

UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF IOWA

IN RE:)
)
ANDERS H. KNUDSEN, and) Chapter 12
) Bankruptcy No.: 05-03136
CYNTHIA J. KNUDSEN,)
)
Debtors.)

DEBTORS' POST- HEARING BRIEF IN SUPPORT OF CONFIRMATION

This case presents the court the opportunity draw the roadmap to be followed by all future courts and Chapter 12 Debtors for treatment of income taxes arising from the sale of any farm asset used in the Debtor's farming operation. Of necessity, the new roadmap to be drawn by this court differs from the map that existed prior to the enactment of BAPCPA 2005. The pre-BAPCPA treatment of such taxes is illustrated by this court's prior decision *In re Specht*, bankruptcy number 96-21022-D on April 9, 1997.¹ The pre-BAPCPA treatment of income taxes is well documented. It did not provide for the fresh start of the Debtor as the taxes incurred as the result of the sale of farm assets used in the Debtor's farming operation were classified as priority claims that were not dischargeable and had to be paid in full as a condition of confirmation of the Chapter 12 plan.² Congress recognized the ineffectiveness of prior §1222(a)(2) and enacted §1222(a)(2)(A).³ By the enactment of §1222(a)(2)(A) Congress signaled the courts that the old roadmap, which lead to the inevitable dead end -- no discharge

¹ In *Specht*, this Court held that the tax on the proposed post-petition deeding of 80 acres to FSA would lead to taxable income which undermined the plan's feasibility due to the administrative expense in the form of income taxes that the debtors could not pay.

² See, 11 U.S.C. §1222(a) as it existed prior to the enactment of BAPCPA 2005, which read as follows:

- (a) CONTENTS OF PLAN- Section 1222(a)(2) of title 11, United States Code, is amended to read as follows:
(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; or
(B) the holder of a particular claim agrees to a different treatment of that claim; and'

³ Section 1222(a)(2)(A) now reads as follows:

- (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;

for these taxes -- represented by *In re Specht* has been trashed and discarded. Congress has provided some guidance to the court to bound its decision and this cartography project. First of all Chapter 12 was formulated in 1986 as a relief chapter to allow family farmers to reorganize and obtain a fresh start. Thus, the destination of this cartography project is a workable Chapter 12 framework through which family farmers can pass to reorganize their debts and not be left with significant taxes due to the liquidation of farm assets used in their farming operations.

Section 1222(a)(2)(A) is a radical departure from the past treatment of taxes for family farm debtors. Congress's new design is for these taxes to be classified, treated and discharged as unsecured claims not entitled to priority. This court is in the enviable position of being the first to interpret §1222(a)(2)(A). It has a blank road map in front of it upon which it will draw the road to follow to the goal of providing Chapter 12 debtors that obtain a discharge with a "fresh start". It must be careful to avoid the meaningless detours urged by the Internal Revenue Service. Those detours and the inevitable dead ends to which they lead will be explored in this brief. In addition, this brief will present this court with a suggested roadmap for deciding this case and guiding future courts to the goal of providing a "fresh start" to Chapter 12 debtors.

**THE TAXES TREATED UNDER §1222(a)(2)(A) ARE
DISCHARGED NOT MERELY DEFERRED.**

The first detour suggested by the IRS is that the taxes treated under §1222(a)(2)(A) are not discharged, merely deferred until the entry of the order of discharge after which time the IRS is authorized, if not compelled, to seek to collect the unpaid portion of the tax that arises from the sale, transfer, exchange, or other disposition of farm assets used in the debtor's farming operation together with interest and penalties allowed by law.⁴ This detour leads to the dead end of "no fresh start" and can not have been the result intended by Congress. The taxes must be discharged or §1222(a)(2)(A) is meaningless. The court must avoid this IRS detour of mere deferral of the taxes which leads to a very frustrating dead end.

**SECTION 1222(a)(2)(A) APPLIES TO ALL TAXES ARISING FROM THE
DISPOSITION OF FARM ASSETS USED IN THE DEBTOR'S FARMING
OPERATION, NOT JUST "CAPITAL ASSETS" USED IN THE DEBTOR'S
FARMING OPERATION.**

The second dead end detour suggested by the IRS is that only the disposition of assets that result in either capital gains or depreciation recapture qualify for §1222(a)(2)(A) treatment, so called "*capital assets*". Following this detour results in poor policy as tax treatment of sales of various farm assets is not consistent.⁵ Since the holding periods for various types of livestock

⁴ Testimony of IRS bankruptcy specialist Howard Hoy. See Debtor's Exhibits 65, 66, 67 and 68 that outline penalties for Failure to Pay, Interest on Underpayments, Interest, Rates, Tables, and Factors respectively to be followed by the IRS in collecting the unpaid taxes. The penalty on failure to pay is 0.5% per month up to a maximum of 25% of the unpaid tax. 26 U.S.C. §6651(a)(2) as is shown on page 2 of Exhibit 65. This penalty is in addition to the daily compounded interest on the unpaid tax afforded by 26 U.S.C. §6621(a)(2), which is the Federal short-term rate *plus* 3 percent.

⁵ See 26 U.S.C. §1231(b) that defines "property used in the trade or business". §1231(b)(3) provides different holding periods for various classes of livestock as follows:

(3) **Livestock.**--Such term includes--

