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# Did Bad Debtors Influence the Tenth Circuit to Make an Unfortunate Decision? Making Reorganization More Difficult for Farmers in *United States v. Dawes*

## I. INTRODUCTION

As part of the Bankruptcy Abuse Prevention and Consumer Protection Act<sup>1</sup> of 2005 (“BAPCPA”),<sup>2</sup> Congress added 11 U.S.C. § 1222(a)(2)(A) to the Bankruptcy Code. At first blush, this provision appears to grant favorable treatment to Chapter 12 debtor-farmers, allowing them to “avoid some, if not all, of the tax generated from the sale of [their] assets.”<sup>3</sup> In *United States v. Dawes*,<sup>4</sup> the Tenth Circuit addressed the implications of this code section for tax liabilities that arise during the pendency of a Chapter 12 bankruptcy.<sup>5</sup>

Relying primarily on what it considered to be the plain language and overall structure of the Bankruptcy Code, the Tenth Circuit greatly limited the application of § 1222(a)(2)(A)<sup>6</sup> by holding that it did not apply to tax liabilities arising after the filing of the bankruptcy petition.<sup>7</sup> As a result, the application of that section was restricted to debtor-farmers who liquidate property before filing.<sup>8</sup>

This Note argues that the Tenth Circuit’s holding in *Dawes* was wrong because the court should have interpreted § 1222(a)(2)(A) to apply to postpetition filings. Part II reviews the relevant legal background, while Part III reviews the facts and procedural history

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1. Pub. L. No. 109-8, 119 Stat. 23 (2005).

2. Pronounced “bap-see-puh.” Glenn Stearns, *Chapter 13 Repayment Plans: Development and Drafting Considerations*, 21 J. DUPAGE COUNTY B. ASS’N 22, 22 (2008–2009).

3. Wesley F. Smith, “Reorganizing” to Liquidate: Chapter 12 Anomaly, AM. BANKR. INST. J., Oct. 2011, at 46.

4. *United States v. Dawes*, 652 F.3d 1236 (10th Cir. 2011).

5. *Id.* at 1237–38.

6. Statutory references in the main text refer to Title 11 of the United States Code, unless stated otherwise.

7. *Dawes*, 652 F.3d at 1244.

8. *In re Dawes*, 382 B.R. 509, 519 (Bankr. D. Kan. 2008), *aff’d*, 415 B.R. 815 (D. Kan. 2009), *rev’d*, 652 F.3d 1236.

of *Dawes*. Part IV summarizes the Tenth Circuit's decision, and Part V argues that the *Dawes* decision was flawed because (1) the court adopted a definition of "incurred" that was at odds with its use in the applicable statute; (2) the court failed to address the appropriate question at issue; and (3) the court refused to recognize relevant legislative history. Part VI briefly concludes.

## II. RELEVANT LEGAL BACKGROUND

### A. Tax Treatment in Bankruptcy

In 1980, Congress passed the Bankruptcy Tax Act of 1980, which helped clarify how income taxes were to be treated in bankruptcy. The Act provided for the "creation of a new tax entity" in Chapter 7 and 11 cases filed by individuals.<sup>9</sup> This creation of a separate tax entity or taxable estate allowed debtors' tax attributes to "pass into the bankruptcy estate."<sup>10</sup> This resulted in the bankruptcy estate itself (rather than the debtors) becoming legally responsible for paying most of the taxes triggered in bankruptcy, including ordinary income taxes and capital-gains taxes.<sup>11</sup>

In 1986, Congress enacted Chapter 12 of the Bankruptcy Code as a response to the farm-debt crisis.<sup>12</sup> Chapter 12 was tailored to meet the needs of financially distressed family farmers by assisting them in repaying "all or part of their debts,"<sup>13</sup> with the ultimate goal of "allowing them to continue operating their business at the conclusion of the bankruptcy."<sup>14</sup> However, Congress did not extend the concept of a separate bankruptcy estate to Chapter 12 filers,<sup>15</sup> which caused serious problems for farmers.<sup>16</sup>

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9. Neil E. Harl, *Chapter 12 Bankruptcy Treatment*, 2008 EMERGING ISSUES 2964, Nov. 2008, at 1.

10. *Id.*

11. *Id.*

12. Neil Harl, *Continue Business to Protect Gains Triggered in Chapter 12 Bankruptcy from Tax*, 2010 EMERGING ISSUES 5103, June 2010, at 1.

13. U.S. COURTS, *Family Farmer or Family Fisherman Bankruptcy*, <http://www.uscourts.gov/FederalCourts/Bankruptcy/BankruptcyBasics/Chapter12.aspx> (select the "Background" tab) (last visited Mar. 5, 2012).

14. Douglas A. Bass, Annotation, *Consideration and Consequences of Whether Chapter 12 Bankruptcy Estate Can "Incur" Tax*, 56 A.L.R. Fed. 2d 289, 295 (2011).

15. Harl, *supra* note 12, at 2.

16. Harl, *supra* note 9, at 1.

In many cases, farmers attempted to fund their bankruptcy plans,<sup>17</sup> in part, by selling farm property.<sup>18</sup> The capital-gains taxes resulting from “these sales established the [IRS] as a new creditor.”<sup>19</sup> The IRS then argued that the resulting tax was an “administrative expense” incurred by the bankruptcy estate “in furtherance of preserving the estate” pursuant to § 507(a)(2).<sup>20</sup> As such, under the Bankruptcy Code, the resulting capital gains were a priority claim that had to “be paid in full” during the course of the debtor’s plan.<sup>21</sup> The IRS frequently “used this characterization to object to or outright veto otherwise acceptable bankruptcy plans.”<sup>22</sup> As a result, debtor-farmers often were placed in a position of being unable to formulate a viable plan.<sup>23</sup>

Congress attempted to address this problem in BAPCPA.<sup>24</sup> However, instead of extending the concept of a separate tax estate (in which the bankruptcy estate is liable for taxes triggered in bankruptcy rather than the debtor personally) to Chapter 12 filers, Congress added 11 U.S.C. § 1222(a)(2)(A) to the Bankruptcy Code.<sup>25</sup> Section 1222 gives the necessary requirements for a Chapter 12 plan to be confirmed.<sup>26</sup> Before the passage of BAPCPA, § 1222 stated that “[t]he plan shall . . . provide for the full payment, in deferred cash payments, of all claims entitled to priority under section 507 of this title, unless the holder of a particular claim agrees

17. U.S. COURTS, *supra* note 13 (“Unless the court grants an extension, the debtor must file a plan of repayment with the petition or within 90 days after filing the petition. The plan, which must be submitted to the court for approval, provides for payments . . . to the trustee . . . . The trustee then distributes the funds to creditors according to the terms of the plan . . .”).

18. Bass, *supra* note 14, at 297.

19. *Id.*

20. *Id.*

21. *Id.* at 296.

22. *Id.* at 298.

23. *Id.*; see also 145 CONG. REC. S750-02 (daily ed. Jan. 20, 1999) (statement of Sen. Grassley) (“Under current law [before BAPCPA], farmers often face a crushing tax liability if they need to sell livestock or land in order to reorganize their business affairs.”); Harl, *supra* note 12, at 2.

24. Harl, *supra* note 12, at 1.

25. *Id.* at 2.

26. *In re Dawes*, 382 B.R. 509, 512 (Bankr. D. Kan. 2008), *aff’d*, 415 B.R. 815 (D. Kan. 2009), *rev’d*, 652 F.3d 1236 (10th Cir. 2011).

to a different treatment of such claim.”<sup>27</sup> With the addition of § 1222(a)(2)(A), § 1222(a) now states that a plan must

(2) provide for the full payment, in deferred cash payments, of all claims entitled to priority under section 507, *unless*—

(A) the claim is a *claim owed to a governmental unit that arises as a result of the sale, transfer, exchange, or other disposition of any farm asset* used in the debtor’s farming operation, in which case the claim *shall be treated as an unsecured claim* that is not entitled to priority under section 507, but the debt shall be treated in such manner only if the debtor receives a discharge.<sup>28</sup>

Section 507, in turn, specifies ten categories of expenses and claims that are entitled to priority treatment in bankruptcy.<sup>29</sup> Two of these categories apply specifically to taxes.<sup>30</sup> The first is in § 507(a)(2) and includes “administrative expenses allowed under section 503(b).”<sup>31</sup> Section 503(b)(1) allows for “administrative expenses . . . including . . . any tax . . . incurred by the estate.”<sup>32</sup> The second category is in § 507(a)(8) and allows for “claims of governmental units . . . for a tax on . . . income or gross receipts for a taxable year ending on or before the date of the filing of the [bankruptcy] petition.”<sup>33</sup>

With the addition of § 1222(a)(2)(A), certain tax claims arising out of the sale of farm assets lose their priority status.<sup>34</sup> By allowing such claims to be treated under a plan as unsecured rather than as priority claims, these claims could be paid at less than 100%, with the balance being discharged.<sup>35</sup> This was a significant benefit for debtor-farmers in Chapter 12 because they were no longer required to pay their full tax liabilities.<sup>36</sup> At the same time, § 1222(a)(2)(A) was unfavorable to the IRS because it would no longer be able to collect the discharged taxes.<sup>37</sup>

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27. 11 U.S.C. § 1222(a) (2000).

28. *Id.* § 1222(a)(2) (2006) (emphasis added).

29. *Id.* § 507.

30. *Knudsen v. I.R.S.*, 581 F.3d 696, 706 (8th Cir. 2009).

31. 11 U.S.C. § 507(a)(2).

32. *Id.* § 503(b)(1)(B)(i).

33. *Id.* § 507(a)(8).

34. Harl, *supra* note 9, at 2.

35. *Id.*

36. Brendon Hansen, Note, *All that Glitters Isn't Gold: Deciphering In re Knudsen's Tax Allocation Methods Under 11 U.S.C. § 1222(a)(2)(A) for Chapter 12 Debtors*, 44 U.C. DAVIS

### B. Development of a Circuit Split

While § 1222(a)(2)(A) was undoubtedly implemented to assist debtor-farmers in their reorganization under Chapter 12, the language of the section<sup>38</sup> fails to indicate whether the provision applies only to taxes arising from the transfer of farm assets prepetition, or to both prepetition and postpetition transfers.<sup>39</sup> In the ensuing litigation, it is not surprising that debtor-farmers have adopted the position that the exception applies to both pre- and postpetition transfers while the IRS has argued that it applies only to prepetition transfers.<sup>40</sup>

#### 1. Allowing the application of § 1222(a)(2)(A) to postpetition sales

Until recently, most courts considering the application of § 1222(a)(2)(A) have agreed with the debtor-farmers' position that both pre- and postpetition taxes are subject to reclassification as "unsecured claims that may be discharged following the successful administration of the bankruptcy estate."<sup>41</sup> These courts have adopted the rationale that even though a separate taxable estate is not created in Chapter 12, a "nontaxable entity [the bankruptcy estate] can incur taxes as administrative expenses in a bankruptcy context."<sup>42</sup> Thus, tax claims arising from farm assets sold postpetition can attach to the bankruptcy estate and be subject to discharge under § 1222(a)(2)(A).<sup>43</sup> Further, these courts have indicated that this

L. REV. 651, 654 (2010).

37. Bass, *supra* note 14, at 299.

38. Despite "congressional testimony to the effect that the act was so perfect that not a word need be changed," BAPCPA has been heavily criticized for its complexity, the poor quality of its draftsmanship, confusing language, and contradictions. Andrew J. Neumann, Note, "Money for Nothing and Your [Expenses] for Free"—Federal Circuit Split on Vehicle Ownership Expense In BAPCPA Means Testing, 75 MO. L. REV. 595, 596 (2010) (citing Jean Braucher, *Rash and Ride-Through Redux: The Terms for Holding on to Cars, Homes, and Other Collateral Under the 2005 Act*, 13 AM. BANKR. INST. L. REV. 457, 457 n.3 (2005)) (quotations omitted). The poor draftsmanship may be due in part "to the role that lawyers and lobbyists employed by various banks and credit card companies played in drafting it." *Id.* at 595–96.

39. Harl, *supra* note 9, at 2.

40. Bass, *supra* note 14, at 298–99.

41. *Id.* at 301; see *Knudsen v. I.R.S.* 581 F.3d 696, 710 (8th Cir. 2009). *But see* *United States v. Hall*, 617 F.3d 1161, 1161 (9th Cir. 2010), *cert. granted*, 131 S. Ct. 2989 (2011).

42. Bass, *supra* note 14, at 300.

43. *Id.* at 303; *Knudsen*, 581 F.3d at 709–10.

reading of BAPCPA is more in line with congressional intent to assist debtor-farmers in reorganizing.<sup>44</sup>

In *Knudsen v. I.R.S.*,<sup>45</sup> the Eighth Circuit (the first federal circuit to address this issue) adopted the rationale prevailing in the bankruptcy courts that § 1222(a)(2)(A) was applicable to postpetition sales.<sup>46</sup> The court relied on its previous recognition that “incurred by the estate” is interpreted as meaning “incurred postpetition.”<sup>47</sup> As such, taxes resulting from a postpetition sale of farm property are *administrative expenses* pursuant to §§ 507(a)(2) and 503(b) and thus subject to § 1222(a)(2)(A).<sup>48</sup> The court also noted that the plain language of § 1222(a)(2)(A) did not restrict its application to only prepetition sales.<sup>49</sup> Additionally, the court pointed out that while the Internal Revenue Code (“IRC”) does not create a separate taxable estate in Chapter 12, a *bankruptcy* estate is still created in a Chapter 12 case pursuant to 11 U.S.C. § 1207(a). That statute incorporates “all legal or equitable interest of the debtor in property as of the commencement of the case,”<sup>50</sup> as well as all property acquired “after the commencement of the case but before the case is closed, dismissed, or converted to a case under chapter 7.”<sup>51</sup> Because the sale of debtors’ farm property falls within the scope of § 1207(a), postpetition taxes are an *administrative expense* subject to the application of § 1222(a)(2)(A).<sup>52</sup>

## 2. Prohibiting the application of § 1222(a)(2)(A) to postpetition sales

Since the passage of BAPCPA, the IRS has completely changed its position. Instead of arguing that taxes arising from postpetition sales are priority claims under § 507,<sup>53</sup> the IRS now argues that, pursuant to I.R.C. § 1399, it does not recognize a separate taxable

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44. See Smith, *supra* note 3, at 46.

45. *Knudsen*, 581 F.3d at 710.

46. *Id.* at 706.

47. *Id.* at 708–09 (citing *Mo. Dep’t of Revenue v. L.J. O’Neill Shoe Co.*, 64 F.3d 1146, 1149 (8th Cir. 1995)).

48. *Id.*

49. *Id.* at 709.

50. 11 U.S.C. § 541(a)(1) (2006).

51. *Id.* § 1207(a)(1).

52. *Knudsen*, 581 F.3d at 709–10.

53. Bass, *supra* note 14, at 297.

estate in Chapter 12 cases.<sup>54</sup> Consequently, a Chapter 12 estate is not a taxable entity that can incur taxes.<sup>55</sup> Therefore, postpetition taxes are incurred by the debtor personally and do not qualify as a priority claim subject to § 1222(a)(2)(A).<sup>56</sup>

In *United States v. Hall*, the Ninth Circuit adopted the position and rationale of the IRS, thereby creating a circuit split.<sup>57</sup> Additionally, the court reasoned that because the statutory language was clear, it was unnecessary to refer to legislative history.<sup>58</sup>

### III. FACTS AND PROCEDURAL HISTORY

In 1988, Donald W. Dawes and Phyllis C. Dawes (the “Debtors”) were convicted of “willfully failing to file income tax returns for the tax years 1981, 1982, and 1983.”<sup>59</sup> Both served seven months in federal prison.<sup>60</sup> In addition, the Debtors later failed to pay income taxes for the years 1984, 1986, 1988, and 1990.<sup>61</sup>

As a result, tax liability was originally assessed at \$142,007, but by 2006 this amount had increased to \$1,747,841.53.<sup>62</sup> In an attempt to avoid tax judgments, the Debtors began transferring their property into trusts managed by their family members.<sup>63</sup> They also transferred eight parcels of real property to the Plainsman Property Company.<sup>64</sup>

In 2003, the Internal Revenue Service (“IRS”) brought an action in the District of Kansas to reduce the Debtors’ assessed tax liability to judgment and to set aside property transfers to the Plainsman Property Company as fraudulent.<sup>65</sup> The District Court entered a judgment fixing tax liability and setting aside the transfers as null and void. The Tenth Circuit Court of Appeals affirmed the

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54. *Knudsen*, 581 F.3d at 709–10.

55. *Id.*

56. *Id.*

57. *United States v. Hall*, 617 F.3d 1161, 1163–64 (9th Cir. 2010), *cert. granted*, 131 S. Ct 2989 (2011).

58. *Id.* at 1166–67.

59. *In re Dawes*, 415 B.R. 815, 817 (D. Kan. 2009).

60. *Id.*

61. *Id.*

62. *Id.*

63. *Id.* at 818.

64. *Id.*

65. *Id.* at 817–18.

ruling on appeal.<sup>66</sup> The IRS then sought to execute the judgment and notified the Debtors of its intent to take possession of the parcels.<sup>67</sup>

On July 14, 2006, before the IRS could execute on its judgment, the Debtors filed a bankruptcy petition under Chapter 7,<sup>68</sup> which was subsequently converted to a Chapter 12 case.<sup>69</sup> On October 23, 2006, the IRS received relief from the automatic stay<sup>70</sup> to continue executing its judgment against the eight parcels.<sup>71</sup> On November 13, 2006, the debtors filed their Chapter 12 plan of reorganization, which proposed to surrender the eight parcels in satisfaction of the IRS's claim.<sup>72</sup> The plan also proposed that any postpetition (postfiling) taxes arising from the "sale, transfer, exchange, or other disposition" of the eight parcels would be treated as a general unsecured claim pursuant to 11 U.S.C. § 1222(a)(2)(A).<sup>73</sup> The IRS objected to the Debtors' plan on several grounds, including the downgrade of its claim from priority to unsecured.<sup>74</sup> However, the objection was not immediately addressed, and the eight parcels were sold for more than \$900,000.<sup>75</sup> The Debtors and the IRS agreed that the sale would result in the Debtors owing a large capital gains tax.<sup>76</sup>

On August 9, 2007, the Debtors moved for a grant of partial summary judgment on the IRS's objection to their plan of reorganization.<sup>77</sup> The Debtors asked the court to enter a judgment indicating that § 1222(a)(2)(A) allowed them to treat the postpetition (post-filing) capital gains tax resulting from the sale of

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66. *Id.* at 818.

67. *Id.*

68. *In re Dawes*, 382 B.R. 509, 511 (Bankr. D. Kan. 2008), *aff'd*, 415 B.R. 815 (D. Kan. 2009), *rev'd*, 652 F.3d 1236.

69. *Id.* at 512. Section 1222(a)(2)(A) (the statute at issue in *In re Dawes*) is not applicable in Chapter 7 cases.

70. Upon the filing of a bankruptcy proceeding, an automatic stay is put in place to bar creditors from enforcing judgments against the debtor or property of the estate. *See* 11 U.S.C. § 362 (2006).

71. *Dawes*, 415 B.R. at 818.

72. *Id.*

73. *Id.*

74. *Id.*

75. *Id.*

76. *Id.*

77. *In re Dawes*, 382 B.R. 509, 512 (Bankr. D. Kan. 2008), *aff'd*, 415 B.R. 815 (D. Kan. 2009), *rev'd*, 652 F.3d 1236.

the eight parcels as an unsecured claim in their Chapter 12 plan.<sup>78</sup> The IRS filed a reply and cross-motion for partial summary judgment.<sup>79</sup> The bankruptcy court granted the Debtors' motion for partial summary judgment.<sup>80</sup> The IRS appealed that order to the District Court of Kansas where the bankruptcy court's judgment was affirmed.<sup>81</sup> The IRS then appealed to the Tenth Circuit.<sup>82</sup>

#### IV. THE COURT'S DECISION

In *United States v. Dawes*, the Tenth Circuit concluded that the plain language and overall structure of the Bankruptcy Code indicate that taxes resulting from the postpetition sale of farm property cannot be downgraded to an unsecured claim pursuant to § 1222(a)(2)(A).<sup>83</sup> Thus, the Tenth Circuit joined the Ninth Circuit in the circuit split.

The court began its analysis with what it considered to be the "plain language of § 503(b)." More specifically, the court focused on the phrase "incurred by the estate."<sup>84</sup> Referring to several dictionaries, which defined the term "incur" to mean "to 'suffer or bring on oneself,' as in a 'liability or expense,' . . . 'to become through one's own action liable or subject to,'"<sup>85</sup> the court concluded that "one who has 'incurred' an expense is *liable* for it."<sup>86</sup> The court then looked to the relevant tax authority in the IRC to determine who was liable for the tax resulting from the sale of the Debtors' farm parcels,<sup>87</sup> concluding that whoever was "liable" for the tax is the party who "incurred" it.<sup>88</sup>

The court then concluded that the Debtors were personally liable for the taxes because, according to the IRC, Chapter 12 debtors remain personally liable for taxes incurred postpetition. Pursuant to

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78. *Id.*

79. *Id.*

80. *Id.* at 521.

81. *Dawes*, 415 B.R. at 817.

82. *United States v. Dawes (In re Dawes)*, 652 F.3d 1236, 1236 (10th Cir. 2011).

83. *Id.* at 1244.

84. *Id.* at 1239.

85. *Id.* (quoting BLACK'S LAW DICTIONARY 782 (8th ed. 2004); 7 OXFORD ENGLISH DICTIONARY 834–35 (2d ed. 1989)).

86. *Id.*

87. *Id.* at 1240.

88. *Id.*

the IRC, in Chapter 7 and 11, a separate tax estate is created.<sup>89</sup> The trustee of the bankruptcy estate is required to file separate returns for the bankruptcy estate and pay any resulting taxes from the estate assets.<sup>90</sup> The bankruptcy estate is personally liable for paying any taxes incurred by the estate.<sup>91</sup> On the other hand, in Chapter 12 and 13, a separate tax estate is not created and “the *debtor*—not the bankruptcy estate—bears the sole responsibility for filing and paying postpetition . . . taxes.”<sup>92</sup> The court therefore concluded that because it is the debtor in a Chapter 12 that is “liable” for paying the taxes, it was the Debtors—and not the estate—who incurred the postpetition taxes in this case.<sup>93</sup> Although the bankruptcy estate may have possessed the farm assets at one point and caused the tax liability, this did not mean that the taxes were incurred by the bankruptcy estate. Rather, they were incurred by the Debtors.<sup>94</sup> The court analogized that a bankruptcy estate, like a corporate officer, “may have *caused* the tax to arise, but it is the [debtor or the] corporation that *incurred* and is *liable* for it.”<sup>95</sup>

The court rejected the Debtors’ interpretation of “incurred by the estate” as meaning “tax incurred during bankruptcy,”<sup>96</sup> indicating that there is no way to read this interpretation into the text of the statute.<sup>97</sup> Because the court adopted the premise that “one who has ‘incurred’ an expense is *liable* for it,”<sup>98</sup> the language “incurred by the estate” clearly focuses on *who* did the incurring rather than “*when* a liability was incurred.”<sup>99</sup>

The court further indicated that its decision was supported by the “larger structure of the bankruptcy code.”<sup>100</sup> If Congress had wanted § 503(b) to apply to taxes incurred postpetition, “it surely knew how to do so.”<sup>101</sup> For example, the language in

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89. *See id.*

90. *Id.*

91. *Id.*

92. *Id.*

93. *Id.*

94. *Id.*

95. *Id.*

96. *Id.*

97. *Id.*

98. *Id.*

99. *Id.* at 1241.

100. *Id.*

101. *Id.*

§ 503(b)(1)(A)(i), “wages salaries, and commissions for services rendered after the commencement of the case,” clearly refers to postpetition services.<sup>102</sup>

Additionally, the court argued that a reading of § 503(b) requiring the inclusion of postpetition taxes in Chapter 12 would require inclusion of postpetition taxes in Chapter 13,<sup>103</sup> in which case postpetition tax liability would have to be included in a debtor’s Chapter 13 plan.<sup>104</sup> However, 11 U.S.C. § 1305(a)(1) gives the government the option to include or not include a postpetition tax claim in a Chapter 13 plan.<sup>105</sup> Moreover, the Debtors’ reading of § 503(b) would require the bankruptcy estate to pay for “state income taxes incurred during the bankruptcy.”<sup>106</sup> This would be at odds with § 346(b), which prohibits the bankruptcy estate from paying state and local taxes.<sup>107</sup>

Therefore, relying on what it determined to be the “plain language and larger statutory structure” of the Bankruptcy Code, the court held that the Debtors personally, and not the bankruptcy estate, incurred the tax liability resulting from the sale of the parcels.<sup>108</sup> Therefore, the liability could not be treated as an unsecured claim in their Chapter 12 plan of reorganization pursuant to § 1222(a)(2)(A).<sup>109</sup>

## V. ANALYSIS

The Tenth Circuit’s decision in *Dawes* was flawed for a number of reasons. First, the court adopted an incorrect definition for the term “incurred” in the phrase “incurred by the estate” because that definition was at odds with its use in § 503. Second, the court ignored the relevant question at issue, which was whether Congress was referring to a taxable estate or to the bankruptcy estate in the phrase “incurred by the estate.” And third, because the issue above

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102. *Id.*

103. *Id.*

104. *Id.*

105. *Id.*

106. *Id.* at 1242.

107. *Id.*

108. *Id.* at 1244.

109. *Id.*

has no clear answer, the court should have consulted relevant legislative history, which it improperly ignored.

### A. *Incorrect Interpretation*

The Tenth Circuit based its decision on an incorrect interpretation of the phrase “incurred by the estate” in § 503(b). The court looked to dictionary definitions of the word “incurred” to conclude that there was no “room for debate on [the] proposition [that] one who has ‘incurred’ an expense is *liable* for it.”<sup>110</sup> While some definitions of the word “incurred” may suggest that a party who has incurred an expense is liable for it, the court’s adoption of this definition is incorrect when taken in the context of § 503.

Section 503 sets forth the different types of expenses or claims that are considered *administrative expenses*, meaning those claims that are entitled to priority status and must be paid in full through a debtor’s Chapter 12 plan.<sup>111</sup> Among these types of claims are “the actual, necessary costs and expenses of preserving the estate including . . . taxes *incurred* by the estate,” certain expenses “*incurred* by a creditor,” and “costs and expenses of closing a health care business *incurred* by a trustee or by a Federal agency.”<sup>112</sup>

Bankruptcy trustees are not personally liable for the costs that arise in the appropriate execution of their duties in administering the bankruptcy estate.<sup>113</sup> Under the court’s definition of “incurred,” the section relating to health care businesses above would in essence have to read: “costs and expenses of closing a health care business for which the trustee is liable.” Because trustees are generally not liable for costs incurred in preserving the estate, the costs of closing a health care business could not be included as an administrative expense. This would clearly be at odds with the purpose of § 503 to

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110. *Id.* at 1239.

111. 11 U.S.C. §§ 503, 507(a)(2), 1222(a)(2)(A) (2006).

112. *Id.* § 503(b)(1) (emphasis added).

113. See *Mosser v. Darrow*, 341 U.S. 267, 274 (1951). The Bankruptcy Code does not provide any guidance as to when a bankruptcy trustee may be held liable in his or her individual capacity, and courts have come to differing conclusions on this issue. See E. Allan Tiller, *Personal Liability of Trustees and Receivers in Bankruptcy*, 53 AM. BANKR. L.J. 75 (1979). However, in cases where the trustee has been held personally liable, it has been due to a breach of his or her fiduciary duties. See *e.g.*, *In re San Juan Hotel Corp.*, 847 F.2d 931, 937 (1st Cir. 1988) (trustee has personal liability for willful and deliberate violations of the trustee’s duties); *In re Gorski*, 766 F.2d 723, 727 (2d Cir. 1985) (trustee has personal liability for negligence).

treat costs of preserving the estate as administrative expenses, and would render § 503(b)(8) meaningless. Thus, when Congress used the phrases “incurred by” in § 503, it likely was not referring to the party *liable for* the tax or expense, but rather intended to refer to the party *responsible for creating it*. This conclusion is also consistent with the Eighth and Ninth Circuits’ reading of “incurred” in § 503.

The court therefore hastily adopted the view that by determining who was “liable” for the tax, it could determine who “incurred” the tax for purposes of § 503(b). If the court had adopted an interpretation of the word “incurred” in § 503 that was consistent with the language and scope of the statute, the more appropriate question in this case would have been whether party responsible for creating the tax liability was the debtor or the bankruptcy estate. This is the question that was addressed by the Eighth and Ninth Circuit. The Eighth Circuit’s answer to this question was the *bankruptcy estate*, while the Ninth (rejecting legislative history) responded that it was the *debtor personally*.<sup>114</sup>

### B. What Did Congress Intend?

Even though the Tenth Circuit in *Dawes* did not specifically address the question of who was responsible for creating the tax liability, it did point out that the bankruptcy estate “may have once possessed the farm assets in question . . . . And the [bankruptcy] estate might well have caused a tax liability to arise.”<sup>115</sup> From this language, it appears that the court could easily have determined that it was the bankruptcy estate that was responsible for creating the tax liability. In turn, the postpetition tax liability could have been downgraded and discharged. Yet, because of the court’s incorrect reliance on “liability” being the key factor in determining who “incurred” the tax rather than who was responsible for creating the tax, the court concluded that it did not matter.<sup>116</sup>

Due to the ambiguity in the Bankruptcy Code, there are persuasive arguments that postpetition taxes are incurred by the bankruptcy estate, *and* that they are incurred by the debtor personally. It seems that the underlying question invoked by the

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114. See *United States v. Hall*, 617 F.3d 1161, 1166–67 (9th Cir. 2010), *cert. granted*, 131 S. Ct 2989 (2011); *Knudsen v. I.R.S.*, 581 F.3d 696, 709–10 (8th Cir. 2009).

115. *Dawes*, 652 F.3d at 1240.

116. See *id.*

Eighth and Ninth Circuit opinions is whether the IRC or the Bankruptcy Code's recognition of "estate" should control. The IRC does not recognize a separate taxable entity in Chapter 12, so under this recognition, there is no *estate* that could incur taxes and, as such, it is the debtor who incurs the taxes.<sup>117</sup> At the same time, the Bankruptcy Code does recognize a separate bankruptcy *estate* in Chapter 12.<sup>118</sup> This leaves courts and practitioners wondering what Congress meant when it used the term "incurred by the estate" in § 503(b). Was it referring to the bankruptcy estate or to the taxable estate (available only in Chapter 7 and 11 cases)?

There is no definite way of knowing what Congress was thinking. In fact, the Tenth Circuit may have incorrectly interpreted the phrase "incurred by the estate" in order to get around having to decide what Congress had in mind. Yet, in situations like the one presented in *Daves*, where the language of the statute is ambiguous, it would have been appropriate for the court to look at the relevant legislative history.<sup>119</sup>

The Senate Committee Report relating to § 503 states: "In general, administrative expenses include . . . taxes on capital gains from sales of property by the trustee and taxes on income earned by the estate during the case."<sup>120</sup> While this language suggests that postpetition taxes could be an administrative expense, it does not give any guidance as to whether the term "estate" is referring to the taxable estate available only in Chapter 7 and 11, or to the bankruptcy estate applicable in all chapters, including 12.

There is limited legislative history for § 1222(a)(2)(A). In fact, there is no direct history for this section. However, a proposed amendment to § 1222(a)(2) of language identical to that ultimately implemented by BAPCPA in § 1222(a)(2)(A)<sup>121</sup> "was originally introduced as part of the 'Safety 2000' legislation in 1999."<sup>122</sup> Senator Grassley made the following remark when introducing the 'Safety 2000' legislation:

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117. See 26 U.S.C. § 1399 (2006).

118. See 11 U.S.C. § 1207(a)..

119. *Knudsen*, 581 F.3d at 716.

120. S. REP. NO. 95-989, at 66 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5854.

121. *In re Flicker*, 430 B.R. 648, 653 (Bankr. D. Colo. 2009).

122. *In re Knudsen*, 389 B.R. 643, 660 (N.D. Iowa 2008).

Under current law, farmers often face a crushing tax liability if they need to sell livestock or land in order to reorganize their business affairs . . . [H]igh taxes have caused farmers to lose their farms. Under the bankruptcy code, the I.R.S. must be paid in full for any tax liabilities *generated during a bankruptcy reorganization*. If the farmer can't pay the I.R.S. in full, then he can't keep his farm. . . . 'Safety 2000' takes this power away from the I.R.S. by reducing the priority of taxes *during proceedings*. This will free up capital for investment in the farm, and help farmers stay in the business of farming.<sup>123</sup>

In *Dawes*, the Tenth Circuit refused to give any weight to this statement because it was made six years prior to the enactment of § 1222(a)(2)(A).<sup>124</sup> However, because the problem that existed for farmers trying to reorganize in 1999 still existed when this section was added in 2005 (tax liabilities were preventing farmers from effectively reorganizing under Chapter 12), it is unlikely that the reason for adding the identical language to § 1222(a)(2) dramatically changed. Senator Grassley's statement clearly indicates that this section was intended to reduce tax liabilities generated *during* bankruptcy reorganization, meaning taxes arising in Chapter 12. Thus, it can be inferred that Congress intended for § 1222(a)(2)(A) to apply to taxes arising postpetition in Chapter 12. Since this is the case, it can be presumed that in § 503, "estate" refers to the bankruptcy estate and not the separate taxable estate created only in Chapter 7 and 11. Thus, although it is not clear from the language of § 503 whether "incurred by the estate" referred to a taxable estate or the bankruptcy estate, legislative history makes it clear that Congress intended to assist debtor-farmers in their Chapter 12 reorganizations and that § 1222(a)(2)(A) was added to the Bankruptcy Code to provide relief from tax liabilities arising in bankruptcy.

## VI. CONCLUSION

In *Dawes*, the Tenth Circuit may have concluded that § 1222(a)(2)(A) did not apply to postpetition tax liabilities in order to prevent two bad debtors from using the bankruptcy code to reduce

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123. 145 CONG. REC. S750-02 (daily ed. Jan. 20, 1999) (emphasis added) (statement of Sen. Grassley).

124. *United States v. Dawes* (*In re Dawes*), 652 F.3d 1236, 1244 (10th Cir. 2011).

their tax liabilities. Nevertheless, the Court's decision in *Daves* was based on an incorrect interpretation of the phrase "incurred by the estate" and was inconsistent with Congress's intent. As a result of this decision, reorganization for many honest debtor-farmers will unfortunately remain difficult, and many may unnecessarily lose their farms. Only those farmers who are savvy enough to sell assets prior to the filing of their Chapter 12 will be able to take advantage of § 1222(a)(2)(A). Because the language of § 503 is ambiguous, the court should have consulted relevant legislative history and found, consistent with Congress' intent, that § 1222(a)(2)(A) applies to taxes incurred postpetition. This finding would have resulted in helping debtor-farmers to keep their farms and remain in business.

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