v. United States*,[19] brought a refund action in the district court with respect to certain prepetition taxes following its discharge in bankruptcy, as to which the IRS alleged certain offsets. In the process, the IRS also raised certain bankruptcy specific issues that the district court determined were best resolved by the original bankruptcy court. Accordingly, the matter was referred back to the bankruptcy court to resolve such issues. After resolving such issues, the bankruptcy court (rather than referring the matter back to the district court) proceeded to trial on the refund action, ultimately dismissing the debtors' refund claim with prejudice for failure to prosecute. The debtor appealed. Although recognizing there existed contrary authority, the Ninth Circuit held that the debtor's refund actions were *not* "core" proceedings, since such actions did not depend on the Bankruptcy Code for their existence and could proceed in another court. The Ninth Circuit acknowledged that the Sixth Circuit, in *In re Gordon Sel-Way, Inc.*,[20] had held that a tax refund claim with an alleged IRS offset was a "core" proceeding since the outcome could affect the adjustment of a debtor-creditor relationship, but believed that a debtor's right to an adjudication of its refund by an Article III (district) court should not depend on whether or not the IRS asserts an offset. As a "non-core" proceeding, the bankruptcy court could only propose findings of fact and conclusions of law to the district court. Accordingly, the Ninth Circuit remanded the case to the district court, holding that the bankruptcy court had abused its discretion in dismissing the debtor's refund actions.

In contrast, in *In re Mahon*,[21] wherein the debtor asserted a tax refund claim defensively as an offset to an IRS proof of claim, the court easily concluded that the refund claim was a "core" proceeding. The court also concluded, on the facts involved, that the Supreme Court's decision in *Stern v. Marshall*[22] did not invalidate the court's jurisdiction. In *Stern*, the Supreme Court limited the authority of the bankruptcy court under 28 U.S.C. § 157(a) with respect to counterclaims, holding that a bankruptcy court (a non-Article III court) may not enter a final judgment as to a counterclaim *unless* the counterclaim "stems from the bankruptcy itself or would necessarily be resolved in the claims allowance process."[23]

As indicated above, under Bankruptcy Code section 505(a), the Bankruptcy Court may not rule on any tax claim for which there was a prebankruptcy adjudication in a contested proceeding by a judicial or administrative tribunal of competent jurisdiction. This balances the policies of *res judicata* while protecting (i) the debtor, on the one hand, from being bound by a pre-bankruptcy tax liability determination that,

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[19] 358 F.3d 1107 (9th Cir. 2004).

[20] *Gordon Sel-Way, Inc. v. United States* (*In re Gordon Sel-Way, Inc.*), 270 F.3d 280, 2001-2 U.S.T.C. ¶50,720 (6th Cir. 2001).

[21] *Mahon v. IRS* (*In re Mahon*), 2017 Bankr. LEXIS 419 (Bankr. D. Mass. 2017).

[22] 131 S.Ct. 2594 (2011).

[23] Id. at 2615-2618. For a general discussion of *Stern* as relates to tax claims, *see, e.g., In re Galluzzo*, 2018 Bankr. LEXIS 2436 (Bankr. D. N.J. 2018) (unpublished decision).

because of lack of funds, it was unable to contest,[24] and (ii) the creditors, on the other hand, from the dissipation of estate assets in the event that the debtor failed to contest a questionable tax liability.[25] A tax claim has been previously "adjudicated" if judgment has been entered and has become final.[26] This includes a Tax Court decision rendered pursuant to the stipulation of the parties.[27] Accordingly, if judgment has not been entered, the bankruptcy court may preempt another court's jurisdiction and determine the debtor's tax liability.[28] In addition, a default judgment will generally not preclude a redetermination by the bankruptcy court.[29] However, a default judgment entered in a Tax Court proceeding after the IRS has filed its answer is binding on the bankruptcy court.[30] A judgment that, as of the commencement of the bankruptcy case, is appealable (or on appeal) and thus not yet final will not bar reconsideration by the bankruptcy court (subject to *res judicata* considerations).[31]

One district court, in a 2005 decision later reversed by the Ninth Circuit,[32] gave a more expansive reading to the concept of a prebankruptcy adjudication. In that case, a partnership in which the debtor corporation was a substantial indirect partner was the subject of a partnership level audit and administrative appeal governed by then Code §§6221-6234 (a so-called "TEFRA proceeding," named for the enacting legisla-

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[24] *See, e.g., Mantz v. Calif. State Board of Equal. (In re Mantz)*, 343 F.3d 1207 (9th Cir. 2003).

[25] *New Haven Projects L.L.C. v. City of New Haven (In re New Haven Projects L.L.C.)* (2d Cir.), *supra* note 3.

[26] *See, e.g., Mantz v. Calif. State Board of Equal. (In re Mantz)* (9th Cir.), *supra* note 20 (reversing bankruptcy and district courts); *cf. infra* notes 29 and 30.

[27] *See, e.g., IRS v. Teal (In re Teal)*, 16 F.3d 619 (5th Cir. 1994) (irrelevant that the stipulation did not specifically address the legality of the penalty in question, but simply fixed the amount); *Baker v. IRS (In re Baker)*, 74 F.3d 906 (9th Cir. 1996) (similarly concluding), *cert. denied*, 116 S. Ct. 1683 (1996); *Graham v. IRS (In re Graham)*, 94 B.R. 386, 397 (Bankr. E.D. Pa. 1988); *Dufault v. United States (In re Dufault)*, Case No. 89-61431, Adv. No. 90-6065 (Bankr. N.D. Ind. April 24, 1992).

[28] *See* 11 U.S.C. §362(a)(8), and discussion at §1009.2.

[29] *In re Tapp*, 16 B.R. 315 (Bankr. D. Alaska 1981) ("contested" proceeding generally excludes default judgment); *In re Buchert*, 1987 U.S. Dist. LEXIS 7550 (N.D. Ill. 1987); *cf. City of Jersey City v. Mocco (In re Mocco)* (D.N.J.), *supra* note 8 (held that a *dismissal* of an action under New Jersey state law did not constitute a previous adjudication; distinguished *Northbrook Partners, infra*, which analogized a dismissal to a default judgment, since under New Jersey law a default judgment did not necessarily have preclusive effect); *but see Northbrook Partners LLP v. County of Hennepin (In re Northbrook Partners LLP)*, 245 B.R. 104 (Bankr. D. Minn. 2000) (analogizing a dismissal to a default judgment which, under the governing state law, had preclusive effect, the court held that a dismissal of a prior state court action amounted to a previous adjudication).

[30] *Von Tempske v. United States (In re Von Tempske)*, 1989 Bankr. LEXIS 1415 (Bankr. N.D. Ga.); 124 Cong. Rec. H 11,110 (daily ed. September 28, 1978) (statement of Rep. Edwards), S 17,427 (daily ed. October 6, 1978) (statement of Sen. DeConcini).

[31] *See, e.g., City Vending of Muskogee, Inc. v. Oklahoma Tax Comm'n*, 898 F.2d 122, 125 (10th Cir.), *cert. denied*, 498 U.S. 823 (1990); *In re Freytag*, 93-2 U.S.T.C. ¶50,531 (Bankr. N.D. Tex. 1993), *aff'd*, 173 B.R. 330, 94-2 U.S.T.C. ¶50,456 (N.D. Tex. 1994) (holding that a Tax Court judgment that was on appeal when the bankruptcy petition was filed was not a complete "adjudication"; however, upon becoming final, *res judicata* barred the bankruptcy court from reconsidering debtor's tax liability); *Lipetzky v. Dept. of Rev. (In re Lipetsky)*, 64 B.R. 431 (Bankr. D. Mont. 1986) (property tax assessment held not fully "adjudicated" where appeal from decision of State Tax Appeals Board was still pending); *but see In re The Railroad Street Partnership*, 255 B.R. 644 (Bankr. N.D.N.Y. 2000).

[32] *Central Valley AG Enterprises v. United States*, 326 B.R. 807, 2005-2 U.S.T.C. ¶50,612 (E.D. Cal. 2005), *rev'd*, 531 F.3d 750, 2008-2 U.S.T.C. ¶50,405 (9th Cir. 2008).

tion) that resulted in the issuance of a Notice of Final Partnership Administrative Adjustment (FPAA). The FPAA provided each of the partners with the opportunity to challenge the adjustments in the Tax Court, the filing period for which expired prior to the debtor's filing for bankruptcy. Although no Tax Court review was ever sought, the district court held that the adjustments had been previously adjudicated. The court stated that the "partners fully participated in the proceedings described by TEFRA up to the point of the issuance of the FPAA" and that "the critical point is that [the debtor] could have, under the terms of TEFRA, proceeded to judicial review of the FPAA." The Ninth Circuit reversed, emphasizing that the statute "requires a matter be *actually* contested and adjudicated before it is entitled to preclusive effect in a bankruptcy proceeding."[33]

Although an action for the determination of taxes under Bankruptcy Code section 505(a) is generally commenced by the debtor-in-possession (or trustee), most courts have held that such section is not so restricted and that such an action may be commenced, in appropriate circumstances, by any party in interest including the post-reorganization debtor or its successor.[34] For example, it is not unusual for an action to be brought by a trustee of a liquidating trust under a conferred grant of authority pursuant to the debtor's Chapter 11 plan,[35] though the Second Circuit has held that the prior filing of a claim for refund by the debtor-in-possession (or bankruptcy trustee) itself is a precondition to a subsequent refund action by a liquidating trustee or other plan-appointed estate representative (see discussions at

[33] 531 F.3d at 755-757.

[34] *See, e.g., Gordon Sel-Way, Inc. v. United States* (*In re Gordon Sel-Way, Inc.*) (6th Cir.), *supra* note 19 (involved a debtor's postconfirmation claim for a tax refund); *IRS v. Luongo* (*In re Luongo*), 259 F.3d 323, 2001-2 U.S.T.C. ¶50,527 (5th Cir. 2001) (2:1 decision) (to same effect); *Schroeder v. United States* (*In re Van Dyke*) (Bankr. C.D. Ill.), *supra* note 8 (involved a postconfirmation trustee of a liquidating trust established pursuant to a liquidating Chapter 11 plan and which, in the confirmation order, was delegated the responsibility of dealing with the bankruptcy estate's tax liability for specified years and given all of the rights of a debtor-in-possession); *In re Agway, Inc.*, 412 B.R. 32 (Bankr. N.D. N.Y. 2009), *rev'd on other issues*, 447 B.R. 91 (N.D. N.Y. 2011) (to similar effect); *United States v. Official Comm. of Unsecured Creditors of Indus. Comm. Electrical, Inc.* (*In re Indus. Comm. Electrical, Inc.*), 319 B.R. 35, 53, 2005-1 U.S.T.C. ¶50,312 (D. Mass. 2005) (creditors' committee took over prosecution of objection to IRS claim). *See also* discussion at §1013.2 (tax liability of non-debtors). *Consider also Commodore Int'l, Ltd. v. Gould* (*In re Commodore Int'l, Ltd.*), 262 F.3d 96 (2d Cir. 2001) (non-tax case, holding that a creditors' committee may obtain standing to pursue a debtor's claims (i) if the committee has the debtor's consent and the court finds that the litigation is in the best interests of the estate and necessary and beneficial to the fair and efficient resolution of the bankruptcy case," as well as (ii) if the debtor "unjustifiably failed to bring suit or abused its discretion in not suing;" but recognized that many bankruptcy courts only permit such creditor actions in the latter situation); *Smart World Technologies, LLC v. Juno Online Services, Inc.* (*In re Smart World Technologies, LLC*) 423 F.3d 166 (2d Cir. 2005) (to same effect; under the circumstances, creditors did *not* have standing to settle an adversary proceeding over the debtor's objection); *In re Kowalczyk*, 600 B.R. 806 (Bankr. D. N.D. 2019) (creditor that would receive a dollar-for-dollar benefit from any reduction in the IRS claim did *not* have standing to challenge the claim under Bankruptcy Code section 505; neither the bankruptcy trustee nor the debtor objected to the claim; even if standing were present, the bankruptcy court stated that it would abstain from determining the tax liability).

[35] *See* 11 U.S.C. §1123(b)(3)(B); *see, e.g., In re Gordon Sel-Way, Inc.* (6th Cir.), *In re Van Dyke* (Bankr. C.D. Ill.), and *In re Agway, Inc.* (Bankr. N.D. N.Y.), cited in note 34, *supra.*

§§1011 and 1013.6).[36] In general, an action for a determination of taxes arises either by filing an objection to a previously filed claim or initiating an adversary proceeding (*see* §1004 above). In some cases, debtors have attempted to sidestep this process by fixing the amount of, or otherwise addressing, the tax claim in their Chapter 11 plan; however, where timely challenged, such attempts have generally failed.[37]

Removal of reference from bankruptcy court. Even where the bankruptcy court otherwise has jurisdiction, the district court has the power, under 28 U.S.C. §157(d), to remove any pending action from the bankruptcy court to the district court, either on its own motion or on a timely motion of any party, for cause shown. Moreover, the same section provides that, on timely motion by any party, the district court must remove any action if it determines that the resolution of such action requires consideration of both bankruptcy and "other laws of the United States regulating organization or activities affecting interstate commerce." However, the legislative history cautions (and the courts have so held) that such provision should be narrowly construed so as not to become an "escape hatch" through which most bankruptcy matters could be removed to the district court.[38]

For example, the IRS in *In re CM Holdings, Inc.*[39] argued successfully that the tax issues involved necessitated the mandatory withdrawal of the pending action from the bankruptcy court to the district court. At issue was the deductibility of interest on nonrecourse insurance policy loans obtained in connection with Corporate-Owned Life Insurance (COLI) policies under Code §§163(a) and 264 (for policies issued prior to 1996). The court stated that removal of the action was mandatory where the consideration of federal laws outside the Bankruptcy Code are "substantial and material," such that there is required a "meaningful consideration" of the federal law and not just a straightforward "simple application" of federal law to the facts of the case. The court noted that some courts might require that the law in dispute be either one of first impression or in sharp conflict with competing provisions of the Bankruptcy Code. Nevertheless, the court held that, under both formulations, removal was mandatory in that the tax issues involved would require meaningful consideration (as evidenced by the existence of an adverse technical advice memorandum) and were matters of first impression.[40]

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[36] *United States v. Bond*, 762 F.3d 255, 2014-2 U.S.T.C. ¶50,406 (2d Cir. 2014) (adopted a "plain reading" of the reference to "the trustee" in section 505(a)(2)(B); the refund claim properly filed by the liquidating trustee did not suffice; district court had viewed section 505(a)(2)(B) as simply a timing and exhaustion of remedies provision), *rev'g* 486 B.R. 9 (E.D. N.Y. 2012), *aff'g in relevant part, sub. nom. In re PT-1 Communications Inc.*, 403 B.R. 250 (Bankr. E.D. N.Y. 2009).

[37] *See* cases at §1011 note 16 above, and discussion at §1014.3.1 below.

[38] *See* 130 Cong. Rec. H 1849-50 (daily ed. March 21, 1984); *see also* S. Rep. No. 55, 98th Cong., 1st Sess. 16 (1983). For a discussion of 28 U.S.C. §157(d), *see* 1 Collier on Bankruptcy ¶3.01 (15th ed.); IRS Litigation Guideline Memorandum, "Withdrawal of the Reference to the Bankruptcy Court—Defending 100% Penalty Assessments in Bankruptcy," dated September 23, 1991, *reprinted at* 96 TNT 155-66. *See also Scharffenberger v. United States*, 2006 U.S. Dist. LEXIS 91548 (W.D. Pa. 2006) (IRS motion to remove action was untimely when brought more than 10 months after the issues were known, where there was prejudice to the estate and no justification for the delay).

[39] *IRS v. CM Holdings, Inc. (In re CM Holdings, Inc.)*, 221 B.R. 715 (D. Del. 1998).

[40] For other cases considering this question, *see, e.g., United States v. G-I Holdings, Inc. (In re G-I Holdings, Inc.)*, 295 B.R. 222, 2003-2 U.S.T.C. ¶50,535 (D. N.J. 2003) (mandatory removal was appropri-

§1013.1 *Jurisdiction Is Discretionary*

The bankruptcy court, although empowered to determine the merits of any tax claim, generally may abstain and leave the tax claim in abeyance.[41] One exception to this general rule is where the tax dispute results from the IRS's prompt determination of the debtor's tax liability pursuant to Bankruptcy Code section 505(b) (*see* §1011 above). In addition, to avoid undue delay, the bankruptcy court may be required to estimate the tax claim (*see* §1010.1). Alternatively, the bankruptcy court may, on request of the debtor or the IRS, terminate the stay and permit the debtor's tax liability to be determined by another court.[42] Although the bankruptcy court is not compelled to terminate the stay, a debtor's request to have its tax liability determined by the Tax Court is not likely to be denied. More frequently, however, it will be the IRS who requests relief from the automatic stay, given that bankruptcy judges are generally less experienced in tax matters and are generally viewed as having a pro-debtor bias.[43] Also, until 2000, a debtor might also have benefited from a potentially different burden of proof in bankruptcy cases (*see* §1013.4 below).

(Footnote Continued)

ate where the primary issue was an issue of first impression involving the applicability of Code §707 versus §721, which would necessarily require substantial and material consideration of competing nonbankruptcy legal standards; the court also observed that close to a billion dollars in tax liability was at issue); *United States v. Heller Healthcare Finance, Inc.* (*In re Numed Healthcare, Inc.*), 2001 U.S. Dist. LEXIS 19264 (M.D. Fla. 2001) (denied government motion to remove to district court a dispute involving competing liens); *Central Valley AG Enterprises v. United States*, 326 B.R. 807, 2005-2 U.S.T.C. ¶50,612 (E.D. Cal. 2005) (noting that it had previously withdrawn from the bankruptcy court an action to determine the legality of a lease-stripping tax shelter).

[41] 28 U.S.C. §1334(c)(1); Bankruptcy Rule 5011(b) (bankruptcy court can make findings, conclusions, and recommendations on abstention, but ultimate disposition is vested in district court); *see, e.g., Arkansas Corp. Commissioner v. Thompson*, 313 U.S. 132 (1941); *New Haven Projects L.L.C. v. City of New Haven* (*In re New Haven Projects L.L.C.*) (2d Cir.), *supra* note 3 (upheld bankruptcy court abstention with respect to redetermination of multiple year property tax assessments where only *de minimis* benefit to other creditors, aside from insiders); *Queen v. United States* (4th Cir. January 20, 1993) (unpublished decision), *reprinted at* 94 TNT 21-24; *Smith v. United States* (*In re Smith*), 122 B.R. 130 (Bankr. M.D. Fla. 1990) (abstention appropriate only where interests of the creditors and the debtor would be served; Bankruptcy Rule 5011 not implicated where decision is to permit continuation of Tax Court proceeding, rather than simply to hold the tax claim in abeyance); *In re Fairchild Aircraft Corp.*, 124 B.R. 488 (Bankr. W.D. Tex. 1991) (rejected abstention motion, despite prior *postpetition* adjudication of property tax valuation, since the matter was properly before the bankruptcy court and did not challenge "the overall valuation methodology used by the appraisal district," nor otherwise affect the amount of taxes payable by other taxpayers); *Northbrook Partners LLP v. County of Hennepin* (*In re Northbrook Partners LLP*) (Bankr. D. Minn.), *supra* note 28 (abstained from deciding property tax valuation case). *See also Millsaps v. United States* (*In re Millsaps*), 133 B.R. 547 (Bankr. M.D. Fla. 1991) (burden on court's docket constituted an additional factor favoring abstention), *aff'd*, 138 B.R. 87 (M.D. Fla. 1991).

[42] 11 U.S.C. §362(d).

[43] *See* IRS Manual, Part 34, Ch. 3 (Procedures in Bankruptcy Cases), §1.2.1 (1/20/15), at ¶2 (factors that the IRS considers in deciding whether to request a lifting of the stay on Tax Court litigation); *see also In re Sheffield*, 225 B.R. 234 (Bankr. E.D. Okla. 1997) (court lifted stay at request of IRS to allow Tax Court proceeding to continue where bankruptcy case was filed within seven weeks of trial date); *United States v. Matthew*, 232 B.R. 554 (Bankr. D. Conn. 1999) (court denied IRS's request to lift stay where debtor would be forced to litigate in a different state and possibly have to hire new counsel).

In *In re Hunt*,[44] the debtors and the IRS were still in the early stages of preparing for trial in the Tax Court when the debtors filed voluntary petitions for reorganization under Chapter 11. The filing automatically stayed the continuation of the Tax Court case. Shortly thereafter, the debtor filed a "Motion for Determination of Tax Liability Pursuant to 11 U.S.C. § 505;" in response, the IRS moved to have the stay modified to permit the Tax Court case to continue. In deciding whether to hear the tax case or to lift the stay, the court considered the following factors:

(1) the extent to which the debtors actively contest the assessment;
(2) the need to ensure prompt and orderly administration of the bankruptcy estate;
(3) the complexity of the tax issues and the "special expertise" of the Tax Court;
(4) the potential "whipsaw effect" to the IRS where, as here, there are related cases not before the court (the court observed that the potential whipsaw effect could, in this case, be avoided in the Tax Court since the related cases were already docketed and could be consolidated);
(5) the burden on the bankruptcy court's docket; and
(6) the fact that a trial before the bankruptcy court adds a potential layer of review (*i.e.*, the district court), thereby extending the time for ultimate resolution.

Balancing these factors and taking into account the magnitude of the proposed deficiency (over $250 million including interest), the court lifted the stay to permit the parties to prepare for—but, at least initially, not to proceed to—trial before the Tax Court. The court conditioned the further lifting of the stay on the parties progressing toward trial in a "meaningful manner" and upon their announcement that they are ready for trial. To ensure the debtors' compliance, the court cautioned that "[a]ppropriate actions will be taken if [they] do not diligently progress toward preparation for trial . . . ."[45]

In *Pursue Energy Corp. v. Mississippi State Tax Commission*,[46] the debtor had filed for bankruptcy relief under Chapter 11 promptly after receiving three assessments from the Mississippi State Tax Commission totaling approximately $11 million. The

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[44] 95 B.R. 442, 89-1 U.S.T.C. ¶¶9231 and 9232 (Bankr. N.D. Tex 1989) (identical cases involving two brothers and their spouses).

[45] 95 B.R. at 448 n.14; *see also IRS v. Luongo* (*In re Luongo*) (5th Cir.), *supra* note 34 (discussing factors to consider in whether to abstain from determining a tax dispute, citing *Hunt* and other cases); *New Haven Projects L.L.C. v. City of New Haven* (*In re New Haven Projects L.L.C.*) (2d Cir.), *supra* note 3; *In re Ryckman Creek Resources, LLC*, 570 B.R. 483 (Bankr. D. Del. 2017) (abstained from fact-intensive determination of fair market value for property tax purposes where local review process available); *D'Alessio v. IRS* (*In re D'Alessio*), 181 B.R. 756 (Bankr. S.D.N.Y. 1995) (abstention held inappropriate where tax issues were not complex and could be resolved sooner and the bankruptcy case could be closed following a resolution of the tax issues); *In re Huddleston*, 75 A.F.T.R.2d ¶95-482 (Bankr. W.D. La. 1994) (jurisdiction retained); *Universal Life Church, Inc. v. United States* (*In re Universal Life Church, Inc.*), 127 B.R. 453 (E.D. Cal. 1991) (bifurcated tax issues, retaining jurisdiction as to some and allowing Tax Court proceeding to continue as to others), *aff'd*, 965 F.2d 777 (9th Cir. 1992); *Noli v. Commissioner*, 860 F.2d 1521, 88-2 U.S.T.C. ¶9595 (9th Cir. 1988).

[46] 338 B.R. 283 (S.D. Miss. 2005) (the bankruptcy court's decision is unpublished but described in the district court's opinion).

Tax Commission thereafter filed a proof of claim. However, by motion, the Tax Commission requested that the bankruptcy court abstain from resolving the claim and/or grant relief from the automatic stay so that the assessments could be resolved in administrative and judicial proceedings under state law. The bankruptcy court denied both requests, and the district court affirmed.[47] Most of the factors considered by the two courts (although set forth with greater delineation than in *Hunt*) are subsumed within the factors described above. Other factors included:

- the likelihood that the commencement of the bankruptcy case involves forum shopping;
- the presence in the proceeding of non-debtor parties; and
- the possibility of prejudice to other parties in the action.

In this case, the bankruptcy court observed that no state proceeding had yet commenced, and that the state process would have subjected the debtor to possibly four levels of administrative and judicial review. As such, the bankruptcy court concluded (and the district court concurred) that the tax issue could be determined faster and more efficiently in the bankruptcy court. Moreover, state law would have required the debtor to first pay the full tax liability in connection with an appeal, which the court considered particularly unfair to the unsecured creditors (despite the Tax Commission's suggestion that special accommodations could be made) in view of the amount involved and the fact that the unsecured creditors could not participate in the state proceedings. The court also discounted, in view of the substantial amount involved, the Tax Commission's concern that the debtor in filing for bankruptcy was simply forum shopping.[48]

In *In re Altegrity, Inc.*,[49] the debtors had at the time of their bankruptcy filing a long progressing tax dispute with the Oklahoma Tax Commission relating to a prior sale of one of its businesses and whether any of the resulting gain from the sale was apportionable to Oklahoma. The debtors had filed a protest with the Tax Commission two years earlier challenging the tax assessment (on technical and constitutional grounds), discovery had already occurred and the matter would likely have proceeded to trial but was stayed by the parties pending an Oklahoma Supreme Court decision in another case that raised (ultimately unsuccessfully) the same constitu-

[47] The district court also concurred with the bankruptcy court's initial conclusion that the determination of the Tax Commission's claim was a "core" proceeding under 28 U.S.C. § 157(a), noting that only in a "non-core" proceeding is a federal court required to abstain from hearing a state law claim or cause of action for which there is no independent jurisdiction other than the bankruptcy case, "if an action is commenced, and can be timely adjudicated, in a State forum of appropriate jurisdiction." *See* 28 U.S.C. § 1334(c)(2); *see also* discussion of "core" and "non-core" proceedings in the preceding section, above.

[48] In *Vanguard Operating, LLC v. State of Wyoming* (*In re Vanguard Natural Resources, LLC*), 603 B.R. 310 (Bankr. S.D. Tex. 2019), the State of Wyoming requested that the bankruptcy court abstain from resolving the debtor's claimed overpayments of severance taxes on oil and natural gas production. Denying the State's request, the court concluded that the size of the potential refund and its likely impact on the debtor's formulation of its upcoming plan and on creditor distributions tilted the balance in favor of retaining jurisdiction despite the volume and complexity of the tax dispute (involving thousands of wells, each with its own tax return, and issues of tax valuation).

[49] 544 B.R. 772 (Bankr. D. Del. 2016).

tional arguments. The amount at issue was not material to the debtors' Chapter 11 plan. Promptly after the debtors' plan was confirmed, the debtors filed a motion seeking the bankruptcy court's determination of the Oklahoma tax liability. In deciding to abstain, the bankruptcy court focused first on what it gleaned as the two primary purposes underlying the court's jurisdiction under Bankruptcy Code section 505(a)—namely, the prompt resolution of a tax claim which otherwise could result in delaying the administration of the bankruptcy case, and to protect the creditors from being bound to a tax assessment that the debtor did not contest due to its ailing financial condition. (These generally align with the first two factors in *Hunt*.) The court had little difficulty in concluding that neither purpose would be furthered by it resolving the tax claim. The Chapter 11 plan had already been confirmed, payment of the claim would not undermine the plan, and the debtors had been actively protesting the assessment before the Tax Commission. The court then took exception to the debtors' assertion that the bankruptcy court would be in a position to more efficiently adjudicate the dispute, observing that the doctrine of constitutional avoidance would necessitate that the constitutional issue be decided last and that the technical tax issues (such as whether the assets sold were used in a unitary business conducted in Oklahoma) were far from simple. Moreover, the court viewed the present motion as essentially a collateral attack on the adverse decision of the Oklahoma Supreme Court (in part based on the debtors' admission that it was unlikely that they would have filed the motion had such decision gone the other way). The court summed up the situation in short: "The Debtors can obtain a prompt decision in the Oklahoma system, it just may not be the one they want."

In *In re Wheadon*,[50] the debtor had received a discharge under Chapter 7, and the case was closed. Subsequently, the IRS issued a notice of deficiency to the debtor for certain prepetition years. Two days after the debtor timely filed a petition with the Tax Court, he also filed an adversary proceeding in the bankruptcy court for a determination of his tax liability for the years in question and its dischargeability in the earlier bankruptcy. The bankruptcy court reopened the debtor's bankruptcy case for the sole purpose of considering the debtor's request.

Identifying the threshold issue—from both a tax and dischargeability perspective—as being the statute of limitations on assessment (complicated by certain tolling events and an issue of fraud), the court abstained from deciding the issue and left the parties to proceed in the Tax Court. If and when the dischargeability issue again became relevant—that is, if the IRS won in the Tax Court—the debtor could again reopen the case and raise the issue with the bankruptcy court.

The principal considerations cited by the court in reaching its decision were: (1) the "general proposition" that complicated, technical tax disputes should be decided by the Tax Court, given its well-developed expertise (citing *Hunt*); (2) the estate had no assets to distribute so that fixing the tax liability had no bearing on the administrative function in bankruptcy; (3) the only two parties affected by this dispute were the

[50] 1990 Bankr. LEXIS 1978 (Bankr. D. Minn.).

debtor and the IRS; and (4) the dispute would "almost certainly" have gone into litigation even if the debtor had not filed for bankruptcy.[51]

Under similar circumstances to, but distinguishable from, *Wheadon*, the bankruptcy court in *In re Jung* undertook jurisdiction to determine the debtor's tax liability as a prelude to determining the dischargeability of the tax since the underlying tax issues were not complex or (as to issues of fraud) not unfamiliar to the court.[52] The court concluded that exercising jurisdiction would result in a more efficient administration of the bankruptcy case and increased judicial economy. Similarly, in *In re Sprout*,[53] the bankruptcy court upheld jurisdiction to determine whether the IRS's claims had been paid or had otherwise been discharged pursuant to the debtor's Chapter 11 plan. The court declined to abstain from exercising jurisdiction in part due to the absence of a better or more effective alternative remedy.

In contrast to *Wheadon*, where the bankruptcy court reopened the debtor's bankruptcy case to consider the debtor's request, in *Plachter v. United States*,[54] the debtor's postconfirmation motion for a determination that certain prepetition tax liabilities were discharged upon confirmation was dismissed for lack of jurisdiction. The court in *Plachter* rejected the debtor's contention that the bankruptcy case was still open, finding that the confirmation order only preserved postconfirmation jurisdiction until the plan was substantially consummated, which it was. We would question whether, as in *Wheadon*, the bankruptcy court could have "reopened" the bankruptcy case pursuant to Bankruptcy Code section 350(b) (*see* discussion at § 1002.9 above).

At least one court has held that a bankruptcy court may *not* abstain from determining the merits of a tax claim if such abstention would be preclusive, *i.e.*, if there is no alternative forum in which relief can be granted. In *Hospitality Ventures/Lavista v. Heartwood 11, L.L.C. (In re Hospitality Ventures/Lavista)*,[55] the bankruptcy court held that section 505(a) does not permit a bankruptcy court to decline to exercise jurisdiction other than under 28 U.S.C. § 1334(c)(1) (which permits abstention "in the interest of justice, or in the interest of comity with State courts or respect for State law"), and that 28 U.S.C. § 1334(c)(1) permits abstention only if there is an alternative forum. The *Hospitality Ventures/Lavista* court observed that most courts have exercised discretion under section 505(a) either without even mentioning 28 U.S.C. § 1334(c)(1) or noting it without any meaningful discussion. The court cited a

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[51] *See also Zack v. United States*, 224 B.R. 601, 98-2 U.S.T.C. ¶ 50,756 (E.D. Mich. 1998) (abstention held appropriate under somewhat analogous circumstances); *Cain v. United States*, 142 B.R. 785 (Bankr. W.D. Tex. 1992) (also a Chapter 7 "no asset" case where case had been previously closed; although "extenuating circumstances" justified bankruptcy court's retention of jurisdiction over debtor's two complaints for a determination of its tax liability for several prepetition taxable years, the bankruptcy court was "unwilling" to retain jurisdiction where only the debtor would be benefited and prior to the bankruptcy the debtor had chosen not to seek administrative or Tax Court review).

[52] *Jung v. IRS (In re Jung)*, 597 B.R. 872 (Bankr. W.D. Wis. 2019), *reconsid. denied*, 604 B.R. 773 (Bankr. W.D. Wis. 2019) (IRS sought reconsideration based in part on assertions of the complexity of the tax issues).

[53] *Sprout v. IRS (In re Sprout)*, 2020 Bankr. LEXIS 1305 (Bankr. S.D. Ohio 2020).

[54] 1992 U.S. Dist. LEXIS 17234 (S.D. Fla.), *aff'd*, 39 F.3d 323 (11th Cir. 1994) (*per curiam*).

[55] 314 B.R. 843 (Bankr. N.D. Ga. 2004).

number of cases in which courts abstained under section 505(a) in preclusive situations, and criticized these courts for not squarely addressing whether section 505(a) permits abstention when 28 U.S.C. § 1334(c)(1) does not.

§1013.2 Tax Liability of Non-Debtors

Several courts (including the Second, Fifth, Ninth, and Eleventh Circuits) have held that the bankruptcy court's jurisdiction to resolve tax claims extends only to claims against the debtor or the estate, not against its officers, equity holders or any other third party.[56] Although Bankruptcy Code section 505(a) is not by its terms so restricted, such courts have relied principally on the legislative history.[57] Thus, such courts have held that the bankruptcy court may not resolve claims of the IRS against officers of the debtor corporation for failure to pay employment withholding taxes,

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[56] *See, e.g., In re Brandt-Airflex Corp.*, 843 F.2d 90, 88-1 U.S.T.C. ¶9258 (2d Cir. 1988) (involved liability of lender under Code § 3505; in so holding, the court stated that "[t]his is particularly true in the present case because even if [the lender] were liable for the withholding taxes, the mere fact of its liability could have no practical impact on [the debtor's] reorganization plan"); *United States v. Prescription Home Health Care, Inc. (In re Prescription Home Health Care, Inc.)*, 316 F.3d 542, 2003-1 U.S.T.C. ¶50,163 (5th Cir. 2002) (vacated injunction precluding IRS from assessing and collecting Code § 6672 penalty from non-debtor officers); *American Principals Leasing Corp. v. United States*, 904 F.2d 477, 90-1 U.S.T.C. ¶50,292 (9th Cir. 1990) (involved liability of non-debtor partners for the activities of a debtor partnership; *see also* discussion at § 1013.6 note 201, *infra*); *Central Valley AG Enterprises v. United States*, 531 F.3d 750, 2008-2 U.S.T.C. ¶50,405 (9th Cir. 2008) (similar so concluding, under TEFRA provisions); *United States v. Huckabee Auto Co.*, 783 F.2d 1546, 86-1 U.S.T.C. ¶9268 (11th Cir. 1986) (involved corporate officer's liability under Code § 6672); *Armstrong v. United States (In re AWA Fabrication and Construction, LLC)*, 2019 Bankr. LEXIS 30 (Bankr. M.D. Ala. 2019) (involved liability of S corporation shareholders for the activities of the debtor corporation); *Holland Indus., Inc. v. United States (In re Holland Indus., Inc.)*, 103 B.R. 461 (Bankr. S.D.N.Y. 1989) (involved tax liens imposed on property of corporate officers liable under Code § 6672, which property was to be contributed to the debtor under the debtor's proposed plan); *In re Vermont Fiberglass, Inc.*, 88 B.R. 41 (D. Vt. 1988) (sought to invoke Bankruptcy Code section 505(a) to require IRS to apply tax payments held to be involuntary to trust fund portion of debtor's tax liability, thereby reducing officer's tax liability); *but see, e.g, In re Major Dynamics, Inc.*, 14 B.R. 969, 81-2 U.S.T.C. ¶9766 (Bankr. S.D. Cal. 1981).

See also Hoffman v. United States, 130 B.R. 526 (W.D. Wis. 1991) (bankruptcy trustee's liability under Code § 6672 could not be declared by bankruptcy court because the trustee was not a debtor, nor did he have any controversy with the bankruptcy estate or with any of the estate's creditors over an asset of the estate); *In re American Motor Club, Inc.*, 139 B.R. 578 (Bankr. E.D.N.Y. 1992) (denied former officer/director's motion seeking a determination of the debtor's tax liability for unpaid withholding taxes, and an order authorizing the debtor's payment of such liability).

In the case of a debtor partnership, the courts have generally held—*see American Principals Leasing* (9th Cir.), *supra*, and its progeny—that the bankruptcy court's jurisdiction to resolve tax disputes does not permit the determination of the income tax treatment of partnership-level activities since the partnership itself is not subject to income tax, even if involving a partnership-level TEFRA proceeding. However, in *In re Wilshire Courtyard v. Calif. Franchise Tax Bd. (In re Wilshire Courtyard)*, 729 F.3d 1279 (9th Cir. 2013), discussed at § 1013.6 below, the Ninth Circuit found other grounds for jurisdiction where the determination involved the state and local consequences under Bankruptcy Code section 346(j) of transactions consummated as part of a bankruptcy reorganization plan.

[57] *See* H. Rep. No. 595, 95th Cong., 1st Sess. 356 (1977) (refers to "liability of the debtor"); S. Rep. No. 989, 95th Cong., 2d Sess. 67 (1978) (same); *see also* 124 Cong. Rec. H 11,110 (daily ed. September 28, 1978) (statement of Rep. Edwards) (tax "of the debtor or the estate"), S 17,426-17,427 (daily ed. October 6, 1987) (statement of Sen. DeConcini) (same).

even if the debtor corporation's Chapter 11 plan provides for those claims to be satisfied fully.[58]

Although the Third Circuit in *Quattrone Accountants, Inc. v. IRS*[59] reached a similar result in an analogous situation, in doing so it concluded that the jurisdiction of the bankruptcy court was not limited per se to tax claims against the debtor. In its view, the specific grant of authority in Bankruptcy Code section 505(a)—which, the court agreed, addresses only the debtor's tax liability—was intended to clarify certain aspects of prior law without limiting the bankruptcy court's general jurisdiction.

Pursuant to 28 U.S.C. §157(a), a bankruptcy court has general jurisdiction over any civil proceeding that is at least "related to" the bankruptcy case.[60] It has been generally held that a proceeding is "related to" a bankruptcy case when "the outcome of that proceeding could conceivably have any effect on the estate being administered."[61] Under 28 U.S.C. §157, a bankruptcy court's jurisdiction in proceedings that are "related to" the bankruptcy case but do not also constitute "core" proceedings is limited to proposing findings of fact and conclusions of law that are submitted to the district court for *de novo* review, unless the parties otherwise consent.[62] Examples of "core" proceedings—as to which the bankruptcy court may enter a binding determination—include matters concerning the administration of the estate, allowance or disallowance of claims, orders to turn over property, preference or avoidance actions,

[58] *See also United States v. Regas* (*In re Earnest S. Regas, Inc.*), 1993 U.S. Dist. LEXIS 12324 (D. Nev. 1993) (bankruptcy court did not have jurisdiction to order release of officers and directors over IRS objection as part of corporate settlement of trust fund liability).

[59] 895 F.2d 921, 90-1 U.S.T.C. ¶50,103 (3d Cir. 1990).

[60] *See also* 28 U.S.C. §1334(b).

[61] *Quoting Pacor, Inc. v. Higgins*, 743 F.2d 984, 994 (3d Cir. 1984) (original in italics). This formulation of the bankruptcy court's general jurisdiction under 28 U.S.C. §157 has been adopted by most circuit courts, although with varying results, for actions brought *preconfirmation*. *See, e.g., Bush v. United States* (*In re Bush*), 939 F.3d 839 (7th Cir. 2019) (upheld jurisdiction due to the potential effect on the bankruptcy when the action was filed, but concluded that the bankruptcy court should abstain from deciding the tax penalty dispute; the tax dispute was on the verge of trial in the Tax Court when the bankruptcy commenced and, at the time of the court's decision, the resolution would no longer affect creditor distributions); *Mich. Emp't Sec. Comm'n v. Wolverine Radio Co.* (*In re Wolverine Radio Co.*), 930 F.2d 1132, 1142 n.15 (6th Cir. 1991) (collecting cases), *reh'g denied*, 1991 U.S. App. LEXIS 15,283, *cert. dismissed*, 112 S. Ct. 1605 (1992); *Randall & Blake, Inc. v. Evans, et al.* (*In re Canion*), 196 F.3d 579 (5th Cir. 1999). The Seventh Circuit has interpreted "related to" jurisdiction somewhat more narrowly than most circuits, requiring more than "mere possibility" that the dispute affects the amount of property available for distribution or the allocation of property among creditors. *See, e.g., In re Xonics, Inc.*, 813 F.2d 127, 131 (7th Cir. 1987); *In re Management Control Systems, Inc.*, 99-2 U.S.T.C. ¶50,766 (Bankr. S.D. Ind. 1999). However, most courts recognize that what is "conceivable" similarly may become too attenuated at times to support jurisdiction. *See, e.g., Wolverine Radio*, 930 F.2d at 1142; *In re McGuirl*, 2002-1 U.S.T.C. ¶50,276 (Bankr. D.C. 2001). If a sufficient connection existed at the filing of the particular proceeding, but ceases to exist during the proceeding (such as where the debtor no longer has any assets available to satisfy any resulting claim), the bankruptcy court may be divested of subject matter jurisdiction and required to dismiss the action. *Enterprise Bank v. Eltech, Inc.* (*In re Eltech, Inc.*), 313 B.R. 659 (Bankr. W.D. Pa. 2004) (so concluding based on Third Circuit authorities).

Many courts employ a more restrictive standard for *postconfirmation* actions, see discussion below at §1013 notes 180-205.

[62] *See In re Johnson*, 960 F.2d 396, 403 (4th Cir. 1992) ("The substantial weight of authority indicates that a party can impliedly consent to entry of judgment by the bankruptcy court in a non-core related matter"; express consent is not necessary).

and confirmation of the Chapter 11 plan (as well as any other proceeding affecting the liquidation of the assets of the estate or the adjustment of the debtor-creditor or the equity holder relationship, except certain tort claims).[63] Thus, a determination of the corporate debtor's own tax liability is almost always a "core" proceeding; it makes no difference that such determination may impact, and possibly bind, non-debtors.[64]

In *Quattrone Accountants*, both the debtor accounting firm and its principal officer (also a part owner) were potentially liable under Code §6672 for the unpaid withholding taxes of one of the firm's clients. Although the Third Circuit believed the bankruptcy court had power to determine the tax liability of the principal officer if the liability was "related to" the debtor's bankruptcy, the court concluded that it was not so "related." In reaching this conclusion, the Third Circuit noted:

> the fact remains that [the] debtor is jointly and severally liable for the 100% penalty, and, given this fact combined with the highly contingent nature of [the officer's] actually paying a portion of [the client's] tax liability, we cannot conclude that a determination of [the officer's] tax liability under Section 6672 would conceivably have any effect on the bankrupt estate.[65]

In contrast, the Third Circuit, in *In re Kaplan*,[66] found that it was within the bankruptcy court's jurisdiction to consider the debtors' motion to compel the IRS to reallocate tax payments made by a related non-debtor corporation first to the payment of the corporation's unpaid withholding taxes, given that such payments would reduce the debtors' acknowledged liability under Code §6672.[67] (However, the court thereafter concluded that debtors' motion could not be sustained under the bank-

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[63] 28 U.S.C. §157(b)(2). *Consider In re Franklin*, 1990 U.S. Dist. LEXIS 16402 (W.D. Mo. 1990) (upheld bankruptcy court's approval of a settlement agreement providing for (1) the sale of certain property in which the estate had a part interest and (2) an allocation of the tax liability from the sale that provides that *neither party* would be liable for tax on the portion of the property owned by the other party; given that the settlement permitted the trustee to dispose of property in which the estate only had a part interest, the district court concluded that, "in this case, the [tax] liability of the nondebtor is sufficiently related to the bankruptcy case to permit the Bankruptcy Court's jurisdiction").

[64] *See* Collier on Bankruptcy Taxation, at ¶¶TX5.01 ("Most tax disputes will fall within the ambit of core proceedings and the bankruptcy court will, accordingly, have authority to issue final orders."), and TX5.04[4] n.26; *ACME Music Company, Inc. v. IRS* (*In re ACME Music Company, Inc.*), 196 B.R. 925, 96-2 U.S.T.C. ¶50,391 (Bankr. W.D. Pa. 1996). *Consider also Illinois v. Raleigh* (*In re Stoecker*), 179 B.R. 532, 541 (N.D. Ill. 1995) (bankruptcy court could determine non-debtor corporation's use tax liability as one means of establishing individual debtor's responsible person liability).

[65] 895 F.2d at 927, n.4. *Cf. United States v. Heller Healthcare Finance Inc.* (*In re Numed Home Healthcare*), 2002-1 U.S.T.C. ¶50,383 (Bankr. M.D. Fla. 2002) (concluded, under any interpretation of the jurisdictional reach of Bankruptcy Code section 505(a), that it could not determine a creditor's liability for the debtor's unpaid withholding taxes under Code §3505).

[66] *IRS v. Kaplan* (*In re Kaplan*), 104 F.3d 589, 97-1 U.S.T.C. ¶50,169 (3d Cir. 1997).

[67] Under analogous circumstances, the bankruptcy court in *In re Donaldson*, 586 B.R. 822 (Bankr. N.D. Miss. 2018), reached the opposite conclusion based on the Fifth Circuit's decision in *Prescription Home Health Care, Inc.* (5th Cir.), *supra* note 56, since the tax liability directly at issue was not the debtors. Contrary to the Third Circuit's view in *Quattrone Accountants* (that Bankruptcy Code section 505(a) clarifies without limiting the bankruptcy court's general jurisdiction), the Fifth Circuit views

ruptcy court's grant of equitable authority in Bankruptcy Code section 105, *see* § 1013.5 below.)

Closely resembling the issue of officer liability for a debtor's unpaid taxes, the Third Circuit, in *Belcufine v. Aloe*,[68] was presented with an action by the employees of the debtor seeking to hold the debtor's officers personally liable under Pennsylvania law for the nonpayment of wages. The employees' action had initially been filed in state court, but had been successfully removed by the officers first to the district court and then to the bankruptcy court, following the filing by the officers of a third party complaint against the debtor for indemnification under the debtor's by-laws. The bankruptcy court proceeded to find in favor of the officers, and the district court affirmed. Challenging the bankruptcy court's jurisdiction, the employees argued that the officers' indemnification claims against the debtor were barred under the Bankruptcy Code and were a collusive attempt to manufacture jurisdiction. The Third Circuit dismissed the officers' arguments, readily recognizing that an indemnification claim could have a conceivable effect on the bankruptcy estate and observing that the question of whether claims are barred is uniquely within the jurisdiction of the bankruptcy court. The Third Circuit also found no evidence of collusion.

In *Michigan Employment Security Commission v. Wolverine Radio Company*, the Sixth Circuit adopted the analysis of Third Circuit in *Quattrone Accountants* and upheld a bankruptcy court's authority to resolve a tax dispute involving a non-debtor.[69]

In *Wolverine Radio*, the debtor, pursuant to its confirmed Chapter 11 plan, sold its broadcasting business "free and clear" of all liens and other interests and indemnified the purchaser against any damages arising out of the debtor's operations. Subsequently, the purchaser was notified by the Michigan Employment Security Commission (MESC) that, due to the debtor's employment history, its "contribution rate" to the employment security fund would be substantially higher than for new employers, and of certain other charges. Upon motion by the debtor, the bankruptcy court entered an order enforcing its earlier confirmation order and prohibiting the MESC from assigning the debtor's experience rating to the purchaser. In upholding the bankruptcy court's jurisdiction, the Sixth Circuit relied extensively on the Third Circuit's analysis in *Quattrone Accountants*, similarly concluding that Bankruptcy Code section 505(a) did not limit the bankruptcy court's general jurisdiction over a non-debtor's tax liability. In holding that the purchaser's tax dispute was at least "related to" the debtor's bankruptcy and, thus, within the bankruptcy court's general jurisdiction under 28 U.S.C. § 157, the Sixth Circuit stated that—due to the contractual indemnification over against the debtor, the fact that the debtor may thus be bound by the outcome of the dispute and the fact that the MESC had filed a claim in the debtor's bankruptcy and thus obtained creditor status—it could not conclude that the

(Footnote Continued)

Bankruptcy Code section 505 as a more specific statute that controls over the bankruptcy court's more general grant of jurisdiction.

[68] 112 F.3d 633 (3d Cir. 1997).

[69] *Supra* note 61.

dispute would have no "conceivable effect" on the debtor.[70] It then also concluded that the debtor's motion was (in form and substance) a core proceeding under 28 U.S.C. §157, because it involved "issues which arose because of the bankruptcy proceeding—the dischargeability of debts and the confirmation of a plan—and because [the debtor] asserts a right based on bankruptcy law," namely, the right under Bankruptcy Code section 363(f) to sell property "free and clear." Thus, it was within the bankruptcy court's juisdiction to enter judgment on the motion. (On the substantive issue, the Sixth Circuit disagreed with the bankruptcy court, and affirmed the district court which held that the MESC could take into account the debtor's prior employment history. However, the Fourth Circuit, among others, have held under similar circumstances that the employment history could *not* be taken into account.[71]

Query, whether the Sixth Circuit would have reached a different result as to jurisdiction had the MESC not filed a claim in the debtor's bankruptcy? Consider, for example, Bankruptcy Code section 106 (discussed at §1005.1), which provides for a limited waiver of a government's sovereign immunity in bankruptcy cases.[72] Some courts have held, within a similar context, that the "state" Tax Injunction Act (28 U.S.C. §1341) bars the bankruptcy court from exercising its jurisdiction.[73]

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[70] *Cf. Pacor, Inc. v. Higgins, supra* note 61, at 995-996 (potential third-party claim for indemnification did not support jurisdiction where issues involved in underlying action could be relitigated by the debtor with respect to any subsequent indemnification claim and the plaintiff in such action had not filed a claim against the debtor); *see also Marlow v. United States* (*In re Julien Co.*), 136 B.R. 760 (Bankr. W.D. Tenn. 1991) (tax case). The Sixth Circuit recognized, however, that the "conceivable effect" standard must be applied with the caveat that situations may arise where an extremely tenuous connection to the estate would not satisfy the jurisdictional requirement. *Wolverine Radio, supra* note 61, at 1142. Query whether the decision in *Quattrone Accountants* would have turned out differently had the officer sought indemnification from the debtor? As discussed at §1006.3.2, it is unclear whether an officer has a right to indemnification from the debtor for liability under Code §6672. *Consider also Randall & Blake, Inc. v. Evans, et al.* (*In re Canion*) (5th Cir.) *supra* note 61 (raising equivalent considerations in affirming a bankruptcy court's denial of jurisdiction in a non-tax case).

[71] *See, e.g., United Mine Workers of Am. 1992 Benefit Plan v. Leckie Smokeless Coal Co.* (*In re Leckie Smokeless Coal Co.*), 99 F.3d 573 (4th Cir. 1996); *Mass. Dept. of Unemployment Assist. v. OPK Biotech, LLC* (*In re PBBPC, Inc.*), 484 B.R. 860 (Bankr. 1st Cir. 2013) (favored the more expansive reading of the concept free and clear of "any interest" adopted by the greater number of circuits; unpersuaded by rationale in *Wolverine Radio*); *In re USA United Fleet Inc.*, 496 B.R. 79 (Bankr. E.D. N.Y. 2013). *See also In re ARSN Liquidating Corp., Inc.*, 2017 Bankr. LEXIS 185 (Bankr. D. N.H. 2017) (similarly concluded that a debtor's workers compensation experience rating could not be imposed on a purchaser of the debtor's assets in court-approved section 363 sale).

[72] *See also MDFC Equipment Leasing Corp. v. Robbins* (*In re Interstate Motor Freight System*), 62 B.R. 805 (Bankr. W.D. Mich. 1986) (the fact that a non-debtor's tax liability may be within the court's general jurisdiction is not alone sufficient; one must also find "an express waiver of sovereign immunity necessary for this court to make decisions as to non-debtor taxpayers that would be binding upon the United States"; the court concluded that Bankruptcy Code section 106 did not provide the necessary waiver, as it only waives sovereign immunity with regard to the interests of the debtor or the estate); *United States v. Zellers* (*In re CNS, Inc.*), 255 B.R. 198, 2000-2 U.S.T.C. ¶50,846 (N.D. Ohio 2000) (to same effect).

[73] In accord with *Wolverine Radio* and involving analogous facts, but without the debtor indemnity, *see* the bankruptcy court decision in *In re Eveleth Mines, LLC*, 312 B.R. 634 (Bankr. D. Minn. 2004) (bankruptcy court had "core" jurisdiction over proceeding brought by non-debtor purchaser; also concluded that state could take into account debtor's pre-sale history in assessing a production tax against purchaser), *rev'd*, 318 B.R. 682 (Bankr. 8th Cir. 2004). The bankruptcy court's decision was subsequently reversed by the Bankruptcy Appellate Panel of the Eighth Circuit, however, on the

In *Illinois v. Schechter*,[74] the State of Illinois asserted personal liability against a Chapter 11 trustee for unpaid hotel and use taxes, arguing in part that the trustee had breached his fiduciary duty to pay over the taxes. The district court upheld the bankruptcy court's jurisdiction to determine the trustee's liability on the grounds that any claim for breach of the trustee's fiduciary duty could only "arise" out of the provisions of the Bankruptcy Code and thus was a "core" proceeding.

In *In re Plymouth House Health Center Inc.*,[75] the debtor challenged certain real estate tax assessments for which it was contractually responsible under a lease arrangement. The amount of such taxes was being held in a separate account, pending the bankruptcy court's determination. The bankruptcy court held that the tax dispute was clearly "related to" the debtor's bankruptcy case and thus within the court's jurisdiction, since the debtor's estate would directly benefit from any reduction in the taxes.

In *In re Labrum & Doak*,[76] a Pennsylvania district court upheld a bankruptcy court's jurisdiction to consider a bankrupt partnership's proposed allocation of so-called "recapture" income among current and former partners, none of whom were debtors.[77] The IRS argued that the allocation could only affect the tax liability of the partners and thus was not "related to" the partnership's bankruptcy case. The district court (as did the bankruptcy court) disagreed, given the partnership's affirmative obligation under the Internal Revenue Code (subject to the imposition of penalties for failure to perform) to file information returns and statements reflecting the proper allocation of tax liability, and further held that the allocation was significant to the administration of the bankruptcy case and thus a "core" proceeding (presumably due to the partnership's position that the former partner's who received the earlier tax

(Footnote Continued)

grounds that the Tax Injunction Act barred the bankruptcy court from exercising it jurisdiction as there was a "plain, speedy, and efficient" remedy available under state law (even though such remedy could take as long as two years, and even though it was unclear whether the state courts would give proper deference to the bankruptcy court's sale order). In contrast, the district court in *In re Old Carco LLC*, involving the acquirer of substantially all of the assets of Chrysler Motors, reversed the bankruptcy court which agreed with the Bankruptcy Appellate Panel in *Eveleth Mines. In re Old Carco LLC*, 2014 U.S. Dist. LEXIS 166623 (S.D. N.Y. 2014), *vacating* 505 B.R. 151 (Bankr. S.D. N.Y. 2014). The district court, relying on the Supreme Court's decision in *Travelers Indemnity Co. v. Bailey*, 557 U.S. 137, 152 (2009), held that the bankruptcy court clearly had subject matter jurisdiction to interpret and enforce its prior final order, and that a challenge at this stage based on the Tax Injunction Act was an improper collateral attack on the court's jurisdiction. *Consider* also discussion at §§1102.4 and 1102.12.

[74] 195 B.R. 380 (N.D. Ill. 1996).

[75] Memorandum decision, dated Sept. 10, 2004 (Bankr. ED. Pa.), Ch. 11 No. 03-19135F, *reprinted at* BNA TaxCore (Nov. 17, 2004).

[76] 2000 U.S. Dist. LEXIS 12066 (E.D. Pa. 2000), *aff'g*, 222 B.R. 749 (Bankr. E.D. Pa. 1998) (within Third Circuit).

[77] The so-called "recapture" income involved in this case relates to the application of Code §467 to a lease with increasing rent, and refers to the portion of the partnership's net income that, during the latter part of the lease, would have been offset by rental expense but for the spreading of such expense under Code §467 to earlier years of the lease with lower rental payments.

benefits had an actual or implied obligation to bear their appropriate share of the subsequent "recapture" income).[78]

In *In re G-1 Holdings Inc.*,[79] a New Jersey bankruptcy court overruled the IRS's objection to the debtors' plan that precluded the IRS from going against non-debtor members of the debtors' consolidated group for postpetition interest and penalties, consistent with the IRS's prior agreement with the debtors, and allowed the non-debtor members to satisfy any IRS priority claim for group taxes on the same payment schedule as the debtors. The non-debtor members were indemnified by the parent (a debtor) and included the group's principal subsidiary on which the plan was significantly dependent. Accordingly, the court concluded that it properly had jurisdiction under the Third Circuit authorities described above. (The court also concluded that it was not restrained by the Anti-Injunction Act due to the waiver of sovereign immunity embodied in Bankruptcy Code section 106.)

In *In re Goldblatt Bros., Inc.*,[80] the bankruptcy court took a more expansive view of Bankruptcy Code section 505(a). There, the unsecured creditors' committee sought a declaratory judgment that an account established pursuant to a confirmed Chapter 11 plan for the benefit of creditors, and administered by the committee (including evaluating and contesting the allowability of any claims payable out of the fund), was not required to pay federal and state income tax and file tax returns. In holding that the tax liability of the account was within the subject matter jurisdiction of the court, the court first concluded that the dispute was a core proceeding and, thus, within its general jurisdiction under 28 U.S.C. § 157. The court decided it was a core proceeding because the account was an integral part of the debtor's plan (serving as an efficient vehicle for the processing of disputed claims) and any tax due would proportionately reduce distributions to general unsecured creditors.

The court then addressed the question of whether it had jurisdiction to decide the dispute under Bankruptcy Code section 505(a). Recognizing that most courts have read Bankruptcy Code section 505(a) as limiting the bankruptcy court's general jurisdiction to the determination of the tax liability of the debtor, the court nonetheless concluded that it had jurisdiction under Bankruptcy Code section 505(a) to determine the tax liability of the account *even if* it was found to be a separate taxable entity from the debtor. The court observed that the legislative history to Bankruptcy Code section 505(a) sometimes referred to the tax liability of the "debtor" and other times to the "debtor or the estate," and, therefore, it cautioned against an overly restrictive interpretation of the court's jurisdiction based on such terms. Rather, it asserted that, "in light of the legislative purpose of § 505, Congressional drafters were referring to the collection of [a] debtor's assets to be used to satisfy its creditors'

[78] This should be contrasted with the Ninth Circuit's decision in *American Principals Leasing Corp.*, *supra* note 56, which arguably can be distinguished both on the law (the present case being within the Third Circuit and governed by the principles of *Quattrone Accountants*) and on the facts (the tax matter at issue in that case apparently involving the application of the "at risk" rules of Code § 465 at the partner level, and arguably not proper partnership reporting or other partnership level consequences).

[79] 420 B.R. 216, 233 n.22, 266 (Bankr. D. N.J. 2009), discussed further at § § 1014.4 and 1016.1 below.

[80] 106 B.R. 522 (Bankr. N.D. Ill. 1989).

claims." The court concluded that, because the account operates for that purpose, it was certainly part of the bankruptcy "estate." The court then observed that under its holding:

> the parameters of a bankruptcy court's jurisdiction over the subject matter of federal and state taxation under [Bankruptcy Code section] 505(a)(1) corresponds with general principles governing a bankruptcy court's power to adjudicate at least core matters under 28 U.S.C. § 157.[81]

Consolidated return. In the context of a consolidated return group where the common parent is in bankruptcy, it would seem that a substantive determination of the group's tax liability by the bankruptcy court should be binding upon the IRS as to all group members, regardless of whether they are in bankruptcy. This is due to the fact that, under the consolidated return regulations, the common parent generally has the exclusive authority to represent the consolidated group in tax litigation matters (*see* § 1007.4).[82]

Moreover, it is possible that even where the bankruptcy court's determination purports to be binding on the IRS as to some, but not all, the members of the group—such as where the common parent is not in bankruptcy, but other members are—the IRS may nevertheless be bound by such determination as to all members of the group. This result is premised on the principles of *res judicata* and collateral estoppel and has been referred to by some courts as the doctrine of "judicial estoppel." A similar situation can arise where the bankruptcy court approves a settlement of the tax dispute that reflects the IRS's position on the substantive tax issues involved. As

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[81] Id. at 529. *But consider Portfolio Lease Funding Corp. v. Seagate Technology, Inc.* (*In re Atlantic Computer Systems, Inc.*), 163 B.R. 704 (Bankr. S.D.N.Y. 1994) (assets transferred to Liquidating and Reserve Trusts established under the debtor's plan were no longer considered part of the bankruptcy estate; accordingly, the fact that a pending litigation involving two non-debtors could result in an additional claim for distributions from the Trusts did not have any "conceivable effect" on the bankruptcy estate so as to support subject matter jurisdiction). We question whether the result in *Atlantic Computer Systems* would have been different had the Chapter 11 plan expressly provided that the Liquidating and Reserve Trusts were to be treated as successors in interest to the debtor's estate. Moreover, literally read, the court's reasoning would appear to preclude even postconfirmation jurisdiction over the claims reconciliation process presumably continued by the Trusts—a seemingly unintended result.

[82] *Cf. McQuade v. Commissioner*, 84 T.C. 137, Dec. 41,859 (1985), involving a husband (*H*) and wife (*W*) who had filed joint returns. *H* died shortly after filing bankruptcy. Thereafter, the IRS issued both a separate and joint notice of deficiency to *W*, individually, and as executrix of *H*'s estate. On behalf of *H*'s estate, *W* litigated the proposed deficiency in the bankruptcy court, after which the bankruptcy court concluded that "the McQuades" (jointly) had no federal tax liability for the years at issue. Although *W* was neither in bankruptcy nor a named party to the litigation, the Tax Court held that the IRS was collaterally estopped from relitigating *W*'s tax liability for such years. The Tax Court found that *W* had exercised sufficient control over the litigation and had a sufficient financial stake so as not to be considered "a stranger to the cause," that the bankruptcy court had before it both deficiency notices and other documents relating to *W*'s liability, and that the issues involved were exactly the same. *Consider also Lone Star Life Ins. Co. v. Commissioner*, T.C. Memo 1997-465 (decision of IRS to deal directly with subsidiary, as permitted by Reg. § 1.1502-77, did not preclude subsidiary from also allowing its common parent to continue to act as its agent).

discussed below, the bankruptcy court's approval of the settlement may be treated as an effective adjudication of the underlying tax issues.

The Sixth Circuit's decision in *Reynolds v. Commissioner*[83] illustrates the potential application of the doctrine of judicial estoppel in the case of a bankruptcy settlement. In *Reynolds*, the IRS was "judicially estopped" from asserting that sales proceeds received by the taxpayer's ex-wife from certain leasehold interests were actually attributable to the taxpayer, where during the ex-wife's bankruptcy case the IRS entered into a stipulation of settlement with the ex-wife wherein the IRS took the position (and, in substantial part, the ex-wife conceded) that the sales proceeds were properly those of the ex-wife, and such stipulation was approved and ordered by the bankruptcy court. In so holding, the Sixth Circuit, in a split decision, stated that "when a bankruptcy court—which must protect the interest of all creditors—approves a payment from the bankruptcy estates on the basis of a party's assertion of a given position, that, in our view, is sufficient 'judicial acceptance' to estop the party from later advancing an inconsistent position." Moreover, the court stated that, in considering a proposed settlement, the bankruptcy court is charged with an affirmative obligation to apprise itself of the underlying facts and to make an independent judgment as to whether the compromise is fair and equitable.

In a subsequent decision, the Sixth Circuit clarified that the application of judicial estoppel is limited to those situations where the stipulation of settlement or court order contains admissions or findings of law or fact, in contrast to a settlement that simply fixes the tax liability owed.[84] For example, in *Reynolds*, the IRS admitted that the sales proceeds were those of the ex-wife, implicitly exonerating the taxpayer.

Another case in which preclusion concepts have been applied to a settlement agreement is *In re Donahue*.[85] In *Donahue*, the IRS filed a claim in the debtor's bankruptcy case asserting that certain expenditures of the debtor's wholly owned corporation constituted constructive distributions to the debtor. The debtor objected (in the form of a motion for summary judgment), claiming that the IRS's position was fundamentally inconsistent with the resolution of the deductibility of such expenditures by the corporation in an earlier Tax Court case. The IRS and the corporation had in that case reached a settlement partially allowing and partially disallowing the corporation a deduction for such expenditures, which was stipulated to the Tax Court and embodied in the Tax Court's decision. Relying in part on the Sixth Circuit decision in *Reynolds*, the bankruptcy court concluded:

(1) that a settlement embodied in a judicial decision that resulted in an "actual and necessary" determination of the issues is entitled to the same *res judicata*/collateral estoppel effect as a litigated result and should not be equated to a mere contract between the parties; and

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[83] 861 F.2d 469, 88-2 U.S.T.C. ¶9591 (6th Cir. 1988).

[84] *Teledyne Indus., Inc. v. NLRB*, 911 F.2d 1214, 1218 (6th Cir. 1990), *reh'g denied, en banc*, 1990 U.S. App. LEXIS 22,065. *See also In re Matunas*, 261 B.R. 129, 2001-1 U.S.T.C. ¶50,388 (Bankr. D. N.J. 2001) (applying claim preclusion concepts to stipulated agreement of tax liability approved by the bankruptcy court; discusses case law), *reconsidered on other issues*; *Barrett-Crofoot Investments, Inc. v. Commissioner*, 67 T.C.M. 2166 (1994) (distinguishing *Reynolds*).

[85] *Donahue v. United States* (*In re Donahue*), 107 B.R. 146, 89-2 U.S.T.C. ¶9618 (Bankr. S.D. Ohio 1989).

(2) that preclusion concepts not only apply when the parties in a subsequent proceeding are identical to the parties in a prior proceeding, but also apply to nonparties "whose legal rights and obligations are intrinsically intertwined and dependent upon the results obtained in the prior proceeding."

Accordingly, in light of the specificity of the amounts stated in the settlement and noting the control relationship between the debtor and the corporation, the court held that the IRS was precluded from asserting that the amounts previously allowed as corporate expenses in the Tax Court settlement were now constructive distributions to the debtor.

Presenting a further perspective on the issue is the Tax Court decision in *Kroh v. Commissioner*,[86] which was reviewed by the court (with two judges dissenting). In that case, an earlier bankruptcy court settlement relating to a husband's (H's) joint return tax liability did not preclude the IRS from proceeding against the wife (W) for the full uncompromised amount of the liability. The settlement agreement set forth the amount owed by H by year without any apparent admissions or findings of fact.

Before considering the principles of *res judicata* and collateral estoppel, the Tax Court concluded that the settlement agreement was not binding on W as a matter of tax, bankruptcy, or contract law. Relying on its earlier decision in *Dolan v. Commissioner*,[87] upholding separate assessments against a husband and wife filing a joint return, the Tax Court concluded that the IRS had separate causes of action against W and H that could be independently litigated and compromised. Moreover, the Tax Court observed that the bankruptcy court had no jurisdiction over W's tax liability because W had made "no showing [that H's] title 11 proceedings could not be administered without having the bankruptcy court determine her tax liability,"[88] and it pointed out that the settlement agreement only referred to "the debtor" and thus, by its terms, did not purport to bind W. The Tax Court therefore concluded that the IRS had "no choice" but to proceed against W separately and was not, as a general matter, barred from doing so.

The Tax Court then considered whether the principles of *res judicata* or collateral estoppel applied. In holding they did not, the court found that a husband and wife's joint return liability also were separate causes of action for *res judicata* purposes; that a joint return does not create privity; that W was not a party to, nor did she participate in, H's "bankruptcy proceedings" (presumably referring only to the tax proceedings) in any way; and that the bankruptcy court's approval of the settlement agreement only constituted a "pro forma acceptance" of the settlement agreement and, accordingly, that the bankruptcy court did not actually decide any disputed issue with respect to the merits of W's claim.

Disagreeing with the majority on virtually every point including the preclusive effect of the settlement agreement, the dissent would have held that *res judicata* applies. Neither the majority nor the dissent discussed the Sixth Circuit's decision in *Reynolds*.

[86] 98 T.C. 383 (1992).

[87] 44 T.C. 420 (1965).

[88] *Citing Tavery v. United States*, 897 F.2d 1032, 1033, 90-1 U.S.T.C. ¶50,121 (10th Cir. 1990).

To what extent the *Kroh* decision has relevance in consolidated return situations, aside from its treatment of the settlement agreement is not entirely clear.[89] As noted earlier,[90] the concept of "agency" does not exist in the joint return context, whereas in the consolidated return context the common parent generally acts as the "sole agent" for the group. Moreover, the common parent generally has direct or indirect control over all members of the group—the notable exceptions being former members and members for whom a trustee or receiver has been appointed. In this regard, it should be noted that the Tax Court distinguished the *McQuade* case,[91] wherein the IRS *was* collaterally estopped from proceeding against the wife, from the *Kroh* case, based on the extent of the wife's participation in the earlier proceedings in the bankruptcy court. In *McQuade*, the wife (although not herself in bankruptcy) controlled the earlier proceedings, whereas in *Kroh* the wife did not participate at all. (In addition, the *McQuade* case involved an actual determination by the bankruptcy court, in contrast to a settlement agreement.) This again raises the question in the consolidated return context as to what happens if the IRS notifies the parent that it will deal directly with the subsidiary, in which event the regulations say the subsidiary has "full authority to act for itself" (*see* § 1007.4 above). If the subsidiary is still controlled by the common parent, would the requisite "control" exist for *res judicata* or collateral estoppel purposes (assuming a current determination of the subsidiary's consolidated return liability) to bar the IRS from proceeding anew against the common parent or other members of the group and relitigating the tax liability?

Presenting a different aspect of the interplay of consolidated returns, the liquidating trustee in *In re Consolidated FGH Liquidating Trust*,[92] acting on behalf of the debtor, a former member of a consolidated tax group, sought to utilize a turnover action—which seeks to recover property of the estate from a third party—as justification for bringing an action for a tax refund in lieu of the common parent of the consolidated group. The bankruptcy court concluded, in accordance with the consolidated return regulations, that the common parent was the only person authorized to seek the tax refund for the group. The court was also not enamored with the prospect of determining the tax liability of non-debtors, namely, the other members of the consolidated group.

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[89] *Consider, e.g., Valley Die Cast Corp. v. Commissioner*, T.C. Memo. 1983-103 (unchallenged IRS proof of claim in a subsidiary's bankruptcy case, as to which the confirmation of the bankruptcy case served as a final judgment, was determinative of the subsidiary's tax liability, but not the other members of the consolidated group); IRS Field Service Advice 1999-811 (c. 1993) (discussing the criteria of *Kroh* within the context of a potential consolidated group; however, relationship of the debtor and the asserted common parent at the time of the debtor's bankruptcy case is unclear from the redacted facts), *reprinted at* 1999 TNT 45-97.

[90] *Supra* § 1009 note 19.

[91] Discussed *supra*, at note 82.

[92] *Oakridge Consulting Inc. v. United States* (*In re Consolidated FGH Liquidating Trust*), 325 B.R. 564, 2005-2 U.S.T.C. ¶ 50,448 (Bankr. S.D. Miss. 2005).

§1013.3 Declaratory Judgments

Although declaratory judgments on federal tax issues are generally prohibited by the Declaratory Judgment Act (28 U.S.C. §2201),[93] an express exception applies in the case of "a proceeding under section 505 or 1146 of title 11."[94] Thus, if an actual controversy over federal taxes is otherwise within its jurisdiction, a bankruptcy court may enter a final judgment declaring the rights and other legal relations of any interested party seeking such declaration, whether or not alternative relief could be sought.[95] No similar exception applies in the case of receiverships.[96]

For example, in *In re Goldblatt Bros., Inc.* (also discussed in the preceding section),[97] the bankruptcy court upheld its authority to issue a declaratory judgment as to whether an account established pursuant to a confirmed Chapter 11 plan and administered by the unsecured creditors' committee was required to pay federal and state income tax and file tax returns. In doing so, the court made clear that the filing of a tax return, and the use of the prompt determination procedure of Bankruptcy Code section 505(b) (which the government agreed could be invoked by the creditors' committee, although it was not specifically named therein and although it was several years after confirmation), were not prerequisites to the court's jurisdiction. *See* §1011 above. The court found particularly persuasive the fact that a contrary result

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[93] *See generally* 10A Wright, Miller & Kane, Federal Practice and Procedure, Civil 3d, §2751 *et seq.* (1998 with Supp.). Actions under section 7428 of the Internal Revenue Code (relating to the status and classification of tax-exempt organizations) are specifically permitted.

[94] Consider also *In re Becker's Motor Transportation, Inc.*, 632 F.2d 242, 81-1 U.S.T.C. ¶9348 (3d Cir. 1981), *cert. denied*, 101 S. Ct. 1358 (1981) (holding that bankruptcy court had power to issue declaratory judgments under prior Bankruptcy Act, because a bankruptcy court as then established was not definitionally a court to which the Declaratory Judgment Act applied). Although proceedings under Bankruptcy Code section 1146 are excepted from the general prohibition against declaratory judgments with respect to federal taxes, such section contains special tax provisions generally applicable only to state and local taxes. The inclusion of this section thus appears to be a remnant of the original House and Senate versions of that section, wherein such section also applied to federal taxes. The reference to federal taxes was deleted in the final version. *See* §1101.

[95] *See generally In re McGuirl, supra* note 61. In contrast to federal taxes, a federal court's jurisdiction to issue declaratory judgments as to state tax matters is generally predicated on the absence of an adequate remedy under state law. *See* cases cited at 28 U.S.C.A. §2201, Notes of Decisions #522. *Compare Agnew v. Franchise Tax Board* (*In re Sharon Steel Corp.*), 118 B.R. 30 (Bankr. W.D. Pa. 1990) (bankruptcy court could consider the "proposed decombination" of the debtor and its wholly owned subsidiary for purposes of the California Unitary Tax, even though no assessment was made and no proof of claim was filed; former Bankruptcy Code section 106(c) abrogated sovereign immunity); *with IRS v. Sulmeyer* (*In re Grand Chevrolet, Inc.*), 153 B.R. 296 (C.D. Cal. 1993), discussed below (holding that the bankruptcy court could *not* authorize the consolidation of several commonly controlled corporations for *federal* tax purposes), on the one hand, and *In re PT-1 Communications Inc.*, 403 B. R. 250 (Bankr. E.D. N.Y. 2009), *aff'd in relevant part, sub nom. United States v. Bond*, 486 B.R. 9 (E.D. N.Y. 2012), *appealed and rev'd on different issue*, 762 F.3d 255, 2014-2 U.S.T.C. ¶50,406 (2d Cir. 2014), also discussed below (directing the IRS, under the circumstances, to accept a consolidated subgroup filing on behalf of a subsidiary debtor and its subsidiaries for the last stub period during which it was treated as being in the parent group), on the other hand.

[96] *See, e.g., Sterling Consulting Corp. v. United States*, 245 F.3d 1161 (10th Cir. 2001), *cert. denied*, 534 U.S. 1114 (2002) (so held even though the bankruptcy court in a related case purported to cede jurisdiction to the receivership court).

[97] *See supra* note 80 and accompanying text.

would render meaningless—other than for taxes for which no return is required—the express exception permitting declaratory judgments in section 505 proceedings, which exception was enacted contemporaneously with the enactment of the section 505(b) procedure.[98]

Nevertheless, in order to expedite the resolution of the tax issue, the court required, as a condition to considering the tax issue, that the committee in fact file tax returns (which had already been prepared) and commence the prompt determination procedure of Bankruptcy Code section 505(b). While the IRS examination was pending, the court would then consider the substantive issue of whether the account was subject to tax. If the answer was yes, the filing of the tax returns and the request for a prompt determination would expedite the proper assessment of tax; and, if the answer was no, the prompt determination procedure would become moot.[99]

Similarly, in *In re Amoskeag Bank Shares, Inc.*,[100] the bankruptcy court held that it had authority to rule on a declaratory judgment motion (originally filed by the Chapter 7 trustee but subsequently joined in and pursued by the principal creditor of the estate) as to the trustee's employment tax obligations with respect to pending distributions to general unsecured creditors, and the district court so affirmed. The court rejected the IRS's assertion that there could be no determination of taxes unless

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[98] Although not mentioned by the court, the original House proposal would have permitted declaratory judgments only in "proceedings under section 505(c) or 1146(d)" of the Bankruptcy Code. *See* H.R. Rep. No. 595, 95th Cong., 1st Sess. § 251 (1977). Section 1146(d) has since been redesignated section 1146(b). *See* P.L. 109-8 (2005).

[99] *Contrast United States v. Sterling Consulting Corp.* (*In re Indian Motocycle Co., Inc.*), 261 B.R. 800 (Bankr. 1st Cir. 2001) (held that bankruptcy court does not have jurisdiction to estimate administrative tax liability; noted availability of the prompt determination procedure under Bankruptcy Code section 505(b); did not address bankruptcy court's ability to consider action under Bankruptcy Code section 505(a) in advance of a completed audit by the IRS); *Feldman v. Maryland Natl. Bank* (*In re Wills*), 46 B.R. 333, 334, 85-1 U.S.T.C. ¶ 9222 (Bankr. D. Md. 1985) (denying request for determination where the prompt determination procedure of Bankruptcy Code section 505(b) was more appropriate); *Dycoal Inc. v. IRS* (*In re Dycoal Inc.*), 327 B.R. 220, 2005-2 U.S.T.C. ¶ 50,554 (Bankr. W.D. Pa. 2005), *aff'd*, 2006 U.S. Dist. LEXIS 25078 (W.D. Pa. 2006), discussed in text below. *See also Scharrer v. Dept. of Treasury* (*In re American Leasing and Acceptance Corp. of Lakeland*), 228 B.R. 755, 98-1 U.S.T.C. ¶ 50,113 (Bankr. M.D. Fla. 1997) (debtor had not claimed interest deductions with respect to certain payments for certain years, but had for later years; the IRS allowed the later year deductions, but disagreed as to amount; the IRS made no change to the early years, nor was an amended return filed claiming the deductions; yet, in conjunction with challenging the amount of the later year deduction, the liquidating trustee of the debtor's estate sought the bankruptcy court's declaration that the early year payments should also have been deducted as interest; although the court recognized that there appeared to be no justiciable controversy with respect to the early years, the court stated that "[f]or the sake of judicial economy," it would consider the issue and not await the filing of an amended return and a possible challenge by the IRS), *rev'd on other grounds*, 229 B.R. 210, 99-1 U.S.T.C. ¶ 50,404 (Bankr. M.D. Fla. 1999). *Also consider In re Franklin, supra* note 63, wherein the government asserted that a bankruptcy court order approving an allocation of tax liability in the context of a settlement agreement violated the doctrine of sovereign immunity, in that the bankruptcy court did not have authority to make federal tax determinations unless (1) the government filed a claim for the tax or (2) the trustee filed a tax return and followed the prompt determination procedure of Bankruptcy Code section 505(b). In upholding the bankruptcy court's jurisdiction, the district court stated: "Significantly, the Bankruptcy Court did not assess or determine an amount of tax owed. If it had, then 11 U.S.C. Section 505(b) would provide the proper method for determining the amount of a tax claim."

[100] *Bezanson v. United States* (*In re Amoskeag Bank Shares, Inc.*), 215 B.R. 1 (Bankr. D.N.H. 1997), *aff'd in part and rev'd in part*, 239 B.R. 653, 98-2 U.S.T.C. ¶ 50,746 (D. N.H. 1998).

and until a tax return was filed, given the practicality that the trustee needed to know the liability in advance (in particular the employer's portion) so as to effectuate a complete and final distribution of all estate funds in an efficient and expeditious manner.

In the *Holywell* case,[101] discussed below (in § 1013.3.1 and at § 902.1), the liquidating trustee of a trust created pursuant to a Chapter 11 plan sought and obtained a similar declaratory judgment. Although the Supreme Court subsequently reversed on the merits, the IRS never questioned the court's jurisdiction to rule on the issue.[102] However, in the *United Airlines* (*UAL*) bankruptcy case, discussed below, the bankruptcy court concluded that it *lacked* jurisdiction to consider the issue.

In *In re Grand Chevrolet, Inc.*,[103] a trustee sought a declaratory judgment authorizing him to file a consolidated federal income tax return for several commonly controlled corporations that, for bankruptcy purposes, had already been substantively consolidated. Reversing the bankruptcy court, the district court held that the bankruptcy court *lacked* jurisdiction on the alternative grounds that (1) no "actual controversy" existed (since the trustee had nothing "more than a belief" that the IRS would deny consolidated status)[104] and (2) the relief sought was not within the court's authority under Bankruptcy Code section 505(a) and thus not within the exception to the Declaratory Judgment Act for section 505 proceedings. As to the latter point, the district court stated that section 505(a) only authorized bankruptcy courts to determine the "amount or legality" of any tax; it did not authorize bankruptcy courts to deal with tax issues in a vacuum, unrelated to the determination of a "tax liability." In this regard, the court's analysis seems to come down to the fact that the trustee never suggested and put into issue how much tax would be owed if tax consolidation were allowed, nor otherwise explained the impact of tax consolida-

[101] *Holywell Corp. v. Smith*, 112 S. Ct. 1021, 92-1 U.S.T.C. ¶ 50,110 (1992).

[102] *See also Holywell Corp. v. United States*, 229 F.2d 1142 (4th Cir. 2000) (unpublished decision), *reported in full at* 2000-2 U.S.T.C. ¶ 50,710 (concluding prior adjudication was *res judicata* and that bankruptcy court's exercise of jurisdiction over liquidating trust's tax liability was not manifest error given the fact, in the present appeal, that both parties presented reasonable arguments for their respective positions that jurisdiction did or did not exist), *cert. denied*, 121 S. Ct. 1192 (2001). At least one district court has granted declaratory relief in an analogous nonbankruptcy situation involving two testamentary trusts where the question was who, as between the trusts and their beneficiaries, should pay the tax on certain asset sales by the trusts. *See Dominion Trust Co. of Tennessee v. United States*, 786 F. Supp. 1321, 92-1 U.S.T.C. ¶ 50,136 (M.D. Tenn. 1991), *appealed and aff'd on other issues*, 1993 U.S. App. LEXIS 27,023 (6th Cir. 1993). Even though the IRS had yet taken no action to collect the tax, the court found that an "actual controversy" existed because the due date for filing the (still unfiled) tax returns had passed (a fact that similarly existed in both the *Goldblatt* and *Holywell* cases). Moreover, the court found that the general prohibition against declaratory judgments "with respect to Federal taxes" did not apply. The court observed that such prohibition was only intended to preclude the circumvention of the Anti-Injunction Act (*see* Code § 7421) through a request for declaratory relief and thus only bars declaratory relief "for the purpose of restraining the assessment or collection of any tax" (the scope of the Anti-Injunction Act). In the court's view, the issue of "who" pays a tax—in contrast to whether the tax is due at all—was not such a restriction.

[103] *IRS v. Sulmeyer* (*In re Grand Chevrolet, Inc.*), *supra* note 1.

[104] For a discussion of the "actual controversy" requirement, *see* § 1013.3.1 below. In this regard, it is interesting to note that the corporations involved, although commonly controlled, were not affiliated within the meaning of Code § 1504.

tion on its ultimate tax liability, but, rather, simply contended that separate reporting would substantially defeat the purpose of bankruptcy consolidation, be inequitable, and result in undue expense without any guarantee of accuracy. In juxtaposition to *Grand Chevrolet* are the facts and holding in *In re PT-1 Communications Inc.*, discussed below.

The bankruptcy court in *In re Inter Urban Broadcasting of Cincinnati, Inc.*[105] similarly found that a debtor's action in so far as it requested a declaration that certain purported stock transfers did not have any effect upon its status as an S corporation, and sought a court order reinstating its S status, suffered from the same deficiency as the trustee's action in *Grand Chevrolet*. Accordingly, the court dismissed the action against the United States and the IRS.

In *In re Dycoal Inc.*,[106] the debtor corporation, several years following the confirmation of its Chapter 11 plan, had sought a declaratory judgment from the bankruptcy court that certain synthetic fuels qualified for preconfirmation tax credits under Code § 29, even though the debtor had not yet filed any pre- or postconfirmation tax returns utilizing such credits. The bankruptcy court (affirmed by the district court) held, as alternative grounds, that there was no existent tax liability predicated upon the use of such credits, that the action was not ripe for determination as the IRS had not yet disallowed the credits or challenged certain court findings upon which the debtor sought to rely, and that the action involved a postconfirmation tax liability outside the purview of section 505(a).[107]

In contrast, in *In re Agway, Inc.*[108] a liquidating trustee of a trust established pursuant to a confirmed liquidating Chapter 11 plan sought a determination under Bankruptcy Code section 505(a) that no additional taxes were owed with respect to certain filed returns reflecting postconfirmation transactions effectuated pursuant to a court-approved plan amendment more than three years after the plan originally became effective. The liquidating trustee had filed with the IRS with respect to such returns requests for prompt determination under Bankruptcy Code section 505(b) to which the IRS never responded.[109] The district court upheld jurisdiction under section 505(a) given the retention of jurisdiction provision in the plan and the fact the tax arose during the administration of the liquidating plan. For similar reasons, and also focusing on the need to resolve any additional tax liability to further distributions

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[105] *Supra* note 1.

[106] *Dycoal Inc. v. IRS (In re Dycoal Inc.)*, 327 B.R. 220, 2005-2 U.S.T.C. ¶50,554 (Bankr. W.D. Pa. 2005), *aff'd*, 2006 U.S. Dist. LEXIS 25078 (W.D. Pa. 2006).

[107] For a discussion of the bankruptcy court's limited jurisdiction over postconfirmation taxes, *see* § 1013.6 below.

[108] *Ogle v. IRS (In re Agway, Inc.)*, 447 B.R. 91 (N.D. N.Y. 2011), *reh'g denied*, 2011 U.S. Dist. LEXIS 86774 (2011), *rev'g* 412 B.R. 32 (Bankr. N.D. N.Y. 2009) (the bankruptcy court had upheld standing of liquidating trustee to bring a tax action on behalf of the liquidating corporate debtor, but found postconfirmation jurisdiction lacking), discussed in more detail at § § 1011 and 1013.6.

[109] If the section 505(b) request was proper, the absence of any response by the IRS was itself sufficient to result in the discharge of any further liability. *See* discussion at § 1011 above. The liquidating trustee was concerned, however, that absent an affirmative determination, the IRS might later seek to reopen the tax issue and assess an additional liability. 412 B.R. at 36.

under the plan, the court concluded that the tax liability was ripe for determination, even though the IRS had not expressed any disagreement with the filed returns.

In *In re PT-1 Communications Inc.*,[110] the liquidating trustee of a trust established pursuant to the debtor's Chapter 11 plan successfully obtained a determination directing the IRS to accept a consolidated "subgroup" filing on behalf of the debtor and its subsidiaries. The debtor was a wholly-owned subsidiary at the time of its bankruptcy filing, and for the two tax years preceding the bankruptcy filing included within the parent's consolidated return. However, immediately prior to (and ultimately resulting in) the debtor's bankruptcy filing, a secured creditor of the parent exercised its rights under a pledge of the debtor's stock to elect a new board of directors of the debtor. The parent later informed the debtor that, due to the creditor's exercise of voting control, the debtor (and its subsidiaries) would no longer be included in the parent's consolidated return. Shortly thereafter, the parent filed for bankruptcy and liquidated without filing its return for the year of the debtor's bankruptcy filing (which would have included, as to the debtor and its subsidiaries, the "stub" period prior to the debtor's bankruptcy) and without designating a substitute agent for the group. The debtor filed a separate group return for the period beginning on the date of its filing for bankruptcy, and all tax years thereafter. Desiring to obtain a tax refund with respect to the stub period prior to the bankruptcy and certain prior periods, the liquidating trustee (on behalf of the debtor and its subsidiaries) sought permission from the IRS to file a consolidated return for the stub period that included only the debtor and its subsidiaries (the only other members of the former parent group), and did not include the parent. Following the IRS's refusal, the liquidating trustee brought an action in the bankruptcy court to (i) direct the IRS to accept the return and (ii) order the tax refund.[111]

The bankruptcy court, affirmed by the district court (*sub nom. United States v. Bond*), viewed the dispute over the subgroup stub period return as a predicate to the court's determination of the debtor's tax liability and entitlement to a tax refund and, thus, within its jurisdiction under section 505 and 28 U.S.C. § 1346(a)(1).[112] Both courts

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[110] *Supra* note 95.

[111] The refund action was filed by the liquidating trustee as a counterclaim to the IRS's request for the payment of certain postpetition tax liabilities. According to the bankruptcy court, the filing of a prior administrative claim for refund was not required; however, the district court disagreed, but allowed the liquidating trustee to file a refund claim after the counterclaim was brought, and then amend or supplement its original pleading. Subsequently, the Second Circuit reversed, holding that the bankruptcy court lacked jurisdiction to consider the refund since the refund claim was not originally filed with the IRS by the debtor itself, as debtor-in-possession (*see* §§ 1012.2 and 1013 above).

[112] The latter provision grants to district courts, from which the bankruptcy court derives its jurisdiction under 28 U.S.C. §§ 157, the ability to decide tax refund cases. The bankruptcy court and the district court also rejected the IRS's challenge to the liquidating trustee's ability to act on behalf of the debtor (though, as mentioned in note 111, *supra*, the Second Circuit held that the bankruptcy court lacked jurisdiction with respect to the postpetition refund at issue since the claim was not originally filed with the IRS by the debtor itself)—*see* discussions at §§ 1005.1.1, 1011 and 1013—and the IRS's argument that forcing it to accept the return would violate the Anti-Injunction Act, as a restraint on the assessment or collection of tax. The bankruptcy court's reasoning with respect to the Anti-Injunction Act (and by implication that of the district court) has been criticized. *See, e.g.*, Pisem and

were mindful that, under Reg. §1.1502-77A(d),[113] the IRS had the discretion ("if it deems it advisable") to deal directly with a subsidiary member of a consolidated group *or not* since no substitute agent was yet in place, and therefore approached its review solely from the perspective of whether the IRS's refusal to accept the consolidated subgroup filing was arbitrary and capricious or otherwise an abuse of discretion.[114] The bankruptcy court concluded, and the district court agreed, that the IRS's refusal was arbitrary and capricious in that: it was no longer possible for any other member to act as a substitute agent for the parent group since all members were defunct (nor did they have "access to their records"); the parent had no taxable liability of its own for the stub period;[115] the debtor was only attempting to use NOLs to which it was entitled on a stand-alone basis (including only its share of any consolidated loss); and the IRS previously had accepted the debtor's postpetition consolidated filings even though, as acknowledged by the IRS's counsel, the IRS had no view "as to when, if ever," the debtor ceased being a member of the parent group.

§1013.3.1 Plan-Related Issues

It is unclear whether a bankruptcy court may, pursuant to its declaratory judgment power, declare the federal income tax consequences of a Chapter 11 plan. The *Goldblatt and Amoskeag Bank Shares* cases (discussed in the preceding section) would suggest it can. However, other cases, such as the Fifth Circuit decision in *In re Wingreen Company* and the bankruptcy court decision in the *Allis-Chalmers* case (both discussed below), suggest the contrary.

In *Wingreen*,[116] the bankruptcy trustee had informally proposed a plan of reorganization under Chapter X of the then Bankruptcy Act, but had not yet presented it to the court or the government. One of the important features of the plan was a provision by which the reorganized corporation could take advantage of the debtor's $2.5 million NOL carryforward. Accordingly the trustee requested a ruling from the IRS on the amount and availability of any loss carryforwards, but the IRS declined to rule, responding that the matter was under study. The trustee then asked the court to direct the IRS "to show cause whether, under the proposed plan of reorganization[,] the continuing and reorganized corporation would have available to it the full tax

(Footnote Continued)

Zhang, Loss Carryovers When Part of a Consolidated Group is Bankrupt: *PT-1 Communications*, 110 J. Tax'n 327, 330-331 (2009).

[113] For taxable years beyond those involved in this case (*i.e.*, after 2002), the rules governing the designation of a substitute agent have been modified. *See* Reg. §§1.1502-77(c) (taxable years beginning on or after April 1, 2015), and 1.1502-77B(d)(6).

[114] *See* 5 U.S.C. (the "Administrative Procedures Act"), §706.

[115] The IRS had also expressed concern regarding the potential impact of "any discharge of indebtedness." The court's only apparent response to this was to note that the parent, having liquidated pursuant to its bankruptcy plan, was not entitled to a bankruptcy discharge. *See* 11 U.S.C. §1141(d), discussed at §1014 below. In this regard, the court may have been mistaken that the absence of a discharge avoids COD for tax purposes (*see* discussion at §404.8); nevertheless, the parent's bankruptcy was not even filed until after the tax year at issue.

[116] *United States v. Brock (In re Wingreen Company)*, 412 F.2d 1048, 69-2 U.S.T.C. ¶9511 (5th Cir. 1969).

loss carry forward benefits available to the debtor or a lesser benefit, and whether the ruling would be binding on the Service."[117] Over the government's objection, the district court required that, within 45 days, the IRS conduct an audit to determine the amount, extent, and duration of the debtor's NOL carryforwards, if any.

The Fifth Circuit reversed the district court's order, holding that the district court had no jurisdiction to enter it. Although the Fifth Circuit could have simply held that the district court order granted a form of declaratory relief that was specifically precluded by the Declaratory Judgment Act as then in effect (there being no specific exception at that time for federal tax proceedings in bankruptcy cases), it also provided the following reasoning:

> The order directs a ruling by the Internal Revenue Service on the relationship of the Bankruptcy Act and the Internal Revenue Code, including a determination of the tax consequences of a proposed plan of reorganization regarding the availability to a hypothetical continuing and reorganized corporation of a possible net operating loss carryover *in futuro*. This in effect constitutes an attempt by the trustee to receive a declaratory judgment, yet there is no "actual controversy" between the Service and any taxpayer.[118]

As to the portion of the order directing the IRS to audit the taxpayer, the court also concluded that the IRS had no specific duty to do so and, thus, could not be required to do so.

Although on one level the above quoted reasoning might be dismissed as dicta, it nevertheless raises serious questions as to the practical utility of the bankruptcy court's declaratory judgment power. Assuming that the result in *Wingreen* is sound—namely, that an informally proposed plan of reorganization is not a proper basis for a declaratory judgment—how far does the *Wingreen* reasoning extend? If it is limited to its facts, such that the Fifth Circuit might conclude differently if presented with a formally filed or an approved plan of reorganization, that would be one thing.[119] However, the court's conclusion—that "there is no 'actual controversy' between the Service and any taxpayer"—does not appear so limited. Taken to an extreme, this type of reasoning could, as a practical matter, eliminate the ability of a debtor to

[117] Id. at 1050.

[118] Id. at 1052 (citations omitted).

[119] In this regard, consider *In re Franklin*, *supra* notes 63 and 99, wherein the government asserted that the matter at issue—an allocation of tax liability for the proposed sale of certain property in which the estate only had a part interest (*see* note 62)—involved "no case or controversy because the government had not made a claim against the estate for the sale of [the property]—the reason being that no sale of the property had been made." The court disagreed, finding that the "allocation of potential tax liability relates to the Trustee's ability to dispose of property not owned by the estate (11 U.S.C. §725 (1990)) and to administer a settlement plan." *But see Official Comm. of Unsecured Creditors of Antonelli v. United States* (*In re Antonelli*), 1992 Bankr. LEXIS 2369 (Bankr. D. Md. 1992) (denied request for a declaratory judgment as to the application of the transfer tax exemption of Bankruptcy Code section 1146(c)—now section 1146(a)—with respect to anticipated postconfirmation sales by a liquidating trust provided for in a proposed Chapter 11 plan; court was "mindful" that its decision could delay confirmation efforts and complicate the negotiation process).

obtain declaratory judgments with respect to most plan-related federal tax issues (and would be in direct conflict with the courts' holdings in the *Goldblatt* and *Amoskeag Bank Shares* cases).

Subsequently, in a 1992 decision, the bankruptcy court in the *Allis-Chalmers* case[120] concluded, on the facts, that it was not within its jurisdiction to rule on whether Code §269 precluded the postconfirmation availability of the Chapter 11 debtor's NOL carryforwards. In contrast to *Wingreen*, here the debtor had sought postconfirmation declaratory relief.

Shortly after the debtor emerged from bankruptcy, the IRS notified the reorganized debtor that its future use of NOLs might be challenged under Code §269. The IRS thereafter issued regulations under Code §269 "clarifying" that Code §269 could apply to creditor takeovers of a bankrupt corporation and that a bankruptcy court's finding for plan confirmation purposes that the principal purpose for filing the Chapter 11 plan was not tax avoidance (which the bankruptcy court in this case had earlier determined) was not controlling for Code §269 purposes.[121] In response, the debtor sought various forms of relief from the bankruptcy court.

First, the debtor asserted that the bankruptcy court's earlier finding of no tax avoidance for purposes of confirmation barred a subsequent Code §269 challenge under the principles of *res judicata* or collateral estoppel.[122] However, as discussed at §1002.8, the court concluded that *res judicata* did not apply and that the IRS could not be collaterally estopped from making a subsequent Code §269 challenge "to attempts to use the NOLs after transactions not specifically contemplated in [the debtor's] plan of reorganization." Thus, the court left open the prospect that *res judicata* or collateral estoppel could apply in other cases where the use of the NOLs was more immediate and specifically contemplated by a debtor's plan.

Next, the debtor asked the court to rule on the applicability of Code §269 and the regulations to the creditors' acquisition pursuant to the debtor's Chapter 11 plan. It is here that the court held that it lacked jurisdiction.

The court pointed out that, under the Declaratory Judgment Act, in order for it to issue a declaratory judgment with respect to federal taxes the requested relief must be within the court's authority under Bankruptcy Code section 505 or 1146. In concluding that section 505 did not apply, the court was extremely sensitive to the limits on its jurisdiction as to postconfirmation events. The court commented that "any tax," as used in Bankruptcy Code section 505(a), did not mean any tax of any entity at any point in time. The court also observed that the debtor was seeking an advance ruling since it had not yet attempted to use its NOLs (and might never use them) and that "any ruling would have to consider postconfirmation events which were not even

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[120] *Allis-Chalmers Corp. v. Goldberg (In re Hartman Material Handling Systems, Inc.)*, *infra* note 180.

[121] These regulations are discussed at §509.1.

[122] The debtor also asserted that the IRS should be equitably estopped from subsequently applying Code §269, given that the IRS did not raise the issue when it issued to the debtor prior to confirmation a private letter ruling on certain Code §382(1)(5) issues. Although the court stated that the issue was premature, it nevertheless noted the difficulty that the debtor would have in maintaining such a claim given the "no other opinion" language in the ruling and the fact that the disclosure statement accompanying the plan warned of the Code §269 risk.

known at the time of confirmation to determine a speculative future tax liability of the debtor." Hence, the court concluded that "a §269 action had not ripened at the time of confirmation (and still has not ripened)" and added that: "Such a ruling would establish a precedent for a former debtor to return to bankruptcy court to have any and all of its future tax consequences determined." The court noted that only Bankruptcy Code section 1146(d), since redesignated section 1146(b) (discussed below), provides for prospective tax determinations resembling the relief sought by the debtor, but that such section only applies for state and local tax purposes and appears to contemplate only a preconfirmation determination.

Finally, the court viewed the relief sought by the debtor as "closely analogous" to the position taken by the liquidating trustee in the *Holywell* case[123] and rejected by the Supreme Court (*see also* §902.1) with respect to the binding effect of a confirmed Chapter 11 plan. The liquidating trustee had taken the position that he was not responsible for postconfirmation taxes on certain liquidating sales by the liquidating trust, arguing in part that the IRS, as a creditor in the debtor's bankruptcy, was precluded from seeking payment of the tax since the Chapter 11 plan (which created the trust) did not specifically provide for any taxes. The Supreme Court disagreed, stating that, even if a confirmed Chapter 11 plan binds all creditors with respect to preconfirmation claims (*see* §1014.3 below), "we do not see how it can bind the United States or any other creditor with respect to postconfirmation claims," and noting that the Bankruptcy Code definition of "creditor" for this purpose spoke in terms of preconfirmation claims.

Resembling more closely the *Allis-Chalmers* case is the *McLean Industries* case.[124] Decided prior to *Allis-Chalmers*, that case also involved a confirmed Chapter 11 plan and the effect of the same Code §269 regulations on the future availability of the debtor's NOL carryforwards (its "primary asset"), although at that time the regulations were only in proposed form. Moreover, in a letter ruling obtained by the debtors in connection with their plan, the IRS raised the possibility of a Code §269 determination in the future.[125] The court acknowledged that the proposed regulations, "if adopted, would affect the Debtors by precluding their use of the NOLs."[126]

Although the court did not view the debtors' motion as requesting a declaratory judgment as to the debtors' tax liability (and denied the motion on other grounds, *see* §1002 note 113 above), the court nevertheless commented on whether, if the debtors had wanted such a tax determination, such request would have presented a "justiciable case or controversy" under Article III of the U.S. Constitution.[127] Concluding that it would not, the court stated:

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[123] *Holywell Corp. v. Smith* (S. Ct.), *supra* note 101.

[124] 132 B.R. 267, 91-2 U.S.T.C. ¶50,465 (S.D.N.Y. 1991).

[125] *See* IRS Letter Ruling 9019036, February 9, 1990.

[126] *See* then Prop. Reg. §1.269-3(d). The proposed retroactive effective date of this section of the regulations was changed in the final version. As finalized, this section only applies to bankruptcy plans confirmed after August 14, 1990, the date the proposed regulations were released. Accordingly, the final version does not apply to the *McLean Industries* bankruptcy.

[127] The concept of "case or controversy" for such purpose is the same as the "actual controversy" requirement in the Declaratory Judgment Act. *See, e.g., Public Service Comm'n v. Wycoff Co.*, 73 S. Ct.

> This Court will not render an advisory opinion as to the possible danger to the Debtors' NOLs because such a threat remains purely hypothetical at this juncture. A court can only determine an issue that presents a "real, substantial controversy between parties having adverse legal interests, a dispute definite and concrete, not hypothetical or abstract." . . . Until the [proposed] regulations are officially promulgated, there can be no concrete controversy concerning the Debtors' tax situation . . . .
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> In the future, if the proposed regulations are ultimately adopted, then the appropriate issue would be whether a retroactive application of the I.R.C. would divest the Debtors of their NOLs. Additional issues would involve jurisdictional conflicts between the tax authorities and the bankruptcy courts.

Thus, the *McLean Industries* court never reached the jurisdictional issues that the *Allis-Chalmers* court in part found determinative. It should be noted, however, that the two courts apparently had different views as to what it would take to create an "actual controversy." The *McLean Industries* court apparently believed that the ultimate adoption of the regulations, as proposed, would have supplied the necessary controversy even absent any current income against which the NOLs could be used,[128] whereas the *Allis-Chalmers* court believed the existence of such income to be an essential element. Early on, the Supreme Court focused on the difficulty in distinguishing between an "abstract question" and an "actual controversy" as contemplated by the Declaratory Judgment Act:

> The difference . . . is necessarily one of degree, and it would be difficult, if it would be possible, to fashion a precise test for determining in every case whether there is such a controversy. Basically, the question in each case is whether the facts alleged, under all the circumstances, show that there is a *substantial controversy*, between parties having adverse legal interests, of *sufficient immediacy* and *reality* to warrant the issuance of a declaratory judgment.[129]

(Footnote Continued)

236, 240 (1952); *Harris Trust & Savings Bank v. E-II*, 926 F.2d 636 (7th Cir. 1991), *reh'g denied*, 1991 U.S. App. LEXIS 8606, *cert. denied*, 112 S. Ct. 192 (1991); *In re Kilen*, 129 B.R. 538, 91-2 U.S.T.C. ¶50,761 (Bankr. N.D. Ill. 1991).

[128] It should be noted that, although the court asserted that the proposed regulation, "if adopted, would affect the debtors by precluding their use of the NOLs," this conclusion is not necessarily clear from the face of the regulation. As proposed (and subsequently adopted), the regulation creates a strong presumption of tax avoidance if the level of the debtor's business operations during or subsequent to the bankruptcy is considered "insignificant." *Supra* note 126, and discussions at §§508.5 and 509.1. Thus, under the regulations, there are certain factual issues—namely, the level of business operations and the ability to rebut the presumption—which would appear to require the court to make a factual and legal determination. Whether the court considered these factual issues susceptible to a declaratory judgment, or simply relied on the unchallenged factual assertions of the debtors in their underlying brief, is unclear.

[129] *Golden v. Zwickler*, 394 U.S. 103, 108 (1969), *quoting Maryland Casualty Co. v. Pacific Coal & Oil Co.*, 312 U.S. 270, 273 (1941) (emphasis added).

As discussed below at § 1013.3.2, the bankruptcy court in the *Kilen* case found a "sufficient immediacy and reality" in the debtor's need "to insure that his confirmed plan is implemented as intended." In that case, all events had occurred necessary to establish the debtor's liability other than an actual or proposed assessment by the IRS. The *Kilen* case was also relied upon by the district court in *In re Agway, Inc.*,[130] which involved an actual postconfirmation tax liability of a liquidating debtor for which tax returns had been filed but the IRS had not as yet (and might never) express any disagreement. The liquidating trustee in that case had set aside funds for the payment of any potential tax liability. Moreover, as previously discussed, the district court in the *Amoskeag Bank Shares* case upheld a declaratory judgment motion with respect to a Chapter 7 trustee's employment tax obligations with respect to *pending* distributions to general unsecured creditors that were certain to occur.[131]

Following on the heels of the *Allis-Chalmers* case, the bankruptcy court in the *Monarch Capital* bankruptcy case denied a motion seeking a determination of certain plan related tax issues even though the plan was pending confirmation.[132] In addition to Code § 269, the tax issues raised were (i) the application of Code § 382(l)(5) in a consolidated return context, (ii) the sufficiency of the stock being issued for purposes of the "nominal or token" test to the stock-for-debt exception, (iii) the status of the reorganized debtor as a life insurance company under the Internal Revenue Code, and (iv) the status of the notes being issued as "debt" for federal income tax purposes. In what amounts to a one-paragraph decision, the court ruled from the bench that neither Bankruptcy Code section 505(a) (due to the lack of an actual controversy) nor the court's equitable authority under Bankruptcy Code section 105 ("I don't see that there's that absolute necessity for a ruling or for an action that 105 contemplates") supported the motion. Counsel had indicated, during the course of oral argument, that it would be prepared to opine as to four of the five tax issues (Code § 382(1)(5) being the exception). And the plan proponents acknowledged, in response to the court's inquiry, that they were prepared to go forward with confirmation even absent a determination.

In a 2006 decision in the *United Airlines (UAL)* bankruptcy case, the bankruptcy court likewise denied the debtors' request for an order declaring that certain plan distributions to Union employees would not be "wages" for federal income tax purposes.[133] Engaging in a close examination of the role of Bankruptcy Code section 505(a)—including the location and interplay of section 505(a) with other provisions in the Bankruptcy Code (which it found compelling), the legislative history of section

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[130] *See* discussion in preceding section and at § 1013.6.

[131] *See also In re Labrum & Doak* (E.D. Pa.), *supra* note 76, at *20-*21 (upholding a declaratory judgment motion to approve a debtor partnership's proposed allocation of income among current and former partners, and determining the matter to be a "core" proceeding in view of the significance of the issue to the estate and the confirmability of the debtor's Chapter 11 plan).

[132] *See In re Monarch Capital Corp.* (Bankr. D. Mass.), Chapter 11, Case No. 91-41379-JFQ, "Joint Motion of Plan Proponents to Determine Certain Federal Tax Consequences of the Plan in Furtherance of Confirmation," dated June 3, 1992; and the government's reply, dated June 22, 1992 (to which it attached the *Allis-Chalmers* decision); hearing held and motion denied, on June 25, 1992 (Queenan, J.).

[133] *In re UAL Corporation*, 336 B.R. 370 (Bankr. N.D. Ill. 2006).

505(a) (which it found confirmatory), policy considerations (which it found two-sided), and relevant case law (which it found, at best, unsettled)—the bankruptcy court concluded that section 505(a) does not grant bankruptcy courts the power to determine the tax consequences of a Chapter 11 plan.[134] The court did not comment upon or even reference the *Amoskeag Bank Shares* case upholding the bankruptcy court's jurisdiction to determine a very similar request by a Chapter 7 trustee in the context of a final distribution.

In sum, the above line of cases starting with *Allis-Chalmers* casts a serious blow to a debtor's ability to gain the certainty desired as to the federal income tax consequences of a Chapter 11 plan. Alone, the *Allis-Chalmers* decision leaves room for hope. In contrast to the potentially sweeping holding in the *Wingreen* case, the bankruptcy court's opinion in *Allis-Chalmers* does not purport to address a debtor's ability to obtain a declaratory judgment on the multitude of tax issues that can arise in the plan context for which the facts are known at the time of confirmation. The future availability of a debtor's NOLs under Code § 269 is only one potential tax issue (albeit frequently of considerable and determinative importance).[135] Also at issue may be the current taxability of various plan transactions, as well as numerous other tax issues with an immediate or known impact. There is a chance that when presented with these other issues some bankruptcy courts will conclude that it is within their jurisdiction to resolve them.[136] As demonstrated, though, by the *Monarch Capital* case

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[134] Having so concluded, the court found it unnecessary to decide whether the requested determination presented a constitutional "case or controversy."

[135] Even then, as discussed at § 1002.8, the collateral estoppel effect of confirmation on a debtor's ability to use its NOLs postconfirmation against projected income from an on-going business is arguably outside the court's opinion. In *In re Dycoal Inc.*, also discussed in the introductory section of § 1013, the debtor sought a plan-related determination several years after confirmation as to the future availability of certain Code § 29 fuel credits. *Dycoal Inc. v. IRS* (*In re Dycoal Inc.*), 327 B.R. 220, 2005-2 U.S.T.C. ¶ 50,554 (Bankr. W.D. Pa. 2005), *aff'd*, 2006 U.S. Dist. LEXIS 25078 (W.D. Pa. 2006). The bankruptcy court (affirmed by the district court) held that it did not have jurisdiction under section 505(a) due, among other things, to the absence of any existing (and more particularly preconfirmation) tax liability or IRS challenge, nor could such jurisdiction be supplied by the bankruptcy court's equitable authority under Bankruptcy Code section 105 or 1123(b)(5) (*see* § 1013.5 below). The district court also rejected the debtor's claim that the feasibility of the plan was dependent upon the availability of the Code § 29 credits and consequently that the IRS was bound by certain findings of fact in the bankruptcy court's confirmation order relating to such credits. The court concluded that such a determination "is neither required [on the facts] nor appropriate under" Bankruptcy Code section 1129(a)(11) (the feasibility condition for plan confirmation) or 1142(a) (implementation of the plan by the reorganized debtor).

[136] In addition to several cases discussed in the text, *see, e.g.*, *McCorkle v. Georgia* (*In re McCorkle*), 209 B.R. 703 (Bankr. M.D. Ga. 1997) (court held that it had jurisdiction to determine whether, at such future time as the State's current lien expired, the State could refile its lien or was precluded from doing so due to the debtor's personal discharge; in the court's view, the "immediacy and reality" of the adverse interests was clear, given that the outcome could affect the debtor's decision to abandon his home to the bank or to keep it); *In re Pflug*, 146 B.R. 687, 92-2 U.S.T.C. ¶ 50,586 (Bankr. E.D. Va. 1992) (wherein the bankruptcy court expressed doubt whether it was within its jurisdiction to entertain an individual debtor's motion to compel the bankruptcy trustee to file tax returns not yet due since the motion "essentially requests an advisory opinion on prospective transactions," but nevertheless ruled on the issue "since it raises an important question concerning a Chapter 7 trustee's duty with respect to income tax reporting of forgiveness of indebtedness income"); *Scharrer v. Dept. of Treasury* (*In re American Leasing and Acceptance Corp. of Lakeland*), *supra* note 99 ("for the sake of judicial

and the 2006 decision in the *UAL* bankruptcy case, debtors will not have an easy time of it. One can venture to say that a debtor's likelihood of success will increase as the dependency of the debtor's plan on a favorable resolution of the tax issues increases.[137] Absent a preconfirmation determination, the bankruptcy court may, in certain cases, have jurisdiction to resolve a subsequent challenge or potential challenge to the tax treatment of consummated plan transactions (*see* discussion of postconfirmation jurisdiction in § 1013 above).

Sympathetic to the debtor's plight, the *Allis-Chalmers* court expressed the need for legislative action (footnotes omitted):[138]

> Through the [Code § 269] Regulations, the IRS has highlighted an unfortunate loophole in the finality of the reorganization process and the need for reconciliation and modification of the relevant statutes. The degree of uncertainty in the current statutory scheme jeopardizes the viability of many reorganizations. It is essential that a reorganizing company know how to structure its reorganization to preserve its tax benefits. In many cases, this certainty will be necessary to determine the feasibility of a plan. *See* § 1129(a)(11) . . . .
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> . . . Indeed, the Regulations suggest an ill-fated system for all involved. While the IRS may take some satisfaction in the outcome in this case as it may mean that some favorable tax attributes are never used, its sister governmental organizations may not view the IRS's endeavors with the same glee. The government as a major creditor in many mega cases has an interest in successful reorganizations. The PBGC and the Environmental Protection Agency, for example, will be harmed along with all other creditor types. The government safety net agencies and the courts, furthermore, may find that they have more customers from liquidating companies than anticipated.

As previously mentioned, the issue of declaratory judgments and plan feasibility was specifically addressed for state and local tax purposes in Bankruptcy Code section 1146(d), since redesignated section 1146(b). Such section permits the bankruptcy court to authorize the proponent of a plan to request from the appropriate state and local taxing authorities a determination, limited to questions of law, of the tax effect of the plan; and, in the event of an adverse determination or upon the

(Footnote Continued)

economy" court ruled on liquidating trustee's summary judgment motion for a tax determination prior to the filing of an amended return formally asserting the tax position and any adverse action by the IRS).

[137] We recommend, as well, to the reader the following articles: Jacobs, The Bankruptcy Court's Emergence as Tax Dispute Arbiter of Choice, 45 Tax Law. 971, 1013-1016 (1992); Sheppard, New Tax Avoidance Regs Avoid Bankruptcy Court, 92 TNT 8-8 (January 13, 1992); Faber, The Declaratory Powers of Bankruptcy Courts to Determine the Federal Tax Consequences of Chapter 11 Plans, 3 Am. Bankr. Inst. Law Rev. 407 (1994).

[138] 141 B.R. at 813-14.

passage of 270 days, permits the court to declare such effect.[139] According to legislative statements at the time of enactment, the import of this provision is that:

> the power of the bankruptcy court to declare the tax effects of the plan is limited to issues of law and not to questions of fact such as the allowance of specific deductions. Thus, the bankruptcy court could declare whether the reorganization qualified for tax free status under State or local tax rules, but it could not declare the dollar amount of any tax attributes that survive the reorganization.[140]

Although, as originally proposed, this provision would have applied also to federal taxes, the reference to federal taxes here (as elsewhere in section 1146) was deleted in the final bill (*see* §1101 below). In its report to Congress, the National Bankruptcy Review Commission recommended that this provision also apply to federal taxes.[141] Although no change has yet been made to Bankruptcy Code section 1146(b), Congress in the 2005 bankruptcy reforms expanded the comparable section in Chapter 12 of the Bankruptcy Code (applicable to certain family farmers or fisherman) to cover federal taxes.[142]

§1013.3.2 Prepetition Tax Issues

In the *Kilen* case,[143] the bankruptcy court considered whether it had the power to resolve a tax dispute ostensibly created by the debtor pursuant to Bankruptcy Code section 501(c). As discussed at §1010, Bankruptcy Code section 501(c) permits a debtor to file a proof of claim on behalf of the IRS where the IRS fails to do so.

In *Kilen*, the debtor (an individual) had set aside, as part of his Chapter 11 plan, some $640,000 to satisfy his potential personal liability to the IRS pursuant to Code §6672 for unpaid trust fund taxes of several controlled corporations. However, the IRS had filed a proof of claim for taxes owed by only one of the corporations (although many of the corporations had admitted to owing the taxes in the schedules of liabilities filed in their respective bankruptcy cases). This left the debtor in the position that, if no proof of claim was filed for the taxes owed by the other corporations and the IRS asserted such claim after the bankruptcy, the money set aside would have been distributed to the debtor's general unsecured creditors and the debtor would remain personally liable since, as an individual, his liability under Code §6672 would not be discharged. To prevent this result, the debtor filed a proof

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[139] *See also* discussion at §1102.17; Collier on Bankruptcy ¶8.03[c] (15th ed.).

[140] 123 Cong. Rec. H 11,115 (daily ed. September 28, 1978) (statement of Rep. Edwards), S 17,432 (daily ed. October 6, 1978) (statement of Sen. DeConcini).

[141] National Bankruptcy Review Commission Final Report (October 20, 1997), Recommendation 3.2.5, at pp. 811-817.

[142] *See* 11 U.S.C. §1231(b), *as amended by* P.L. 109-8, §1003(b) (2005) (formerly section 1231(d) of the Bankruptcy Code). *See also* Rev. Proc. 2006-52, 2006-48 I.R.B. 995 (describing the procedure for requesting IRS determinations under the expanded provision).

[143] *Supra* note 127.

of claim on behalf of the IRS for such taxes, pursuant to Bankruptcy Code section 501(c) and, immediately thereafter, objected to the claim, asking the court to declare either that the amount of the liability was zero or that he was not a "responsible person" within the meaning of Code §6672 and, thus, not liable for such taxes. The IRS opposed the motion, contending that, without an actual or proposed assessment, "there is no actual case or controversy between the parties that is ripe for hearing and determination."

Rejecting the IRS's arguments to the contrary, the bankruptcy court held that, given the magnitude of the potential harm to the debtor and the fact that the events and conduct upon which the claim was based already occurred, the relief sought was "ripe" for consideration and that an "actual controversy" existed. In addressing the debtor's need for relief, the court stated:

> Kilen needs declaratory relief under §505, *i.e.*, to have this Court determine what, if anything, he owes the IRS for trust fund liability, in order to insure that his confirmed plan is implemented as intended and the priority tax claims satisfied ahead of the claims of nonpriority unsecured creditors.

The court also found that the debtor's use of Bankruptcy Code section 501(c) was consistent with bankruptcy policy and with Bankruptcy Act precedent and concluded that "Section 501 . . . in effect empower[s] the debtor to create an actual controversy by filing a proof of claim on behalf of the creditor and then turning around and opposing allowance of the claim."

As discussed at §1010, it generally will be rare that a corporate debtor files a proof of claim on behalf of the IRS since, in contrast to the case of an individual debtor, any unpaid prepetition taxes of a corporate debtor for which a proof of claim has not been filed generally are dischargeable. However, any person who may be liable for such taxes with the debtor (such as a former member of the debtor's consolidated group) similarly may file a claim on behalf of the IRS where the IRS fails to do so.

In *In re Schwartz*,[144] the bankruptcy court was presented with a situation similar to that in *Kilen*, but where the debtor, rather than filing a proof of claim on behalf of the IRS, simply filed an adversary proceeding in the bankruptcy court against the IRS (and the New Jersey Division of Taxation) seeking a determination that he was not liable as a "responsible person" within the meaning of the respective tax statutes. What is also striking about the case is that the IRS had not suggested to the debtor that he might be liable, nor had it commenced an investigation to determine whether the debtor had any such liability. However, the IRS readily admitted that it was possible that it could conduct such an investigation sometime in the future. Also, the New Jersey Division of Taxation had in one instance already determined the debtor to be a responsible person under its tax statutes. Thus, the bankruptcy court viewed as real the possibility that the debtor could have substantial liability. Moreover, the

[144] 192 B.R. 90 (Bankr. D.N.J. 1996).

court, discussing *Kilen*, did not view the filing of the proof of claim under Bankruptcy Code section 501(c) as essential to the holding in that case. Rather, in the bankruptcy court's view, what was critical in *Kilen* was the expansive definition of a "claim" under the Bankruptcy Code which includes unliquidated and contingent claims, the equally expansive jurisdiction of the bankruptcy court under Bankruptcy Code section 505(a) to deal with such claims, and the debtor's need for immediate relief to ensure the successful implementation of its Chapter 11 plan. Finding a similar need, and based on its review of other relevant authorities, the bankruptcy court concluded that an "actual controversy" existed between the debtor, on the one hand, and the IRS and the New Jersey Division of Taxation, on the other hand.

The situation in *United States v. Bushnell*[145] presents a third variation on the theme. In this case, the IRS had in fact issued a notice of proposed liability and filed a proof of claim (the issue here being transferee, rather than responsible person, liability), in reaction to which the debtor commenced the present proceeding to determine its liability. Subsequently, however, in response to a previously filed protest by the debtor, IRS Appeals determined that the debtor in fact had no liability. The IRS thus sought to withdraw its proof of claim, but "without prejudice." Wanting to ensure finality, the debtor pursued its action and obtained summary judgment. The IRS argued, among other things, that the debtor's action should be dismissed due to the absence of a case or controversy. The district court found that the bankruptcy court properly exercised its jurisdiction in adjudicating the debtor's tax liability, given that the IRS had originally submitted to the court's jurisdiction by filing its claim and, despite its attempted withdrawal, sought to maintain the right to reassert the claim at a later date.

In *In re Sprout*,[146] the bankruptcy court upheld postconfirmation jurisdiction to hear the debtor's motion seeking a declaratory judgment that the IRS's prepetition claims had been paid or discharged pursuant to the debtor's Chapter 11 plan.

§1013.4 Burden of Proof

Burden of proof issues with respect to taxes can arise in many different situations—such as through an objection to a proof of claim, an action against the IRS to turn over assets, or an action for a declaratory judgment. Depending on the context, the party having the "burden of going forward" and the ultimate "burden of persuasion" may differ.[147]

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[145] 96-2 U.S.T.C. ¶50,472 (D. Vt. 1996).

[146] *Sprout v. IRS* (*In re Sprout*), 2020 Bankr. LEXIS 1305 (Bankr. S.D. Ohio 2020).

[147] *Compare, e.g.*, discussion in text *with* Code §7422(e) (burden generally on taxpayer in tax refund actions). *See also* Jones, The Burden of Proof 10 Years After the Shift, 121 Tax Notes 287 (October 20, 2008) (discussing Code §7491 and general burden of proof considerations in tax cases); Cash, Dickens and Ward-Vaughn, Burden of Proof and the Impact of Code Sec. 7491 in Civil Tax Disputes, 80 Taxes 33 (2002); Khadiri, The Burden of Proof in Court Proceedings Under I.R.C. §7491: Separating Fact From Fiction, Tax Mgmt. Memo. (October 15, 1998); Clukey, Examining the Limited Benefits of the Burden of Proof Shift, 1999 TNT 20-136 (February 1, 1999).

Proof of claim. As to proofs of claim, Bankruptcy Rule 3001(f) provides that "[a] proof of claim executed and filed in accordance with these rules shall constitute *prima facie* evidence of the validity and amount of the claim." Thus, in the case of an objection to a proof of claim, the initial burden of going forward and introducing evidence is on the debtor (or any other objecting party).[148]

Prior to the Supreme Court's decision in *Raleigh v. Illinois Department of Revenue*,[149] in May 2000, courts were divided as to whether the debtor or the taxing authority bore the ultimate burden of persuasion in such cases.[150] As discussed below, the Supreme Court in *Raleigh* held that a taxpayer's burden of proof is a matter of substantive law and thus unaltered in bankruptcy.

At least four different positions had previously emerged from the cases:

(1) A taxing authority was treated no differently than any other creditor. Accordingly, unlike the rule outside bankruptcy, once the debtor produced evidence rebutting the *prima facie* effect of the proof of claim, the burden of persuasion rested with the taxing authority.[151]

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[148] *See also Brown v. United States (In re Brown)*, 82 F.3d 801, 97-2 U.S.T.C. ¶50,559 (8th Cir. 1996) (debtor must present "substantial evidence" to overcome initial burden).

[149] 120 S.Ct. 1951 (2000), *aff'g*, 179 F.3d 546 (7th Cir. 1999).

[150] For a further discussion of the various lines of authorities and a collection of cases, *see In re Premo*, 90-2 U.S.T.C. ¶50,396 (Bankr. E.D. Mich. 1990); and *Kranzdorf v. IRS (In re Fidelity America Corp.)*, 1990 Bankr. LEXIS 1857 (Bankr. E.D. Pa. 1990), *opinion withdrawn. See also* Jenks, The Tax Collector in Bankruptcy Court: The Government's Uneasy Role as a Creditor in Bankruptcy, 71 Taxes 847 (1993); Martin, Burden of Persuasion: The Overlooked Defense to Tax Claims, 21 Cal. Bankr. J. 117 (1993).

[151] *See, e.g., Franchise Tax Board v. MacFarlane (In re MacFarlane)*, 83 F.3d 1041 (9th Cir. 1996), *cert. denied*, 117 S. Ct. 1243 (1997) (involved deductibility of bad debts); *In re Fidelity Holding Co., Ltd.*, 837 F.2d 696 (5th Cir. 1988) (involved state sales and use tax); *In re Placid Oil Co.*, 988 F.2d 554 (5th Cir. 1993) (involved deductibility of pre- and postpetition bankruptcy related expenses; *see* Chapter 13); *Fullmer v. United States*, 962 F.2d 1463, 92-1 U.S.T.C. ¶50,237 (10th Cir. 1992) (applied bankruptcy rule without discussion); *Izzo v. IRS*, 2000-1 U.S.T.C. ¶50,273 (Bankr. W.D. Pa. 2000) (narrowly construing Third Circuit decision in *Resyn, infra* note 152); *In re Forte*, 234 B.R. 607, 99-2 U.S.T.C. ¶50,568 (Bankr. E.D. N.Y. 1999) ("courts in this district have followed the Fifth, Ninth and Tenth Circuits"; involved status as S corporation shareholder and disallowed deductions); *In re Avien, Inc.*, 390 F. Supp. 1335 (E.D.N.Y. 1975) (involved city income tax), *aff'd*, 532 F.2d 273 (2d Cir. 1976); *In re Dakota Indus., Inc.* (Bankr. D.S.D.), 131 B.R. 437 (Bankr. D.S.D. 1991) (involved employment taxes); *United States v. Craddock (In re Craddock)*, 95-2 U.S.T.C. ¶50,475 (D. Col. 1995) (IRS had the ultimate burden of proving negligence for purposes of the Code §6653 negligence penalty; however, the debtor bore the ultimate burden of proving "reasonable cause" exception under Code §6651, as the court viewed such relief "in the nature of an affirmative defense"); *In re Hudson Oil Co.*, 100 B.R. 72 (Bankr. D. Kan. 1989) (but similarly imposed burden on debtor to establish "reasonable cause" exception under Code §6651); *In re L.G.J. Restaurant, Inc.*, 27 B.R. 455 (Bankr. E.D.N.Y. 1983) (involved state sales tax); *Thompson v. United States (In re Waston)*, 456 F. Supp. 432, 79-1 U.S.T.C. ¶9283 (S.D. Ga. 1979); *In re American Electric Const. Inc.*, 1990 Bankr. LEXIS 2252 (Bankr. S.D. Ohio) (involved an IRS "request for payment" of administrative expense claims); *In re Federated Dept. Stores, Inc.*, 135 B.R. 950, 92-1 U.S.T.C. ¶50,097 (Bankr. S.D. Ohio 1992), *aff'd*, 171 B.R. 603 (S.D. Ohio 1994) (involved deductibility of "white knight" break-up fees; also cited equitable factors); *see also United States v. Rasbury (In re Rasbury)*, 141 B.R. 752 (N.D. Ala. 1992) (involved employee status; found that *Terrell, infra* note 152, should be limited to its facts); *Arndt v. United States (In re Arndt)*, 158 B.R. 863 (Bankr. D. Fla. 1993) (also involved employee status). *Cf. In re Premo, supra* note 150; *In re Uninet*, 74 B.R. 156 (Bankr. N.D. Ohio 1987); *In re Imperial Corp. of America*, 91-2 U.S.T.C. ¶50,342 (Bankr. D. Cal.) (estimation proceeding); *In re Compass Marine*

(2) The nonbankruptcy rule applied. Accordingly, the burden of persuasion was generally on the debtor.[152] Effective for taxable periods or events (including examinations) beginning or occurring after June 9, 1998, Code §7491(a) changes the nonbankruptcy rule and generally shifts the burden of persuasion to the IRS in tax cases where the taxpayer (i) in the case of a corporation, partnership, or trust, satisfies the net worth and size requirements of Code §7430(c)(4)(A)(ii) (*i.e.*, not more than $7 million in net worth based on acquisition cost of assets and not more than 500 employees),[153] (ii) has complied with any relevant substantiation requirements under the Code, and (iii) has cooperated with reasonable requests of the IRS for information, witnesses, meetings and interviews.[154]

(Footnote Continued)

Corp., 1992 WL 207671 (Bankr. E.D. Pa.) (suggesting that the Third Circuit decision in *Resyn*, *infra* note 152, should be narrowly construed).

The Eighth Circuit also appears to support the burden of persuasion on the IRS. *Compare Brown v. United States* (*In re Brown*), *supra* note 148 (favorably cited *Placid Oil*, but ultimately held that taxpayer failed to overcome initial presumption of validity), *with Gran v. IRS* (*In re Gran*), 964 F.2d 822, 92-1 U.S.T.C. ¶50,283 (8th Cir. 1992) (the bankruptcy court had shifted burden to IRS; the Eighth Circuit declined to reach the burden of proof issue, since the bankruptcy court further held that the government had established its claim by convincing evidence), *and In re Uneco, Inc.*, 532 F.2d 1204, 76-1 U.S.T.C. ¶9326 (8th Cir. 1976) (Bankruptcy Act case; imposed burden on debtor without discussion of conflict with bankruptcy rule). Many of the above cases are also factually consistent with the third position in that no valid assessment was made.

[152] *See, e.g., Raleigh v. Illinois* (*In re Stoecker*) (7th Cir.), *supra* note 149 (involved responsible person liability under Illinois use tax); *IRS v. Levy* (*In re Landbank Equity Corp.*), 973 F.2d 265 (4th Cir. 1992) (where Form 870 was previously filed; involved deduction for bad debts), *rev'g* 130 B.R. 28 (E.D. Va. 1991); *Resyn Corp. v. United States*, 851 F.2d 660, 88-2 U.S.T.C. ¶9420 (3d Cir. 1988) (without discussion of conflict with bankruptcy rule); *United States v. Charlton*, 2 F.3d 237, 93-2 U.S.T.C. ¶50,469 (7th Cir. 1993) (same); *Thinking Machines Corporation v. New Mexico Tax'n & Rev. Dept.*, 211 B.R. 426 (D. Mass. 1997) (involved sales tax); *In re Duffy*, 95-1 U.S.T.C. ¶50,110 (Bankr. E.D. Cal. 1994) (involved debt/equity issue); *In re Terrell*, 75 B.R. 291, 87-1 U.S.T.C. ¶9269 (N.D. Ala. 1987) (involved Code §6672 penalty; adopted government briefs), *aff'd*, 835 F.2d 1439 (11th Cir. 1987); *United States v. Macagnone* (*In re Macagnone*), 240 B.R. 444, 99-2 U.S.T.C. ¶50,681 (M.D. Fla. 1999) (involved Code §6672 penalty); *In re Rose*, 89-2 U.S.T.C. ¶9533 (Bankr. E.D. Ark. 1989) (involved disallowed deductions); *Cobb v. United States* (*In re Cobb*), 135 B.R. 640 (Bankr. D. Neb. 1992) (reconciles Bankruptcy Rule); *In re Arthur's Industrial Maintenance, Inc.*, 93-1 U.S.T.C. ¶50,092 (W.D. Va. 1993) (involved application of credits, computation of interest and penalties, and "reasonable cause" for nonpayment of taxes).

Not surprisingly, the IRS stated that it agreed with, and would advocate, the position of the Fourth Circuit in *In re Landbank Equity Corp.* and, within the Fifth Circuit, would attempt to distinguish the Fifth Circuit's decision in *In re Placid Oil Co.*, *supra* note 151, on its facts (although it was unclear on what basis). Action on Decision CC-1995-004, April 17, 1995, 1995-16 I.R.B. 4.

[153] *See* Reg. §301.7430-5(f), and discussion of Code §7430 at §1007.7.4 above. Based on the regulations under Code §7430, such requirements are tested as of the earlier of the issuance of a final notice of decision by IRS Appeals or a statutory notice of deficiency. *See* Reg. §§301.7430-5(f)(2), -3(c); *see also* flush language of Code §7430(c)(2) (as amended by the 1998 Reform Act), effective for costs incurred after December 6, 1998, moves such date, if earlier, to the date on which the first letter of proposed deficiency is sent which allows for administrative review. However, in the context of a bankruptcy, the IRS may file a proof of claim prior to the occurrence of either of such events (assuming such events occur at all). Query whether the filing date of the proof of claim will control?

[154] The legislative history indicates that a "necessary element of cooperating . . . is that the taxpayer must exhaust his or her administrative remedies (including any appeal rights provided by the IRS)." H.R. Conf. Rep. 599, 105th Cong., 2d Sess. 57 (1988). *See* generally "Excerpts From IRS Description of Impact of IRS Reform Act With Actions Necessary to Implement Specific Provisions,"

(3) The nonbankruptcy rule applied only if a valid tax assessment had been made. Accordingly, if a prepetition tax assessment was made, the burden of persuasion was generally borne by the debtor; however, in other cases, the burden of persuasion rested with the taxing authority.[155]

(4) The choice between the competing policies of the bankruptcy and nonbankruptcy rules was made on an *ad hoc* basis based on the particular facts and circumstances involved in the case (including, for example, which party presumably had the peculiar means of knowledge as to the facts at hand).[156] In practice, however, this position tended to be just a rationalization for the adoption by a court of one of the first three positions.

This divergence of views similarly reflected the position of the courts with respect to a taxing authority's request for the payment of postpetition taxes,[157] with the excep-

(Footnote Continued)

BNA Daily Tax Report (Sept. 8, 1998), at L-1; Congressional Research Service Report on Code § 7491 (March 9, 1999), *reprinted at* 1999 TNT 52-62; Cash, Dickens and Ward-Vaughn, *supra* note 147; Clukey, *supra* note 147; Khadiri, *supra* note 147. If all of the above conditions are satisfied, *and* the taxpayer provides "credible evidence" with respect to the factual matter at issue, the burden of persuasion with respect to such issue shifts to the government. *See, e.g., Higbee v. Commissioner*, 116 T.C. 438 (2001) (applying the meaning of "credible evidence" in the legislative history, which requires "the quality of evidence which, after critical analysis, the court would find sufficient upon which to base a decision on the issue if no contrary evidence were submitted"); *Griffin v. Commissioner*, 315 F.3d 1017, 2003-1 U.S.T.C. ¶50,186 (8th Cir. 2003) (*per curiam*) (same; taxpayer's uncorroborated testimony was sufficient to satisfy the "credible evidence" requirement); *United States v. Official Comm. of Unsecured Creditors of Indus. Comm. Electrical, Inc.* (*In re Indus. Comm. Electrical, Inc.*), 319 B.R. 35, 53, 2005-1 U.S.T.C. ¶50,312 (D. Mass. 2005) (discusses what is necessary to constitute "credible evidence" within a bankruptcy court proceeding where a debtor's entire tax liability for a particular year is effectively in dispute due to the IRS's filing of a protective claim).

[155] *See, e.g., United States v. Kontaratos*, 36 B.R. 928, 84-1 U.S.T.C. ¶9208 (D. Me. 1984); *In re Coleman American Cos., Inc.*, 26 B.R. 825 (Bankr. D. Kan. 1983); *In re Twomey*, 24 B.R. 799, 82-2 U.S.T.C. ¶9687 (Bankr. W.D.N.Y. 1982) (involved Code § 6672 penalty); *Associated Bicycle Service, Inc. v. United States* (*In re Bicycle Service, Inc.*), 128 B.R. 436, 443-444, 91-1 U.S.T.C. ¶50,134 (Bankr. N.D. Ind. 1991); *D'Alessio v. IRS* (*In re D'Alessio*), *supra* note 45 (does not discuss what happens absent assessment); *consider also In re Unimet*, *supra* note 151 (IRS asserted burden shifted once a statutory notice of deficiency or assessment is issued; however, no assessment was made and court held that, even if the alleged statutory notice of deficiency applied to the issues raised, it was inequitable to shift the burden since the notice was not sent until the eve of trial); *In re BKW Systems, Inc.*, 90-1 U.S.T.C. ¶50,139 (Bankr. D.N.H. 1989) (incorrectly suggesting that, absent assessment, burden of *going forward* also shifts to the government); *but see In re Terrell*, *supra* note 152 (adopting government's brief criticizing this rule, in part on the basis that the proof of claim serves as a substitute for assessment in bankruptcy cases, which, at the time, was generally precluded by the automatic stay).

[156] *See, e.g., In re Premo*, *supra* note 150 (involves Code § 6672 penalty; ultimately adopted general bankruptcy rule "in part as a means of promoting uniformity, if only within the Sixth Circuit"); *Kranzdorf v. IRS*, discussed *supra* note 150; *In re Wilhelm*, 173 B.R. 398, 94-2 U.S.T.C. ¶50,485 (Bankr. E.D. Wis. 1994) (involved farm related expenses; concluding that both the IRS and the debtor had equal access to the facts, court placed burden of persuasion on the IRS). *See also Abel v. United States* (*In re Abel*), 200 B.R. 816, 96-2 U.S.T.C. ¶50,498 (E.D. Pa. 1996) (involved Code § 6672 penalty; considered facts and circumstances, but within the more general backdrop of the competing policies and the Third Circuit decision in *Resyn*, *supra* note 152; imposed burden on debtor).

[157] *See, e.g., In re American Electric Const., Inc.*, 1990 Bankr. LEXIS 2252 (Bankr. S.D. Ohio 1990) (did not distinguish).

tion that when it came to postpetition taxes some courts also imposed the initial burden of going forward on the claimant.[158]

Reacting to the conflicting case law, and recognizing the arguments for and against the various positions, the National Bankruptcy Review Commission, in its report to Congress in October 1997, recommended that the Bankruptcy Code be amended to "clarify" that the burden of proof rules (and related presumptions) applicable to tax controversies outside bankruptcy are equally applicable to the determination of tax claims in bankruptcy.[159]

The debate finally reached the Supreme Court in *Raleigh v. Illinois Department of Revenue*.[160] The Illinois Department of Revenue sought to impose "responsible officer" liability on the debtor for unpaid use tax. The Department issued to the debtor a Notice of Penalty Liability (which, under Illinois law, has the effect of shifting the burden of production and persuasion to the responsible officer) and filed a proof of claim with the bankruptcy court. The trustee in bankruptcy objected to the claim, and asserted that the Department bore the burden of persuasion with respect to its claim. Due to the lack of factual evidence, the burden of proof was critical to the determination of liability.

In a unanimous decision, the Supreme Court held that the burden of proof on a tax claim in bankruptcy "remains where the substantive tax law puts it"—meaning, in this case, on the taxpayer and therefore on the trustee in bankruptcy. The Court justified its holding on several grounds, including (i) that the burden of proof is a "substantive" and essential element of the claim itself and that the validity of claims and property rights in bankruptcy (in contrast to the allowance of claims) is generally left to state law; (ii) the traditional rationales supporting the general imposition of the burden on the taxpayer (including access to information and encouraging compliance with the tax laws),[161] (iii) the absence of any indication that Congress intended to alter the burden of proof for tax claims; and (iv) the uniformity and equality provided by ensuring that the same burden of proof applies whether the bankruptcy court undertakes the determination of the tax claim or lets the claim be determined by another court.[162]

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[158] *See Fullmer v. United States (In re Fullmer)* (10th Cir.), *supra* note 151.

[159] National Bankruptcy Review Commission Final Report (October 20, 1997), Recommendation 3.2.5, at pp. 811-817 (discusses competing considerations).

[160] *Supra* note 149.

[161] The Court acknowledged that a trustee might have less access to the facts than the taxpayer, but noted that the trustee takes custody of the taxpayer's records and may have greater access to the taxpayer than the government.

[162] Also illustrative of the Supreme Court's concern regarding inequality (although not used as an example by the Court) was the potential for the party bearing the ultimate burden of persuasion to be different depending on whether the debtor stylized his objection to a proof of claim in the form of an objection (where the taxing authority might have the burden of proof) or, instead, in the form of an affirmative motion to determine tax liability (where the burden of proof traditionally has been recognized to be on the debtor, as the moving party). In a questionable decision, at least one bankruptcy court, although acknowledging that the debtor's motion was the equivalent of an objection, held that the debtor was stuck with his form and, thus, as the moving party, bore the burden of persuasion. *See In re Carden*, 98-2 U.S.T.C. ¶50,686 (Bankr. E.D. La. 1998) (debtor was held to his form). Other courts had been more willing to look beyond the form. *See, e.g., In re Carson*, 227

Although the Court's decision factually involves a state tax claim, the decision applies with equal force to federal tax claims. The Court's analysis effectively undercuts the reasoning of the various lower courts that had held to the contrary in the context of federal tax claims and is in accord with the Fourth Circuit's 1992 opinion in *In re Landbank Equity Corporation*,[163] which involved a federal tax claim.[164] The Fourth Circuit similarly emphasized that matters of proof (including burdens and presumptions) are properly considered part of the substantive law and found nothing in the Bankruptcy Code that expressed a policy or intent to change any such aspect of federal tax law.

Proving tax avoidance purpose of Chapter 11 plan. As mentioned earlier, the government bears the burden of proof in any hearing under Bankruptcy Code section 1129(d) as to whether the principal purpose of the Chapter 11 plan is tax avoidance (*see* §1002.8.1 note 112). In addition, as discussed in Chapter 5 (at §509.1), the regulations under Code §269 take the position that a determination under Bankruptcy Code section 1129(d) that the principal purpose is not tax avoidance is not controlling for Code §269 purposes. The preamble to the regulations states as the principal justification for this position the differing burden of proof, citing the Restatement (Second) of Judgments §28(4).[165]

Query, whether similar reasoning would not also limit the *res judicata* or collateral estoppel effect of any substantive tax issue favorably resolved by the bankruptcy court where, prior to the Supreme Court's decision in *Raleigh*, the court shifted the burden of proof to the government? For example, assume the bankruptcy court held that certain expenses could be amortized over the life of a debt that extends beyond the bankruptcy case. Can the IRS relitigate the same issue for a postbankruptcy year with respect to the same expense? If so, can the bankruptcy court nevertheless enjoin the IRS from doing so on the theory that the future amortization deductions are "property of the estate"? (Consider, for example, the *Prudential Lines* case, discussed at §§508.2.4 and 1002.4.1.)

(Footnote Continued)

B.R. 148 (S.D. Ind. 1998) (court recognized that the debtor's "Section 505(a)(1) motion certainly amounted to an objection to the United States' proof of claim," and that, had it come down to the burden of proof, the burden of proof rules applicable to objections to tax claims (which were admittedly unclear) would have controlled).

[163] *Supra* note 152.

[164] For post-Supreme Court decisions, *see, e.g., Moser v. United States* (*In re Moser*), 2002-1 U.S.T.C. ¶50,170 (4th Cir. 2002); *IRS v. CM Holdings, Inc.* (*In re CM Holdings, Inc.*), 254 B.R. 578, 2000-2 U.S.T.C. ¶50,791 (D. Del. 2000), *aff'd*, 301 F.3d 96, 2002-2 U.S.T.C. ¶50,596 (3rd Cir. 2002); *In re Yerushalmi*, 2019 Bankr. LEXIS 1769 (Bankr. E.D. N.Y. 2019); *In re Treacy*, 255 B.R. 656, 2000-2 U.S.T.C. ¶50,776 (Bankr. E.D. Pa. 2000); *In re Aboody*, 250 B.R. 1, 2000-2 U.S.T.C. ¶50,556 (Bankr. D. Mass. 2000) (but also recognizing that the burden of proof may shift to the IRS under Code §7491(a), discussed above).

[165] *But consider Allis-Chalmers Corp. v. Goldberg* (*In re Hartman Material Handling Systems, Inc.*), *infra* note 180, at n.14, asserting that the burden of proof may not always differ.

§1013.5 Bankruptcy Court's Broad Equitable Powers

In furtherance of the basic objectives of the Bankruptcy Code, the bankruptcy court is empowered with broad equitable powers.[166] In general, the statutory basis for the court's equitable powers is Bankruptcy Code section 105(a), although other provisions of the Bankruptcy Code also may confer equitable authority for specific purposes. Bankruptcy Code section 105(a) provides:

> The Court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of [the Bankruptcy Code]. No provision of [the Bankruptcy Code] shall be construed to preclude the court from, sua sponte, taking any action or making any determination necessary or appropriate to enforce or implement court orders or rules, or to prevent an abuse of process.

The bankruptcy court's equitable powers are not limitless, however.[167] The basic limitation is contained in Bankruptcy Code section 105(a) itself in that it only grants the bankruptcy court the equitable power to carry out the "provisions" of the Bankruptcy Code. Thus, the bankruptcy court cannot, in order to achieve equity, issue an order contrary to the specific provisions of the Bankruptcy Code.[168]

In addition, a bankruptcy court's exercise of its equitable powers may be inappropriate if the action conflicts with a nonbankruptcy law. For example, as discussed at §1006.3.2, most courts have refused to invoke the bankruptcy court's equitable powers to override the Anti-Injunction Act and thereby enjoin IRS assessment or collection actions against a debtor's officers for the debtor's unpaid withholding taxes under Code §6672. In contrast, the Anti-Injunction Act frequently will not act as a bar in the case of IRS actions against the debtor itself. This is best exemplified by the automatic stay imposed by the Bankruptcy Code, which, as discussed above, enjoins any act to collect, assess (for bankruptcy cases commenced before October 22, 1994), or recover unpaid prepetition taxes.[169]

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[166] *See generally* Collier on Bankruptcy ¶105 (15th ed.); Bankruptcy Service, L Ed, §§11:63 *et seq.*

[167] *See, e.g., United States v. Energy Resources*, 495 U.S. 545 (1990); *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197 (1988).

[168] *See, e.g., Raleigh v. Illinois Department of Revenue* (S. Ct.), *supra* note 149, at 1957: "[T]he scope of a bankruptcy court's equitable power must be understood in the light of the principle of bankruptcy law discussed already, that the validity of a claim is generally a function of underlying substantive law. Bankruptcy courts are not authorized in the name of equity to make wholesale substitution of underlying law controlling the validity of creditors' entitlements, but are limited to what the Bankruptcy Code itself provides."

[169] *But see, e.g., In re Heritage Village Church & Missionary Fellowship, Inc.*, 851 F.2d 104, 88-2 U.S.T.C. ¶9476 (4th Cir. 1988) (Anti-Injunction Act prevented bankruptcy court from enjoining IRS revocation of debtor's exempt status); *IRS v. Barnard (In re Kuppin)*, 335 B.R. 675, 2006-2 U.S.T.C. ¶50,502 (S.D. Ohio 2005) (relying in significant part on cases involving the inapplicability of the automatic stay to non-debtors, asserts that "Congress did not intend the Bankruptcy Code to be an exception to the application of the Anti-Injunction Act"); *Krumhorn v. United States (In re Krumhorn)*, 2002-2 U.S.T.C. ¶50,762 (N.D. Ill. 2002) (asserts, in dicta, that automatic stay does not override Anti-Injunction Act).

In *United States v. Energy Resources Co.*,[170] the Supreme Court acknowledged the limitations on a bankruptcy court's broad equitable powers, but, in that case, held that such limitations had not been transgressed. There, the Supreme Court held that a bankruptcy court had the authority to order the IRS to apply tax payments made pursuant to a corporate debtor's Chapter 11 plan first to outstanding trust fund taxes—thereby eliminating any personal liability of its officers under Code § 6672—if the bankruptcy court determined that such designation "is necessary to the success of a reorganization plan." Although the Bankruptcy Code does not explicitly authorize such designation, the Court found ample authority in Bankruptcy Code section 105 and in then Bankruptcy Code section 1123(b)(5), now section 1123(b)(6), which permits a reorganization plan to include "any . . . appropriate provision not inconsistent with the applicable provisions of this title."

Rejecting the IRS's arguments to the contrary, the Supreme Court observed that what the IRS really wanted was the "added protection not specified in the [Bankruptcy] Code itself" that, if the bankruptcy court was incorrect in its judgment that the reorganization plan would succeed, it might still obtain payment of the entire tax debt by having the nontrust fund liabilities paid before the trust fund liabilities (for which the officers may be personally liable). Moreover, in reaction to the IRS's assertion that such designation would undermine Code § 6672 as an alternative source of collection for trust fund taxes, the Court observed that, rather than preventing the collection of trust fund taxes, the designation, in fact, required that such taxes be paid first. Accordingly, the Court found that the bankruptcy court had not transgressed any limitation on its broad powers.

As a variation on *Energy Resources*, joint debtors, faced with a partially secured and partially unsecured IRS claim for both trust fund and nontrust fund taxes, sought a court order allocating the security to the trust fund portion of the claim.[171] By so doing, the trust fund taxes would be satisfied in full, whereas the nontrust fund taxes

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[170] *Supra* note 168, also discussed at § 1016.2.

[171] *Bates v. United States (In re Bates)*, 974 F.2d34, 92-2 U.S.T.C. ¶ 50,582 (10th Cir. 1992); *accord In re Haas*, 162 F.3d 1087, 99-1 U.S.T.C. ¶ 50,178 (11th Cir. 1998) (similar facts); *In re Lybrand*, 338 B.R. 402 (Bankr. W.D. Ark. 2006) (similar facts but involving postconfirmation setoff; IRS permitted to setoff against non-priority unsecured portion of its claims even though setoff would cause the debtor's plan to fail); *but see In re Moore*, 200 B.R. 687 (Bankr. D. Oregon 1996) (holding to contrary on substantially identical facts involving postconfirmation setoff; does not discuss *Bates*); *United States v. Martinez*, 2007-1 U.S.T.C. ¶ 50,322 (M.D. Pa. 2007) (Chapter 13 case to similar effect), *upon remand* 2007 Bankr. LEXIS 1168 (Bankr. M.D. Pa. 2007) (remanded so that bankruptcy court could explain its reasoning), *reaff'd*, 2008 U.S. Dist. LEXIS 10242 (M.D. Pa. 2008); *see also Small Business Admin. v. Preferred Door Co. (In re Preferred Door Co.)*, 990 F.2d 547 (10th Cir. 1993) (debtor could not reclassify postpetition interest and penalties as general unsecured claims on the basis of *Energy Resources*), *but consider* § 1015.2, discussing the possibility of subordinating tax penalties; *In re Sergent*, 2008-1 U.S.T.C. ¶ 50,105 (Bankr. E.D. Ky. 2007) (trustee of an individual debtor's bankruptcy estate successfully *precluded* IRS from applying a debtor's payments under a postpetition settlement agreement in a manner that would have maximized the IRS priority tax claim against the estate on the grounds that to do so violates the automatic stay); *Kiesner v. IRS (In re Kiesner)*, 194 B.R. 452, 96-1 U.S.T.C. ¶ 50,139 (Bankr. E.D. Wis. 1996) (denied individual debtor's motion to reallocate IRS's setoff of tax overpayments first to nondischargeable trust fund taxes on the basis of *Energy Resources*). With respect to the reclassification of a partially secured IRS tax claim, *see also* IRS Litigation Guideline Memorandum GL-50, May 2, 1994, *reprinted at* 2000 TNT 91-41.

(as nonpriority unsecured taxes) would only receive partial payment. In contrast, were the trust fund taxes unsecured, the IRS would receive full payment of all taxes since the trust fund taxes would be priority unsecured taxes. The Tenth Circuit affirmed the bankruptcy court denial of the debtors' request, distinguishing *Energy Resources*. The court observed that in *Energy Resources* all taxes were to be paid in full and that the only issue was the order in which the taxes would be paid.

In another case, the Third Circuit rejected an individual debtor's attempt to employ *Energy Resources* to compel the retroactive allocation of tax payments of a related non-debtor corporation to the payment of the corporation's unpaid trust fund taxes for which the debtor also had liability under Code § 6672.[172] The court considered of greatest relevance the fact that the corporation was, at the time of the payment, not itself in bankruptcy and thus did not have at stake its own Chapter 11 reorganization (although this seems to misdirect the focus of the inquiry as relates to the individual debtors). In addition (and, we believe, more significantly), the court stated that the IRS lacked the usual protections of a Chapter 11 reorganization to assure payment of the corporation's nontrust fund taxes (such as priority status and nondischargeability), at the time the payments were made. Although the corporation itself subsequently filed for bankruptcy and filed its own motion to compel the allocation, the court observed that the corporation had no pending plan of reorganization and that, to approve a reallocation of prepetition tax payments, would amount to an improper extension of the time applicable to preferential transfers under Bankruptcy Code section 547. On more fundamental grounds, the Sixth Circuit rejected a corporate debtor's attempt to avoid and recover, as a constructive fraudulent conveyance under Bankruptcy Code section 548(a)(1)(B) and under state law, prepetition tax payments properly applied by the IRS to the penalty portion of the debtor's employment tax liability.[173]

Other situations in which bankruptcy courts have exercised their equitable powers in furtherance of tax objectives include the following:

(1) to permanently enjoin the claiming of a worthless stock deduction by a controlling shareholder that would otherwise result in limitations upon the debtor's NOLs under Code § 382 (*see* § 1002.4);

(2) to restrict trading in claims in order to preserve the debtor's ability to maximize the postreorganization value of its NOLs under Code § 382(1)(5) (*see* § 1002.4.1);

(3) to eliminate the remedial voting rights on otherwise excludable Code § 1504(a)(4) preferred stock of a consolidated bankrupt subsidiary in order

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[172] *IRS v. Kaplan (In re Kaplan)*, *supra* note 66. Similarly, *see In re Donaldson*, *supra* note 67.

[173] *Southeast Waffles, LLC v. U.S. Dept. of Treasury (In re Southeast Waffles, LLC)*, 702 F.3d 850, 2012-2 U.S.T.C. ¶50,708 (6th Cir. 2012) ("the fraudulent-transfer statues were not meant to provide debtors with either a means to avoid tax penalties legitimately imposed or a means to recover prepetition payments made in satisfaction of those penalties"), *aff'g* 460 B.R. 132, 2011-2 U.S.T.C. ¶50,740 (Bankr. 6th Cir. 2011) (appellate panel viewed the debtor's action as a "back door" attempt to obtain a bankruptcy court-ordered reallocation of prepetition tax payments, which was outside the bankruptcy court's authority to grant).

to prevent such stock from becoming voting stock and, thus, deconsolidating the subsidiary (*see* § 804.1);[174]

(4) to enforce the automatic stay and discharge provisions of the Bankruptcy Code, in appropriate cases, by finding the IRS in contempt and liable for damages (*see* § 1007.7.2);

(5) to require the IRS to consider a debtor's offer in compromise in accordance with the normal procedures and policies applicable to non-debtors (although some courts have refused to do so, *see* § 1016.1.2);

(6) to enforce the debtor's obligation to file tax returns and, in absence thereof, to find the debtor in contempt and subject to appropriate sanctions (*see* § 1006.1);

(7) to temporarily enjoin a state court tax proceeding where the bankruptcy court reopened the debtor's Chapter 7 case to determine the dischargeability of the state taxes;[175] and

(8) to preclude the IRS from going against non-debtor members of the debtors' consolidated group for postpetition interest and penalties, consistent with the IRS's prior agreement with the debtors, and to allow the non-debtor members to satisfy any IRS priority claim for group taxes on the same payment schedule as the debtors.[176]

Other situations in which bankruptcy courts have *refused* to exercise their equitable powers, or have been held to exceed their equitable powers, include:

(1) to abate any prepetition interest properly claimed by the IRS (*see* § 1006.1.2);

(2) to issue a postconfirmation declaratory judgment to the debtor, such as along the lines of Bankruptcy Code section 1129(d), that the principal purpose of the debtor's reorganization plan was not tax avoidance (*see* § § 1002.8.1 and 1013.3);

(3) to enjoin the IRS from pursuing responsible officers or employees of the debtor under Code § 6672 for the debtor's unremitted withholding taxes (*see* § § 1006.3 and 1014.1);

(4) to alter the burden of proof with respect to tax claims from that under nonbankruptcy law (*see* § 1013.4, discussing the Supreme Court's decision in *Raleigh v. Illinois Department of Revenue*); and

(5) in most Chapter 7 and liquidating Chapter 11 cases, to designate tax payments first to the payment of trust fund taxes (*see* § 1016.2).

As to whether a bankruptcy court might be willing to employ its equitable powers to extend the automatic stay to nonbankrupt members of the debtor's consolidated group, *see* the consolidated return discussion at § 1007.4. In addition, in

[174] The court in that case also based its authority on the principles of section 303 of the Delaware Corp. Law, which permits court ordered amendments to the capital stock of a Delaware corporation in connection with a plan of reorganization. *See In re Federated Dept. Stores, Inc.*, 1991 Bankr. LEXIS 743 (Bankr. S.D. Ohio), *aff'd*, 133 B.R. 886 (S.D. Ohio 1991).

[175] *Mass. Dept. of Rev. v. Crocker (In re Crocker)*, 362 B.R. 49 (Bankr. 1st Cir. 2007) (injunction facilitated the bankruptcy court's proper exercise of its jurisdiction).

[176] *In re G-1 Holdings Inc.*, 420 B.R. 216, 266 (Bankr. D. N.J. 2009), discussed at § 1014.4 below.

the *Continental Airlines* bankruptcy case, Continental Airlines requested the bankruptcy court to invoke its equitable powers, in conjunction with Bankruptcy Code section 554 (which permits the abandonment of property of inconsequential value and benefit to the estate), to extinguish its interest in the worthless stock of its also bankrupt subsidiary (Eastern Air Lines) and, thus, deconsolidate the subsidiary (*see* discussion at §804.1). Subsequently, Continental Airlines entered into a stipulation and order with Eastern Air Lines,[177] which order was appealed by the Department of Labor.[178] The appeal was later withdrawn.

It should be noted that, because appellate courts are extremely reluctant to employ equitable considerations where not previously presented and considered by the trial court, one should be careful to raise the potential application of the bankruptcy court's equitable powers in its initial papers in the bankruptcy court and to present a factual foundation for such position.[179]

§1013.6 Postconfirmation Jurisdiction

Bankruptcy Code section 505(a) does not confer jurisdiction over postconfirmation taxes unrelated to the bankruptcy. Moreover, some circuit courts of appeals have held that the bankruptcy court's postconfirmation jurisdiction is limited exclusively to matters pertaining to the implementation or execution of the plan.[180] Thus, a

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[177] *See In re Continental Airlines, Inc.*, Ch. 11, Case Nos. 90-932 through 90-984, Stipulation and Order, dated December 26, 1991.

[178] *See* amicus curiae brief filed by the Pension Benefit Guaranty Corp. in support of Department of Labor's appeal, dated April 17, 1992.

[179] *See, e.g., Quenzer v. United States (In re Quenzer)*, 19 F.3d 163 (5th Cir. 1993) (rejected IRS position under Bankruptcy Code section 105, since not considered by lower courts, and record devoid of any factual findings justifying exercise of equitable powers).

[180] *See, e.g., Bank of Louisiana v. Craig's Stores of Texas, Inc. (In re Craig's Stores of Texas, Inc.)*, 266 F.3d 388 (5th Cir. 2001) (non-tax case; adopting the more restrictive view, and briefly discussing the split among the circuit courts of appeal). According to the Fifth Circuit in *Craig Stores of Texas* (and taking such case into account), the Second, Fifth, Seventh and Eighth Circuits adhere to the more restrictive view, whereas the Third, Sixth and Tenth Circuits (at least in concept) take a broader approach. The Third Circuit has since taken a more restrictive view in *Binder v. Price Waterhouse & Co., LLP (In re Resorts International, Inc.)*, 372 F.3d 154 (3d Cir. 2004), requiring that there be a "close nexus" to the plan or proceeding, as has the Ninth Circuit in *Montana v. Goldin (In re Pegasus Gold Corp.)*, 394 F.3d 1189 (9th Cir. 2005) (same, even if involving preconfirmation conduct), though the Ninth Circuit liberally interpreted the "close nexus" test in *Wilshire Courtyard v. Calif. Franchise Tax Bd. (In re Wilshire Courtyard)*, 729 F.3d 1279 (9th Cir. 2013) (involving plan-related tax consequences), discussed below in the text. *See also Geruschat v. Ernst Young LLP (In re Seven Fields Development Corp.)*, 505 F.3d 237 (3d Cir. 2007) (in dicta, indicating that close nexus test applies solely based on when complaint is filed, not when the conduct giving rise to the claim occurred). The First Circuit has drawn a distinction between reorganizing bankruptcies (such as in *Craig Stores of Texas*) and liquidating Chapter 11 bankruptcies, as discussed below in the text. *Boston Regional Medical Center, Inc. v. Reynolds (In re Boston Regional Medical Center, Inc.)*, 410 F.3d 100 (1st Cir. 2005).

In the case of state and local income taxes, one bankruptcy court viewed the preconfirmation ruling process in Bankruptcy Code section 1146(b) as the sole means for resolving in the bankruptcy court an actual dispute between the debtor and a state or local taxing authority over the tax impact of a plan, *regardless* of whether the dispute arose pre- *or post*-confirmation. *See Kmart Corp. v. Ill. Dept. of Rev. (In re Kmart Corp.)*, 2012 Bankr. LEXIS 2185 (Bankr. N.D. Ill. 2012), discussed at §1102.17 below. As discussed at §1013.3.1 above, section 1146(b) does not apply to federal income taxes.

former debtor cannot use the bankruptcy court as a second Tax Court.[181] For example, in *In re Callan*,[182] the former debtors filed a motion under Bankruptcy Code section 505(a) seeking a tax refund of postconfirmation federal fuel taxes. The court held that it no longer had jurisdiction because the taxes at issue did not arise from the activities of the estate and, as such, the debtors were no longer acting as debtors-in-possession akin to "trustees." The court further agreed that the IRS's "sovereign immunity is not waived in this contested proceeding which involves postconfirmation taxes which are not specifically alluded to in the confirmed plan." In contrast, in *In re Eagle Bus Manufacturing, Inc.*,[183] the bankruptcy court held it had jurisdiction over similar postconfirmation refund claims. There, however, the court found that, because the IRS's retention of such refunds (and interest) "will allow the Service to effectively satisfy its prepetition tax claims with post-Confirmation Date refunds . . . in violation of section 553" of the Bankruptcy Code (governing setoffs), the refund "claims directly affect the bankruptcy estate."

As relates to postconfirmation refund claims, the Second Circuit, in *United States v. Bond*, considered the situation in which a trustee for a liquidating trust established pursuant to the debtors' Chapter 11 plan filed a claim for refund with, and brought a refund action against, the IRS with respect to a postpetition, preconfirmation taxable year.[184] Pursuant to the plan, the liquidating trustee was assigned "all tax refunds and rights thereto" with respect to preconfirmation taxable years, and was acknowledged by the court to be the estate's representative pursuant to Bankruptcy Code section 1123(b)(3). Reversing the district court, the Second Circuit, based on a "plain reading" of Bankruptcy Code section 505(a)(2)(B), held that a precondition to the bankruptcy court's jurisdiction with respect to a tax refund dispute is that the debtor-in-possession (or bankruptcy trustee) *itself* have filed the original claim for refund with the IRS. The district court had viewed section 505(a)(2)(B)—which provides that the bankruptcy court may not determine any tax refund before the earlier of 120 days after "the trustee properly requests such refund" or the taxing authority grants or denies such refund—as simply a timing and exhaustion of remedies provision, and did not accord any substantive import to the reference to the trustee. In contrast, in a similar context, the bankruptcy court in *In re Van Dyke*,[185] relying on the Sixth Circuit's decision in *In re Gordon Sel-Way, Inc.*,[186] permitted a refund action by the liquidating trustee. The Second Circuit distinguished the Sixth Circuit's decision in *Gordon Sel-*

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[181] *See, e.g., In re Maley* (Bankr. W.D. N.Y.), *reprinted at* 93 TNT 20-24. *Cf. Allis-Chalmers Corp. v. Goldberg* (*In re Hartman Material Handling Systems, Inc.*), 141 B.R. 802, 92-2 U.S.T.C. ¶50,325 (Bankr. S.D. N.Y. 1992), discussed at § 1002.8.

[182] Bankr. D Ala. (March 13, 1992), *reprinted at* 92 TNT 84-85.

[183] Bankr. S.D. Tex., Case No. 90-00985-B-11, memorandum opinion, entered Sept. 22, 1993.

[184] *United States v. Bond*, 762 F.3d 255, 2014-2 U.S.T.C. ¶50,406 (2d Cir. 2014) (also discussed at § 1011), *rev'g* 486 B.R. 9 (E.D. N.Y. 2012), *aff'g in relevant part, sub. nom. In re PT-1 Communications Inc.*, 403 B. R. 250 (Bankr. E.D. N.Y. 2009). The Second Circuit distinguished (without deciding) the situation in which a refund action arose in counterclaim to an IRS proof of claim for prepetition taxes.

[185] *Schroeder v. United States (In re Van Dyke)*, 275 B.R. 854, 2002-1 U.S.T.C. ¶50,270 (Bankr. C.D. Ill. 2002).

[186] 270 F.3d 280 (6th Cir. 2001), discussed at § 1011 above.

Way, simply stating that the jurisdictional requirements of section 505(a)(2)(B) were not addressed in that case. The Second Circuit did not discuss the Sixth Circuit's conclusion that a liquidating trustee could act in place of a debtor-in-possession (or bankruptcy trustee) under Bankruptcy Code section 505(b) (which provides that "[a] trustee may request . . .") in requesting a prompt determination of the debtor corporation's postpetition tax liability. In addition, in *In re Luongo* (decided shortly before *Gordon Sel-Way*),[187] the Fifth Circuit, in a situation involving a refund action brought by an individual debtor following her Chapter 7 discharge, rejected the IRS's "restrictive reading" of section 505(a)(2)(B).

In *In re Holly's, Inc.*,[188] the debtor returned to the bankruptcy court to seek a determination of certain postpetition property taxes assessed preconfirmation, as well as a property tax assessed on the effective date of the plan. Although the court ultimately concluded that it was precluded by the plan from considering any of the assessments, since the period provided for in the plan for filing objections to claims had expired, the court initially determined that it did not have jurisdiction over the property tax assessed on the effective date. In the court's view, the fact that the tax was assessed on the effective date was of no significance, since the plan itself did not effect a discharge of such taxes (as the discharge only related to preconfirmation taxes)—nor, in its view, could it have. According to the court, a plan may only narrow, and cannot enlarge upon, the general discharge of Bankruptcy Code section 1141(d). The court also cited "common sense and notions of due process." These same notions of due process, along with the fact that the tax was never considered during the plan preparation or confirmation process, lead the court to conclude that the tax was unrelated to the bankruptcy.

In contrast, in *In re Dutch Masters Meats, Inc.*,[189] the bankruptcy court held that, given the broad language of the plan regarding the court's retention of jurisdiction over the determination of matters pertinent to the reorganization, it had jurisdiction to hear the debtor's request for an injunction prohibiting the IRS from collecting postconfirmation employment tax deficiencies from the debtor. The court's factual findings disclose that the IRS intended to levy on the debtor's accounts receivable and that the IRS's actions had already jeopardized the debtor's reorganization in that a significant creditor had, as a result, deemed its loan in default and indicated its intention to enforce its lien. (The court thereafter denied the debtor's request on the merits.)

In *In re Boston Regional Medical Center, Inc.*,[190] the First Circuit considered the extent of a bankruptcy court's postconfirmation jurisdiction within the context of a

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[187] *IRS v. Luongo* (*In re Luongo*), 259 F.3d 323, 2001-2 U.S.T.C. ¶50,527 (5th Cir. 2001) (2:1 decision) (the majority observed at the time, "The IRS cites no case supporting its restrictive reading of the bankruptcy court's jurisdiction;" the dissent took exception to the majority's decision on several accounts, some more relevant to the individual debtor situation).

[188] 172 B.R. 545 (Bankr. W.D. Mich. 1994), *aff'd*, 178 B.R. 711 (W.D. Mich. 1995) (only appealed as to preconfirmation taxes).

[189] 182 B.R. 405, 95-1 U.S.T.C. ¶50,224 (Bankr. M.D. Pa. 1995).

[190] *Boston Regional Medical Center, Inc. v. Reynolds* (*In re Boston Regional Medical Center, Inc.*), 410 F.3d 100 (1st Cir. 2005).

liquidating Chapter 11 plan, and held that "when a debtor (or a trustee acting to the debtor's behoof) commences litigation designed to marshal the debtor's assets for the benefit of its creditors pursuant to a liquidating plan of reorganization, the compass of related to jurisdiction persists undiminished after plan confirmation." At issue was the bankruptcy court's ability to interpret and enforce a bequest to the debtor hospital that only became known postconfirmation. The court reasoned that the general post-confirmation concerns over unrelated actions—that the court would become the focal point for all types of post-bankruptcy litigation for years to come that only have tangential relationship to the bankruptcy and would unfairly advantage the reorganizing debtor—did not exist where the debtor corporation's sole continuing purpose pursuant to the plan was to liquidate its assets and distribute the proceeds to its creditors, whereas there existed a "strong" federal policy in favor of the expeditious liquidation of debtor corporations and the distribution of their assets.

In *In re Agway, Inc.*,[191] the debtors confirmed a liquidating Chapter 11 plan, which assigned to the trustee for a plan-established liquidating trust the role of liquidating the assets of Agway's estate. The Chapter 11 plan specifically authorized the liquidating trustee to request an expedited determination of taxes of the Liquidating Trust under section 505(b) of the Bankruptcy Code for all filed returns of the trust. The plan also provided that the bankruptcy court would retain jurisdiction with respect to, *inter alia*, tax matters under Bankruptcy Code section 505:

> including determinations regarding any tax liability arising in connection with the liquidation of assets of the estates pursuant to the Plan (including any request for expedited determination pursuant to section 505(b) of the Bankruptcy Code filed, or to be filed, with respect to the returns [of the debtors] for any and all taxable periods ending after the Petition Date through the closing of the Chapter 11 Cases, and, with respect to the Liquidating Trust, for all taxable periods throughout the termination of the Liquidating Trust).[192]

Under the terms of the Chapter 11 plan as originally confirmed, the employee retirement plan of Agway was to be promptly terminated. However, more than three years after confirmation, the court approved a modification of the Chapter 11 plan pursuant to which sponsorship of the retirement plan was transferred from Agway to a wholly-owned subsidiary and the subsidiary was sold. Agway filed an excise tax return reporting no excise tax liability as owing and an income tax return showing no taxable reversion of plan assets but an overall tax liability (which it paid), and requested under section 505(b) of the Bankruptcy Code that the IRS make a prompt determination of any taxes owing. Meanwhile, the liquidating trustee reserved $5 million for any potential tax liabilities.[193] Not hearing back from the IRS, and in contemplation of a distribution of proceeds from the subsidiary sale, the liquidating trustee sought a determination from the bankruptcy court that the returns were accurate.

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[191] *Ogle v. IRS (In re Agway, Inc.)*, 447 B.R. 91 (N.D. N.Y. 2011), *reh'g denied*, 2011 U.S. Dist. LEXIS 86774 (2011), *rev'g in part* 412 B.R. 32 (Bankr. N.D. N.Y. 2009).

[192] The retention provision also referenced state tax-related sections 346 and 1146.

[193] The reserve is discussed in the district court's decision denying a rehearing.

Subsequently reversed on appeal, the bankruptcy court in *Agway* had held the requested determination was outside of the scope of section 505(a) as well as section 505(b), since the court did "not believe that Congress intended that *Code § 505* be used to determine tax liability arising after confirmation under these circumstances," and thus was prohibited by the Declaratory Judgment Act (see § 1013.3 above). The district court, however, found the provisions of the Chapter 11 plan determinative of jurisdiction under the circumstances—namely, the plan retained jurisdiction to address liquidation-related tax matters and the tax arose, and the action was brought, during the administration of the liquidating plan by the liquidating trustee pursuant to the amended confirmation plan. The district court also held that the fact the tax liability (if any) had already been incurred and arose during the administration of the liquidating plan sufficed to present an "actual controversy" as required by the Declaratory Judgment Act (see further discussion at § 1013.3 above), even though the IRS had not expressed any disagreement with the filed returns. The court expounded on its view in its denial of the government's motion for a rehearing, also focusing on the need to determine the tax liability to ensure that any additional liability is paid and that unsecured creditors receive their proper distributions.[194]

In *In re Wilshire Courtyard*,[195] the Ninth Circuit held that it was within the bankruptcy court's postconfirmation jurisdiction to consider the characterization of the transactions in the Chapter 11 plan for state income tax purposes. The Ninth Circuit applied the "close nexus" test, stating that a postconfirmation matter is sufficiently related to the bankruptcy case to support jurisdiction "when the matter affects the interpretation, implementation, consummation, execution, or administration of the confirmed plan."[196] Such a determination, the court said, requires particularized consideration of the facts and posture of each case looking at the whole picture, since it is intended to retain a certain flexibility. The case involved a consensual reorganization of a debtor partnership, in which the senior creditor received a 99% ownership interest in the reorganized partnership and cash in exchange for its claims and an agreement to contribute a specified amount in cash, and the former partners (in the aggregate) retained a 1% ownership interest and received cash and a loan.[197] There was no discussion of state income tax consequences in the disclosure statement accompanying the plan. The plan was confirmed in April 1998, and the Chapter 11 case was closed later that year. In June 2004, the California Franchise Tax Board (California) issued notices of proposed assessments against the former partners, on the basis that the plan transactions constituted for income tax purposes a "disguised sale" by the partners of a 99% ownership interest in the

[194] The district court also held that the government's sovereign immunity was abrogated under Bankruptcy Code section 106(a) (see § 1005.1 above), given that the requested determination was properly brought under section 505.

[195] *Wilshire Courtyard v. Calif. Franchise Tax Bd. (In re Wilshire Courtyard)*, 729 F.3d 1279 (9th Cir. 2013), *rev'g* 459 B.R. 416 (Bankr. 9th Cir. 2011), *rev'g* 437 B.R. 380 (Bankr. C.D. Cal. 2010).

[196] 729 F.3d at 1289 (internal quotations and brackets omitted).

[197] *See* facts in bankruptcy appellate decision, 459 B.R. at 419.

partnership, resulting in over $200 million in capital gain rather than over $200 million of COD income.[198] It was not until May 2009—more than 11 years after the plan was confirmed and 10-1/2 years since the bankruptcy case was closed—that the dispute was brought before the bankruptcy court.[199] Also at issue was whether the COD income (if so determined) was excludable from the partner's income for state income tax purposes under Bankruptcy Code section 346(j)(1).[200]

In upholding jurisdiction, the Ninth Circuit observed that the ultimate tax question depended, in necessary part, on the interpretation of the confirmed plan and confirmation order (the cancellation of debt being a central concept of the plan). The court also took note of the fact that potentially at issue was the "distinctly federal question" of how Bankruptcy Code section 346(j) applies to the non-debtor partners.[201] Although the court initially discounted the Bankruptcy Code section 346(j) question from a jurisdictional perspective, it clearly factored into the court's view of the equities and was useful in fending off an attack under the "state" Tax Injunction Act.[202] The court viewed postconfirmation jurisdiction in this case as consistent with the equitable objectives of the Bankruptcy Code—in that it allows appropriate bankruptcy court oversight over Bankruptcy Code section 346(j) (preventing such section from being rendered a practical nullity), and recognizes that "tax consequences of reorganization are fundamental to virtually every corporate bankruptcy." As the court explained, the "[p]arties to bankruptcy proceedings negotiate against the backdrop of the tax-policy legislative choices codified in the Bankruptcy Code."[203] Here, had the partners known that California would reclassify the transaction, they

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[198] The bankruptcy court had held in favor of the partners that the plan transactions resulted in excluded COD income. The bankruptcy appellate panel never reached the substantive issue. Accordingly, in its disposition of the case, the Ninth Circuit remanded to the bankruptcy appellate panel to consider the character of the plan transactions and for further proceedings consistent with its opinion.

[199] The reorganized partnership filed the action in the bankruptcy court, asking the court to reopen the bankruptcy case and asserting that (in issuing the proposed tax assessments) California was attempting to collaterally attack the confirmed plan. At the bankruptcy court's behest, the partners of the debtor partnership were joined as parties. The reorganized partnership and the partners thereafter filed a joint motion for summary judgment, ultimately leading to the present appeal (*see* note 198, *supra*).

[200] At issue was the pre-2005 version of Bankruptcy Code section 346(j), discussed at § 1103 below.

[201] The Ninth Circuit distinguished *American Principals Leasing Corp. v. United States*, 904 F.2d 477, 90-1 U.S.T.C. ¶ 50,292 (9th Cir. 1990), wherein it held that the bankruptcy court lacked jurisdiction to determine the tax liabilities of non-debtor partners. That situation, the court said, involved *pre-bankruptcy* activities, in contrast to transactions consummated as part of a bankruptcy reorganization plan or proceeding. Also, the court viewed the jurisdictional focus in this case as the characterization of the plan transactions at the partnership level (even though affecting the partners' tax liability), and only secondarily how Bankruptcy Code section 346(j) applies to the non-debtor partners.

[202] The Ninth Circuit determined that the Tax Injunction Act (28 U.S.C. § 1341) did not preclude jurisdiction, since the state law characterization issue was a necessary predicate to the enforcement of Bankruptcy Code section 346(j).

[203] 729 F.3d at 1292. In contrast, consider *Kmart Corp. v. Ill. Dept. of Rev. (In re Kmart Corp.)*, 2012 Bankr. LEXIS 2185 (Bankr. N.D. Ill. 2012) (bankruptcy court concluded that, due to the preconfirmation determination process available for plan-related state income tax consequences under Bankruptcy Code section 1146(d), now section 1146(b), it lacked postconfirmation jurisdiction over a dispute involving the state tax impact of COD under Bankruptcy Code section 346), discussed at § 1102.17 below.

may never have consented to the plan. Thus, the Ninth Circuit held that "post-confirmation jurisdiction in this case extends to matters such as tax consequences that likely *would* have affected the implementation and execution of the plan if the matter had arisen contemporaneously."[204] The court was careful to emphasize that this does not require that the tax consequences of a bankruptcy case be determined before the transactions are consummated. "It merely allows the bankruptcy court to retain jurisdiction over post-confirmation, post-consummation disputes related to the interpretation and execution of the confirmed Plan as if they had arisen prior to consummation."[205]

In *In re Sprout*,[206] the IRS asserted that the bankruptcy court lacked postconfirmation jurisdiction to determine whether the IRS's prepetition claims had been paid or had otherwise been discharged pursuant to the debtor's Chapter 11 plan. The court easily concluded, and carefully explained, that it did have jurisdiction and that neither the Declaratory Judgment Act, the Anti-Injunction Act nor sovereign immunity precluded such jurisdiction.

§1014 DISCHARGEABILITY OF TAX CLAIMS; BINDING EFFECT OF CHAPTER 11 PLAN

Bankruptcy Code section 1141(d) provides that a debtor corporation in a Chapter 11 case is, in general, discharged from all taxes incurred prior to the confirmation of the Chapter 11 plan that are not provided for in the Chapter 11 plan or order confirming the plan, unless the plan provides for liquidation of all or substantially all of the debtor's property and the debtor does not engage in business after the consummation of the plan.[1] As discussed below, the 2005 bankruptcy reform bill has cut back in certain limited instances on this general corporate discharge.

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[204] 729 F.3d at 1292.

[205] 729 F.3d at 1292-1293. On remand, the Bankruptcy Appellate Panel of the Ninth Circuit considered *de novo* the bankruptcy court's determination that the transaction was not a disguised sale and, in turn, the application of Bankruptcy Code section 346(j)—initially holding that the confirmation order did not itself constitute a determination of the tax treatment of the transaction (*see* §1014.3 below). *Calif. Franchise Tax Board v. Wilshire Courtyard* (*In re Wilshire Courtyard*), 2015 Bankr. LEXIS 1172 (Bankr. 9th Cir. 2015) (unpublished decision).

[206] *Sprout v. IRS* (*In re Sprout*), 2020 Bankr. LEXIS 1305 (Bankr. S.D. Ohio 2020).

[1] **§1014** *See* 11 U.S.C. §1141(d)(1), (3); *In re Enron, Inc.*, 2004 Bankr. LEXIS 2549, *216 (Bankr. S.D. N.Y. 2004) (policy underlying exception to discharge for certain liquidating plans is "to prevent trafficking in empty corporate shells for tax avoidance"). *See also Holly's, Inc. v. City of Kentwood* (*In re Holly's, Inc.*), 172 B.R. 545 (Bankr. W.D. Mich.), *appealed on other issues* (asserting that a Chapter 11 plan cannot extend such discharge to debts incurred through the effective date of the plan), and text accompanying *supra* §1013 note 183. Although Bankruptcy Code section 1141 technically has a third requirement, namely that the debt would have been denied a discharge under Chapter 7, because corporations are not granted a discharge under Chapter 7, the third requirement is automatically satisfied. For a discussion of certain potential ramifications of deferring the date of discharge, particularly to unsecured creditors, *see* Ahart and Meadows, Deferring Discharge in Chapter 11, 70 Am. Bankr. L.J. 127 (1996).