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# THE DECLARATORY POWERS OF BANKRUPTCY COURTS TO DETERMINE THE FEDERAL TAX CONSEQUENCES OF CHAPTER 11 PLANS

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Bankruptcy laws underwent major revisions with the enactment of the 1978 Bankruptcy Code ("Bankruptcy Code") [1] which made reorganization in bankruptcy a more attractive option for financially distressed businesses. Those revisions, in conjunction with the general economic downturn the United States has experienced during the past few years, have caused a dramatic increase in the number of companies seeking debt relief via reorganization under Chapter 11 of the Bankruptcy Code. [2] Meanwhile, the tax ramifications of a business reorganization have become a complex area that demands increased consideration in connection with the formulation and successful execution of a bankruptcy reorganization plan. [3]

To facilitate acceptance of bankruptcy reorganization plans, a provision of the Bankruptcy Code grants the proponent of a reorganization plan the right to request a determination of questions of law relating to the tax aspects of the reorganization plan. [4] In operation, the taxing unit responsible for the collection or determination of a tax is asked for a determination of the tax effects of the proposed plan on taxes based on or measured by income. [5] If a ruling is obtained, the party requesting the ruling may accept that ruling. On the other hand, if some actual controversy exists, the parties may resort to the bankruptcy court, which is granted the authority to resolve the issues and make a final determination of the tax effects of the proposed plan. [6] As originally drafted, bankruptcy courts' declaratory judgment authority regarding the tax consequences of Chapter 11 reorganization plans applied to federal, state and local taxes. [7] However, a last minute amendment prior to enactment of the Bankruptcy Code limited the application of this provision to state and local tax issues. [8] Thus, the question remains whether bankruptcy courts have any declaratory power regarding the federal tax consequences of Chapter 11 plans despite this last minute legislative amendment. If not, should they have that power?

In response to that query, this Article focuses on the federal income tax consequences related to the Chapter 11 confirmation and postconfirmation time frames and whether the bankruptcy court is the proper tribunal to determine those tax consequences. [9] To that end, this Article examines the declaratory powers of bankruptcy courts regarding federal income tax issues of debtors and federal income tax consequences of Chapter 11 plans in four parts: Part I briefly reviews the bankruptcy courts' declaratory powers that existed in the tax area prior to enactment of the Bankruptcy Code; Part II examines the bankruptcy courts' declaratory powers under the Bankruptcy Code; Part III discusses the public policy considerations surrounding determinations by bankruptcy courts of tax issues and consequences of Chapter 11 reorganization plans; and Part IV proposes possible legislative changes to facilitate an orderly and efficient determination of federal income tax issues and consequences of Chapter 11 reorganization plans.

## I. Declaratory Powers of Bankruptcy Courts Regarding Tax Issues Prior to Enactment of the Bankruptcy Code

### A. Bankruptcy Courts' Power to Determine General Tax Issues

To better understand the current extent of the bankruptcy courts' jurisdiction to decide federal income tax matters, it is helpful to review the historical background of bankruptcy court jurisdiction regarding determinations of tax matters in general. [10] The bankruptcy courts were first granted the power to determine tax issues by section 64a of the Bankruptcy Act of 1898 ("Bankruptcy Act"), [11] which provided that "in case *any* question arises as to the amount or

legality of *any* such taxes, the same shall be heard and determined by the court." [12] This provision gave priority to taxes, including federal, state, county, district and municipality taxes, over all other debts. [13] Some cases suggested that the purpose of this provision was "to afford a forum for the ready determination of the legality or amount of tax claims, which determination, if left to other proceedings might delay the conclusion of the bankruptcy proceedings interminably." [14]

The bankruptcy trustee's power under section 64a was far−reaching. Prior to the Supreme Court decision in *Arkansas Corp. Commission v. Thompson*, [15] most courts held that bankruptcy courts could "examine the validity and the amount of taxes constituting the basis for claims entitled to priority under Section 64a of the [Bankruptcy] Act, and [could] withhold the payment of such claims to the extent the court found that the tax exceeded what was justly due and owing." [16] In sum:

[O]nce bankruptcy had intervened, the general creditors of the bankrupt had the right to a determination by the bankruptcy court as to whether or not previous tax assessments were proper regardless of whatever action might or could have been taken by the bankrupt under applicable law short of actual determination by another court. [17]

In *Arkansas Corp.*, the Supreme Court narrowed the reach of section 64a. The case concerned the right and power of a bankruptcy court to redetermine the property value of a railroad in reorganization for state tax purposes. [18] Prior to the trustee's petition, the State of Arkansas had already determined the property value of the railroad through its own taxing officials in accordance with its own state procedures. [19] The district court and court of appeals, based on section 64a, found that the bankruptcy court had the power to redetermine the taxes. [20] The Supreme Court reversed stating:

Nothing in this language indicates that taxpayers in bankruptcy or reorganization are intended to have the extraordinary privilege of two separate trials, one state and one federal, on an identical issue of controverted fact−the value of the property taxed. . . . If the Commission properly found the value of the property, the "amount" of the taxes is not in question. [21]

However, the decision in *Arkansas Corp.* left several questions unresolved. For instance, the Supreme Court did not decide whether section 64a(4) applied in reorganization proceedings. [22]

To resolve some of the open questions and problems remaining after *Arkansas Corp.*, Congress amended the Bankruptcy Act in 1966. [23] The 1966 amendment eliminated the tax provision in section 64a(4). [24] Section 2a(2A) provided that the bankruptcy court had the power to,

Hear and determine, or cause to be heard and determined, any question arising as to the amount or legality of any unpaid tax, whether or not previously assessed, which has not prior to bankruptcy been contested before and adjudicated by a judicial or administrative tribunal of competent jurisdiction, and in respect to any tax, whether or not paid, when any such question has been contested and adjudicated by a judicial or administrative tribunal of competent jurisdiction and the time for appeal or review has not expired, to authorize the receiver or the trustee to prosecute such appeal or review. [25]

This section was enacted to "clarify the power of the bankruptcy court in the area of tax evaluation." [26]

B. Bankruptcy Courts' Power to Make Declaratory Judgments Regarding Tax Issues

Prior to 1978, the Declaratory Judgment Act, [27] which governs the power of Federal courts to issue declaratory judgments, read:

In a case of actual controversy within its jurisdiction, *except with respect to Federal taxes* other than actions brought under section 7428 of the Internal Revenue Code of 1954, any court of the United States, upon the filing of an appropriate pleading, may declare the rights and other legal relations of any interested party seeking such declaration, whether or not further relief is or could be sought. Any such declaration shall have the force and effect of a final judgment or decree and shall be reviewable as such. [28]

Thus, declaratory judgments regarding federal taxes were specifically excluded from the scope of the federal courts' authority.

Despite this exclusionary language, some courts held that the scope of the Declaratory Judgment Act did not affect a bankruptcy court's power to rule on the dischargeability of federal taxes in bankruptcy cases. [29] The Eighth Circuit in *Bostwick v. United States (In re Bostwick)* [30] found that Congress gave the bankruptcy court jurisdiction to determine the dischargeability of tax debts even where the United States had not filed a proof of claim. [31] The court ruled that it was not bound by either the Anti−Injunction Act [32] or the Declaratory Judgment Act [33] because "the overriding policy of the Bankruptcy Act is the rehabilitation of the debtor and we are convinced that the bankruptcy court must have the power to enjoin the assessment and/or collection of taxes in order to . . . fulfill the ultimate policy of the Bankruptcy Act." [34] The Fifth Circuit took the opposite view in *Gilbert v. United States (In re Statmaster Corp.)* [35] and held that requests for bankruptcy courts to issue declaratory judgments were barred by the Declaratory Judgment Act. [36]

In *United States v. Brock (In re Wingreen Co.)*, the trustee informally proposed a reorganization plan which included a provision allowing the continuing and reorganizing corporation to take advantage of the debtor's $2.5 million net operating loss. [37] The trustee requested a ruling by the Internal Revenue Service ("IRS") regarding the availability and amount of any tax loss carryover. [38] The IRS responded that the matter was under study and that no ruling would be made. [39] Shortly thereafter, the trustee petitioned the reorganization court for an order directing the IRS to show cause whether, under the informally proposed plan of reorganization, the full tax loss carry forward benefits would be available to the reorganized company. [40] The district court ordered the IRS to audit the debtor's books and records and to determine the amount, extent and duration of the tax loss carryover within forty−five days. [41] In response, the government appealed. [42]

On appeal, the Fifth Circuit reversed, finding that the district court had no jurisdiction to enter the order. [43] The court found that the effect of the district court's order was to direct the IRS to rule on the relationship of the Bankruptcy Act and the Internal Revenue Code. [44] The IRS would necessarily determine the tax consequences of the proposed plan regarding the future availability of a possible net operating loss carryover to a hypothetical continuing and reorganizing company. The Fifth Circuit viewed the order as an attempt by the trustee to receive a declaratory judgment when there was no actual controversy between the IRS and any taxpayer. [45] Moreover, the Fifth Circuit held that the district court was specifically precluded by the Declaratory Judgment Act from entering a declaratory judgment with respect to federal taxes. [46] Thus, if the Fifth Circuit's pre−Bankruptcy Code holding in *Wingreen* still applies, [47] it would be difficult, at best, to suggest that post−Bankruptcy Code courts have the power to determine the federal income tax consequences of bankruptcy reorganization plans. [48]

II. Declaratory Powers of Bankruptcy Courts Regarding Tax Issues Under the Bankruptcy Code

With the passage of the Bankruptcy Code in 1978, the applicability of the Declaratory Judgment Act to federal tax issues was broadened. [49] Bankruptcy courts may now enter declaratory judgments in proceedings brought under sections 505 [50] and 1146 [51] of the Bankruptcy Code because proceedings brought under those two sections are specific statutory exceptions to the general rule barring the use of declaratory judgments to resolve federal tax disputes. [52] As a consequence of the Declaratory Judgment Act amendment, if an actual controversy over federal taxes is otherwise within its jurisdiction, the bankruptcy court may enter a final judgment declaring the rights and other legal relations of any interested party seeking such a declaration, whether or not alternative relief could be sought. [53] The amendment to the Declaratory Judgment Act was not superseded by the 1984, 1986 or 1994 amendments to the Bankruptcy Code, [54] and thus remains effective. The following two subsections analyze sections 505 and 1146 of the Bankruptcy Code [55] and the applicability of the Declaratory Judgment Act to each of them.

A. Determinations by Bankruptcy Courts of Tax Liabilities Under 11 U.S.C. § 505(a)

Under section 505(a)(1) of the Bankruptcy Code, [56] the bankruptcy court may determine the merits of *any* tax claim against the debtor corporation (including the amount or the legality of any tax, fine, addition or penalty relating to a tax) whether or not previously assessed or contested and whether or not incurred prepetition or postpetition. [57] Thus, at least on its face, section 505(a)(1) grants extremely broad powers to the bankruptcy courts when determining debtors' tax liabilities. [58]

The extent of the bankruptcy courts' declaratory powers under section 505(a)(1) have been the subject of considerable litigation. [59] Courts have consistently referred to the legislative history of section 505 [60] for guidance as to the proper interpretation of this section. [61] The Third Circuit, in *Michigan Employment Security Commission v. Wolverine Radio Co. (In re Wolverine Radio Co.)*, [62] agreed with the bankruptcy court in *MDFC Equipment Leasing Corp. v. Robbins (In re Interstate Motor Freight System)*, [63] that a literal reading of section 505(a)(1) [64] could lead to absurd results: "`[T]aken at face value, without recourse to the legislative history, [section] 505 makes the bankruptcy courts a second tax court system, empowering the bankruptcy court to consider "any" tax whatsoever, on whomsoever imposed.'" [65] Several bankruptcy courts have gone so far as to rule that under appropriate circumstances the bankruptcy court may apply section 505(a)(1) [66] to determine the tax liability of parties other than the debtor. [67] However, more recent circuit court opinions, relying on the legislative history to section 505(a), have held that the court's jurisdiction to resolve tax claims extends only to the debtor or the debtor's estate, not to any other third party. [68]

To define the scope of section 505, bankruptcy courts have looked to the statutes that define the scope of their jurisdiction. [69] Prior to 1984, courts looked to 28 U.S.C. § 1471, which provided that bankruptcy courts had original jurisdiction over "all civil proceedings arising under title 11 or arising in or related to cases under title 11." [70] Then, the Supreme Court in *Northern Pipeline Construction Co. v. Marathon Pipe Line Co.*, [71] held that section 1471 was unconstitutional. [72] Congress responded by enacting the 1984 bankruptcy amendments, [73] which created 28 U.S.C. § 1334 [74] and 28 U.S.C. § 157 [75] as the new jurisdictional statutes for bankruptcy courts. Although section 1334 uses the identical "arising under" language of former section 1471, sections 157(b)(1) [76] and (c)(1) [77] introduce the concepts of core and noncore proceedings. This distinction is significant in determining the ultimate power and jurisdiction of the bankruptcy court. Final orders may be entered by the bankruptcy court in core proceedings, whereas it may not enter final orders in noncore proceedings. [78] In noncore proceedings, the bankruptcy court must submit proposed findings of fact and conclusions of law to the district court. [79] However, because "core proceeding" is not defined in the Bankruptcy Code and the jurisdictional grant provisions contain catch−all phrases, some writers have suggested that a determined bankruptcy judge could find almost any proceeding to be a core proceeding. [80] Thus, bankruptcy courts may ultimately interpret the jurisdictional provisions of sections 1334 and 157 as broadly as they had previously interpreted section 1471.

A broad interpretation of sections 1334 and 157 would provide the bankruptcy courts with extensive latitude when faced with tax liability and ramification issues related to Chapter 11 reorganization plans. At least one commentator has noted that given the tremendous impact that tax obligations and potential tax liabilities have on the feasibility of reorganization plans, "it is inevitable that bankruptcy courts will continue to expand the powers of section 505 to declare the tax liability and tax ramifications connected with the plan." [81]

In spite of that commentator's prediction, however, the ability of the bankruptcy courts to expand the powers of section 505 to determinations regarding the federal income tax consequences of Chapter 11 reorganization plans is by no means certain. It is clear from the plain language of section 505(a)(1), [82] from its placement in Chapter 5 of the Bankruptcy Code, which deals with claims, and from its legislative history, [83] that the bankruptcy courts have the ability to declare the merits of all preconfirmation tax claims. Arguably, determinations of preconfirmation tax claims are the only type of tax issues to which section 505(a)(1) was intended to apply. [84] In order for bankruptcy courts to determine tax ramifications related to plan confirmation under section 505(a)(1), they would need to first find that section 505(a)(1) applies to more than just preconfirmation tax claims. Although there is nothing in the legislative history of section 505(a)(1) that indicates it was intended to apply to tax issues other than preconfirmation tax claims, the legislative history does not explicitly limit section 505(a)(1)'s application to only those types of tax issues. [85] The following two bankruptcy court decisions indicate an expansive view of the breadth of section 505(a)(1) and lend some credibility to the commentator's statement that the bankruptcy courts will continue to expand the powers of section 505 when making determinations regarding the tax ramifications of bankruptcy reorganization plans. [86]

In *Unsecured Creditors' Committee of Goldblatt Bros. v. United States (In re Goldblatt Bros.)*, [87] 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 was not required to pay federal and state income taxes nor file tax returns. [88] In determining whether it had jurisdiction to issue a declaratory judgment in the matter, the bankruptcy court stated that:

If the tax dispute involved a core controversy, then a bankruptcy court could enter final enforceable orders. If the tax dispute was only "related to" the case under title 11 the bankruptcy court could submit proposed findings of fact and conclusions of law. If neither of those tests were satisfied, then the bankruptcy court would not have jurisdiction to hear the case at all. [89]

The court found the tax dispute at issue to be a core proceeding under section 157 because the account was created as part of the debtor's confirmed plan of reorganization. [90] The court commented that under its holding, the parameters of a bankruptcy court's jurisdiction over the subject matter of federal and state taxation under 11 U.S.C. § 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. [91]

Consequently, the court upheld its authority to issue a declaratory judgment in the matter. [92]

In another case, *Kilen v. United States* (*In re Kilen*), [93] Kilen, an individual Chapter 11 debtor, was concerned about his liability for potential trust fund taxes for 31 bankrupt corporations of which he was the owner, director or officer. [94] Accordingly, Kilen included in his confirmed plan of reorganization some $640,000 to satisfy debts owed to various tax collectors, including the IRS. [95] The IRS took few steps to determine the amount of withholding taxes owed by the corporations, and filed a proof of claim in Kilen's Chapter 11 case for unpaid withholding taxes of only one of the corporate debtors. [96] To force the IRS to pursue its claims against the plan's $640,000 tax fund and to prevent the IRS from later pursuing its claims against him individually, Kilen filed an adversary complaint. In the complaint, Kilen asked the bankruptcy court to determine his liability for the trust fund taxes so that they would be paid within the context of his Chapter 11 plan. [97]

The United States responded with a motion to dismiss Kilen's complaint. The government argued that the bankruptcy court had no jurisdiction over any dispute Kilen might think he had with the IRS relating to unpaid withholding taxes. [98] Because the IRS had not assessed any withholding tax liability against the corporations, and it might not have done so, the IRS argued that there was no actual case or controversy between the IRS and Kilen that was ripe for hearing and determination by the bankruptcy court. [99] Moreover, the IRS bluntly stated that if the bankruptcy court took the position that section 505 permitted it to resolve the IRS's potential claims against Kilen, then section 505 was unconstitutional. [100]

The bankruptcy court disagreed with the IRS and found that it had the power to determine the tax issues raised under section 505(a)(1). [101] After reviewing the legislative history to section 505(a)(1) and its predecessor, section 2a(2A) of the Bankruptcy Act, the court noted that when Congress enacted section 505, it chose not to overturn those judicial decisions interpreting section 2a(2A). [102] Therefore, the Bankruptcy Act cases finding it was immaterial whether or not a proof of claim had been filed in order to adjudicate the IRS's claims remained good law. [103] The courts in those cases had based their findings on the plain language of the statute and the fresh start policy of the Bankruptcy Act, which the *Kilen* court found was continued in the Bankruptcy Code. [104] Finally, the court did not accept the IRS's argument that because it had not yet assessed Kilen's possible liability there was no actual controversy that existed. [105] Rather, the court found that a controversy existed between the IRS and Kilen because the "situation pose[d] a direct threat to Kilen's fresh start in bankruptcy." [106]

In sum, the decisions in *Goldblatt* and *Kilen* present a common sense approach to the application of section 505(a)(1) by using it to efficiently administer Chapter 11 cases. The decisions also illustrate that bankruptcy courts are quite willing to read the language of sections 1334, [107] 157 [108] and 505(a)(1) [109] broadly when determining the extent of their jurisdiction over tax matters in Chapter 11 cases. Based on the rationales and holdings in cases like *Goldblatt* and *Kilen*, some commentators have suggested that a bankruptcy court may, pursuant to its declaratory judgment powers in section 505(a)(1) of the Bankruptcy Code, determine the federal income tax consequences of Chapter 11 reorganization plans. [110]

B. Determinations by Bankruptcy Courts of the Income Tax Consequences of Chapter 11 Plans of Reorganization

The current ability of bankruptcy courts to make determinations regarding the income tax consequences of Chapter 11 reorganization plans is best addressed by dividing income tax issues into two categories: those related to state and

local taxes on the one hand and those related to federal taxes on the other. This classification highlights the fact that these two categories have different statutory bases regarding the ability of bankruptcy courts to make determinations of the income tax consequences of reorganization plans.

1. State and Local Questions of Tax Law

As noted earlier, the bankruptcy courts' authority to render declaratory judgments regarding the state and local tax consequences of Chapter 11 plans of reorganization is set forth in section 1146(d) of the Bankruptcy Code, [111] which reads:

The court may authorize the proponent of a plan to request a determination, limited to questions of law, by a State or local governmental unit charged with responsibility for collection or determination of a tax on or measured by income, of the tax effects, under section 346 of this title and under the law imposing such tax, of the plan. In the event of an actual controversy, the court may declare such effects after the earlier of−

(1) the date on which such governmental unit responds to the request under this subsection; or

(2) 270 days after such request. [112]

Shortly after the enactment of the Bankruptcy Code, an article in the *American Bankruptcy Law Journal* referred to the new section 1146(d) as having granted "an extremely important right" to Chapter 11 plan proponents. [113] The authors speculated that many requests for rulings would be litigated in order to define the provisions of section 1146(d). [114] Actually, quite the opposite has happened. To date, there has been only one published decision citing section 1146(d) of the Bankruptcy Code. [115] In that instance, the provision was only mentioned in dicta. [116] Additionally, a mirror provision enacted in 1986 to provide the same relief for Chapter 12 debtors [117] has never been cited in a published court opinion.

At first glance, it seems odd that a provision enacted by Congress over 16 years ago and thought to grant an "extremely important right" to Chapter 11 plan proponents has suffered such a lack of judicial activity. Moreover, the drafters of Chapter 12 in 1986 must have also thought this right was significant because they included it in that chapter as well. However, from discussions with Chapter 11 practitioners, it appears there may be a straightforward answer to the question of why section 1146(d) has not been utilized more often: Compared to federal tax issues, state and local tax issues play a relatively insignificant role in most Chapter 11 cases. Practitioners have not found that questions of law surrounding state or local tax issues "make or break" a Chapter 11 plan of reorganization.

In addition, to invoke the procedural process contemplated under section 1146(d) to obtain a determination of the tax consequences of a plan of reorganization, the plan proponent must first ask the bankruptcy court for its authorization. [118] This procedural requirement may cause a delay in resolving the state or local income tax issue and confirming the plan. Such delay may be more harmful to the overall reorganization effort than an unfavorable determination of a minor state or local tax issue. Thus, because state and local tax issues generally have a minimal impact on the outcome of Chapter 11 cases and because invoking section 1146(d) requires prior approval by the bankruptcy court, it makes sense that state and local tax issues and consequences in Chapter 11 cases are most often resolved in an informal manner directly with the state and local taxing officials rather than through the formal procedural process outlined in section 1146(d).

2. Federal Questions of Tax Law

The ability of bankruptcy courts to render declaratory relief regarding the federal tax consequences of Chapter 11 plans presents a much more difficult question than state or local tax determinations because there is no explicit statutory authority allowing such relief. [119] All references to federal taxes in the draft of section 1146 were deleted by a last−minute amendment prior to enactment of the Bankruptcy Code. [120] Congress took this action to prevent the Bankruptcy Code from becoming stalled in Congress and because it intended to pass a comprehensive bill the following year to address the federal tax ramifications of bankruptcy. [121]

Two years later, Congress passed the Bankruptcy Tax Act of 1980, [122] which amended the Internal Revenue Code of 1954 [123] to provide for federal tax treatment of bankruptcy and insolvency proceedings. [124] In enacting the Bankruptcy Tax Act, however, Congress failed to address federal income tax determinations regarding Chapter 11 reorganization plans that were previously within the scope of section 1146. No reference was made to section 1146 in the legislative history to the Bankruptcy Tax Act. Consequently, the Declaratory Judgment Act's reference to section 1146 as an exception to the general rule barring the use of declaratory judgments in federal tax matters, [125] arguably, has no legal significance. Because section 1146 as enacted in the Bankruptcy Code does not include any references to federal taxes, the reference to section 1146 in the Declaratory Judgment Act appears to be surplusage.

By Congress not including federal taxes within the scope of section 1146(d), one might hypothesize that Congress did not reinstate federal tax determinations within section 1146(d) because it did not want to burden the IRS by including such tax determinations within the request procedure of section 1146(d). The inclusion of federal tax determinations in section 1146(d) would allow a Chapter 11 plan proponent to invoke statutory time limits within which the IRS must determine questions of law surrounding the reorganization plan or risk having the bankruptcy court make those determinations. [126]

However, this hypothesis is not supported by the legislative history to the Bankruptcy Code. In fact, in the legislative history to section 1146(d), prior to the deletion of that section's reference to federal taxes, the House Report stated that section 1146(d) is necessary to facilitate acceptance of Chapter 11 plans and "does not impose an unreasonable burden on Federal, state, or local taxing authorities." [127] This legislative history clearly indicates that, just prior to the enactment of the Bankruptcy Code, Congress placed the efficient resolution of Chapter 11 reorganization plans and the determination of their federal, state and local tax consequences above any perceived burden section 1146(d) might place on the IRS or corresponding state or local taxing authorities. [128] Moreover, there is no indication in the legislative history that Congress's last−minute deletion of the federal tax reference in section 1146(d) was meant to alter the priority Congress had previously placed on the efficient resolution of reorganization plans. [129] Thus, Congress's inaction regarding reinstatement of federal income tax determinations within the scope of section 1146(d) may merely reflect legislative oversight when the Bankruptcy Tax Act was enacted rather than a determination by Congress that the inclusion of federal tax determinations would severely burden the IRS. [130]

This conclusion is also supported by the fact that section 1146 has never been amended out of the Declaratory Judgment Act. [131] By continuing section 1146 as one of the few exceptions to the general prohibition on declarations regarding federal tax issues, Congress's position regarding the utility of having the type of tax determinations contemplated by section 1146(d) made by the bankruptcy courts remains intact. [132]

Although there is no evidence that Congress abandoned its prior view that including federal income tax determinations within section 1146(d) facilitates the acceptance of Chapter 11 plans, section 1146(d) does not cover federal income tax determinations. [133] Consequently, bankruptcy courts cannot utilize section 1146 of the Bankruptcy Code, in conjunction with the explicit exception to the federal tax prohibition in the Declaratory Judgment Act, as justification for rendering declarations regarding the federal income tax consequences of Chapter 11 reorganization plans. However, as explained earlier, section 505 of the Bankruptcy Code applies to certain federal tax determinations, [134] and it is also a specific exception to the Declaratory Judgment Act's prohibition regarding determinations of federal tax issues. [135] Therefore, because the impact of federal income tax issues can have a dramatic effect on the ability to confirm a Chapter 11 plan, the question becomes: Does the lack of reference to federal taxes in section 1146(d) present an insurmountable obstacle to a bankruptcy court declaring the federal income tax effects of a Chapter 11 reorganization plan under section 505 of the Bankruptcy Code?

a. The Case or Controversy Requirement: Does it Apply?

When examining whether bankruptcy courts have the ability to declare the federal income tax consequences of Chapter 11 plans of reorganization under section 505 of the Bankruptcy Code, one must initially determine whether the case or controversy requirement of Article III of the U.S. Constitution [136] applies to Article I bankruptcy courts. The court in *Kilen v. United States (In re Kilen)*, [137] determined that bankruptcy courts, as adjuncts of the district courts, have no subject matter jurisdiction over Title 11 cases in their own right. [138] Therefore, because of the derivative nature of the bankruptcy courts' power, the constitutional standards of Article III, which bind the district

courts, also bind the bankruptcy courts. [139] Furthermore, the court in *Kilen* held that district courts cannot refer to the bankruptcy courts those matters which the district courts themselves cannot hear and determine. [140]

b. Is There an Actual Controversy Sufficient to Enter a Declaratory Judgment?

Next, one must determine whether there is an actual controversy sufficient to justify entering a declaratory judgment regarding the federal tax consequences of a plan of reorganization. Several bankruptcy courts have held that, like district courts, they may not render advisory opinions. [141] For example, the court in *In re Burckardt* [142] reviewed the legislative history to the Bankruptcy Code and stated:

While Congress could grant a legislative or Article I court power to enter advisory opinions, the above quoted language from the Senate Report would not indicate that they have done so. Until they do so, we should not enter advisory opinions but limit our opinions to proceedings where there is a controversy, a dispute, and parties with adverse interests. [143]

The line between an advisory opinion and an actual controversy sufficient to invoke the Declaratory Judgment Act is a fine one and subject to considerable judicial discretion. As stated by the Supreme Court:

The difference between an abstract question and a "controversy" contemplated by the Declaratory Judgment Act 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. [144]

Thus, whether particular facts warrant the issuance of a declaratory judgment depends upon whether they are significant enough to create an actual controversy. Necessarily, such a determination must be made on a case−by−case basis. [145]

The courts have had little difficulty in finding that an actual controversy exists when all of the acts alleged to create the liability or controversy have already occurred. [146] For instance, when the individual debtor in *Kilen* [147] asked the court to determine his liability for possible trust fund taxes owed by 31 corporate debtors, the IRS argued that the bankruptcy court lacked jurisdiction to make that determination because it had never assessed any withholding liability against the individual debtor. [148] However, in deciding that an actual controversy existed, the bankruptcy court noted that its determination would "not be based on an assumed set of hypothetical facts, but on events and conduct which have already occurred." [149]

The problem arises when the courts are asked to declare the legal consequences of some act that may or may not occur. [150] Even so, it is clear that in some instances a declaratory judgment is proper even though there are future contingencies that will determine whether a controversy ever actually becomes real. [151] Moreover, the courts have been quite willing to enter declaratory judgments where "one or both parties have taken steps or pursued a course of conduct which will result in `imminent' and `inevitable' litigation, provided the issue is not settled and stabilized by a tranquilizing declaration." [152]

Inevitable litigation, it seems, would result if, for example, the structure of a Chapter 11 reorganization plan, which was intended to qualify for a taxfree reorganization, was determined to be a taxable transaction. Resources of the reorganized company, its creditors and shareholders would be drained. This unfortunate result may be avoided by the plan proponent obtaining a private letter ruling from the IRS before confirmation, but that procedure can take time and can provide uncertain results. [153] Thus, a bankruptcy court may be inclined to determine, under section 505(a)(1) of the Bankruptcy Code, the federal income tax consequences of the reorganization plan prior to the entry of a confirmation order. Such a determination may be in the best interests of the debtor, the estate and the creditors and shareholders of the reorganized company.

In re Franklin [154]

illustrates this point, although it arose under Chapter 7 of the Bankruptcy Code. [155] In *Franklin*, the district court was asked to determine whether the bankruptcy court had jurisdiction to enter an order, under section 505(a)(1), which determined the federal income tax consequences of a sale of property that had not yet occurred. [156] The real property in question was owned by the debtor's estate and a nondebtor individual, Mea Franklin. [157] The Chapter 7 trustee and Ms. Franklin entered into a settlement agreement whereby the estate and the trustee released Ms. Franklin from any tax liability of the estate and, likewise, Ms. Franklin released the estate from any tax liability allocated to her share of the property. The IRS contended that no case or controversy existed because no sale of the property had occurred and the IRS had not made a claim against the estate for any liability. [158] Without a case or controversy, the IRS argued that, under Article III, section 2 of the Constitution and the Declaratory Judgment Act, the bankruptcy court lacked jurisdiction to approve the settlement agreement. Therefore, the court could not allocate tax liabilities between the parties.

The district court upheld the bankruptcy court's jurisdiction to approve the settlement agreement. The court took a practical approach to the case or controversy issue, realizing that "tax liabilities are a real part of settlement packages," and reasoned that if the bankruptcy court did not have the ability to enter orders approving the settlement and allocation of tax liabilities, "the parties' ability to reach a settlement could be greatly hindered." [159] Moreover, the court upheld the bankruptcy court's jurisdiction because the allocation of tax liabilities involved administration of the estate [160] and the resolution of a dispute between the trustee and Ms. Franklin concerning tax liability from the planned sale of the property. [161] Regarding the fact that no tax claim had been filed by the IRS, [162] the district court, citing *Bostwick*, [163] held that even without a tax claim having been filed, the bankruptcy court still had jurisdiction to allocate the tax liability from the proposed sale. [164] In sum, the *Franklin* decision supports an expansive view of the limits of section 505(a)(1). Under certain circumstances, the lack of finality of events will not necessarily prohibit a bankruptcy court from finding that an actual controversy exists which is sufficient to justify entering a declaratory judgment on the federal income tax consequences of a particular transaction. [165]

c. Bankruptcy Courts Currently Make Determinations Concerning the Federal Income Tax Consequences of Chapter 11 Reorganization Plans Outside the Purview of the Declaratory Judgment Act

Currently, determinations are made by bankruptcy courts concerning the federal income tax consequences of Chapter 11 plans outside of section 505(a)(1) of the Bankruptcy Code and the Declaratory Judgment Act. [166] Therefore, the concept of bankruptcy courts making similar federal income tax determinations under section 505(a)(1) of the Bankruptcy Code, [167] even though those determinations may be based on future contingencies, is not a novel one. [168]

As an example, bankruptcy courts are required to determine whether a plan of reorganization is feasible under section 1129(a)(11) of the Bankruptcy Code. [169] Section 1129(a)(11) states, in relevant part:

The court shall confirm a plan only if all of the following requirements are met . . .

(11) Confirmation of the plan is not likely to be followed by the liquidation, or the need for further financial reorganization, of the debtor or any successor to the debtor under the plan, unless such liquidation or reorganization is proposed in the plan. [170]

The bankruptcy court has a mandatory duty to determine whether a reorganization plan satisfies the confirmation requirements in section 1129(a), and the plan proponents have the burden of proving that those requirements have been met. [171] The factors that should be considered by a bankruptcy court when determining whether the feasibility requirement has been met include: an examination of the capital structure of the business, the earning power of the business, the general economic conditions surrounding the business, the ability of management and the probability that the same management will continue, and "any other related matter which determines the prospects of a sufficiently successful operation to enable performance of the provisions of the plan." [172]

Consequently, the impact of the federal income tax consequences of the proposed reorganization plan is one of the "related matters" that the bankruptcy court must consider in finding that confirmation of the plan will not likely be followed by the need for further financial reorganization. [173] In a large Chapter 11 case, the federal income tax issues and liabilities surrounding the reorganization plan should be contained in the debtor's disclosure statement in order to

provide creditors and interest holders with adequate information to make an informed decision when voting on the plan. [174] Moreover, the tax implications of the reorganization plan and the reorganized company should be reflected in the debtor's financial projections as part of its disclosure statement because taxes play a significant role in determining the profitability of a business and, consequently, the feasibility of the business's reorganization plan. [175] All of these materials, some of which project future events and are based in part on contingencies which may or may not occur, are reviewed by the bankruptcy court in determining plan feasibility. Accordingly, the bankruptcy court must inherently make a determination under section 1129(a)(11) that any adverse tax consequences resulting from confirmation of the plan or events beyond confirmation are not so great as to jeopardize the success of the postconfirmation company.

In re Wandler [176]

illustrates the significance of federal taxes in determining the feasibility of a reorganization plan. In that case, the debtors ran a small family restaurant and catering business. [177] The court found that because the debtors' plan projections showed a small amount of excess cash in any given year, the plan might not be feasible in the face of the large IRS claims that had been filed. [178] One of the debtors testified that their accountant felt they were "`in pretty good shape' on taxes," [179] without presenting any specific dollar figures to the court. This testimony made the court uncertain as to whether the IRS claims could be paid even if they eventually proved to be minimal. [180] Because of this uncertainty, the court held that the plan proponents had not met their burden of proving the feasibility of their plan under section 1129(a)(11). [181]

Thus, it becomes clear that bankruptcy courts are currently called upon to make preliminary determinations regarding the federal income tax consequences of Chapter 11 plans of reorganization when determining whether or not the feasibility requirement of section 1129(a)(11) has been met. [182] These determinations are not unlike those the court would make if federal income tax determinations were within the scope of section 1146(d).

d. Lack of Reference to Federal Income Taxes in Section 1146(d) May Not be an Insurmountable Obstacle to a Bankruptcy Court Declaring the Federal Income Tax Effects of a Chapter 11 Plan Under Section 505(a)

The foregoing review of statutes, legislative history and case law indicates that the bankruptcy courts have generally taken a broad view of their power to determine tax issues under section 505(a)(1). Because the impact of the federal income tax consequences of a Chapter 11 plan may directly affect the ability of a Chapter 11 debtor to present and confirm a plan of reorganization, bankruptcy courts should consider, in appropriate circumstances, determining the federal income tax consequences of events which will happen on or after confirmation in order to fully and efficiently administer Chapter 11 plans of reorganization.

III. Public Policy Considerations

A. Tax Policy Considerations

The need for uniformity in the administration of the federal tax laws [183] is a primary concern when examining the policy issues surrounding the proper role of bankruptcy courts in declaring the federal income tax liabilities of debtors and the federal income tax consequences of Chapter 11 plans of reorganization. This need for uniformity was apparently one of the main reasons for establishing a separate federal tax court, to hear and determine federal tax disputes, [184] as a legislative court under Article I of the Constitution. [185] However, the tax court is not the only court with jurisdiction to hear federal tax disputes. When a taxpayer's efforts to resolve a tax dispute administratively fail and the taxpayer chooses to litigate the controversy, the taxpayer enjoys an unusual and significant strategic advantage because he or she can select from three different courts, each with different procedures, precedents and levels of expertise. Depending upon the particular circumstances, the taxpayer may choose to litigate the matter in U.S. Tax Court, U.S. District Court, or U.S. Claims Court. [186] Thus, there are currently hundreds of federal judges issuing rulings in federal tax disputes, many of whom may have no special expertise in the highly complex area of tax law.

Moreover, because three separate federal courts can hear and decide federal tax cases, the precedents applied by each of the three courts may differ. This lack of uniformity regarding which precedent applies in the area of federal tax law is traced to the Tax Court's 1970 decision in *Golsen v. Commissioner*. [187] In *Golsen*, the Tax Court held that it will

apply and follow the precedent of the court of appeals to which the case before it is appealable. [188] This holding could undermine the federal interest in uniform application of the tax laws. Therefore, although uniform application of the tax laws is a noble goal, uniformity is not present under the current tax system. It seems unlikely, therefore, that the goal of uniformity would be jeopardized if bankruptcy courts were to make determinations regarding the federal income tax consequences of Chapter 11 plans of reorganization.

Before advocating any change which would allow the bankruptcy courts to have a greater role in determining the federal income tax consequences of Chapter 11 reorganization plans, one needs to first examine the present process of making those determinations. The current process available to Chapter 11 plan proponents who desire a declaration of the federal income tax consequences of their plan in advance of confirmation is to request a private letter ruling from the IRS. [189] Private letter rulings are issued to specific taxpayers and may not be relied upon by another taxpayer. [190] The IRS will issue a private letter ruling to a taxpayer only "whenever appropriate in the interest of sound tax administration." [191] The process of requesting a letter ruling from the IRS can be time consuming. Moreover, there are no assurances that a ruling will be issued by the IRS regarding the request and, if a ruling is made, when it will be issued. [192] Because this is the only current method available in the federal income tax arena, the confirmation or the effective date of a Chapter 11 plan of reorganization may be made expressly contingent upon a favorable ruling from the IRS on the taxfree nature of the restructuring.

This was the case in the *United States v. Federated Dep't Stores, Inc. (In re Federated Dep't Stores, Inc.)*. [193] The Disclosure Statement in *Federated* stated that "the law with respect to the federal income tax consequences of the [reorganization plan] is, in several respects, uncertain." [194] Federated had filed a request for rulings with the IRS with respect to some of the uncertain tax consequences of the plan. The debtor disclosed that there could be no assurances that the IRS would issue the requested rulings with respect to their reorganization plan and that the IRS might rule adversely on some or all of the requests, or might refuse to rule pending the issuance of definitive regulations or legislation. Nevertheless, the debtor found the IRS rulings so crucial to the successful implementation of Federated's reorganization plan that "the receipt of the two [IRS] rulings . . . is a nonwaivable condition to the Effective Date [of the plan]." [195]

A final tax policy concern is whether the bankruptcy courts should adjudicate federal tax liabilities where the IRS has not investigated or filed claims for those tax liabilities. As stated earlier, the IRS has lost this argument under both Bankruptcy Act section 2a(2A) and Bankruptcy Code section 505(a)(1). [196] For instance, in *Kilen*, [197] the court disagreed with the IRS's argument that a determination by Congress to allow bankruptcy courts to adjudicate tax liabilities never raised in any way or even investigated by the IRS would be unconstitutional. [198] Instead, the *Kilen* court found that the dispute regarding trust fund taxes owed by Kilen as a result of his involvement with thirty−one corporations was ripe for adjudication. [199] Consequently, courts have determined, at least with respect to prebankruptcy filing tax claims, that the Bankruptcy Code's public policy that a debtor should be entitled to a fresh start outweighs the concern that a federal tax claim must be filed in order for there to be an adjudication of that claim in bankruptcy. [200]

In sum, the current process of obtaining private letter rulings from the IRS concerning the federal income tax consequences of Chapter 11 plans is cumbersome and uncertain at best. Moreover, although the area of federal income tax law is highly specialized, three different federal courts have jurisdiction to hear federal tax disputes and the same precedent may not be followed in all of those courts. [201] Thus, a greater role by bankruptcy courts in determining the federal income tax consequences of Chapter 11 reorganization plans would not seriously compound the current problems of the tax dispute resolution process regarding uniform application of the federal tax laws.

B. Bankruptcy Policy Considerations

The overriding policy of the Bankruptcy Code is the rehabilitation of the debtor, [202] and in a business bankruptcy case, the bankruptcy court has as its central purpose the successful rehabilitation of the debtor corporation. [203] Moreover, because the bankruptcy court is familiar with the financial affairs of the debtor and its reorganization plan, a debtor corporation may find that bankruptcy court is the best forum in which to have its tax liabilities determined. Thus, in order to provide the debtor with a "fresh start" in a timely manner, the bankruptcy court may be looked to by debtors as the logical forum to decide tax disputes.

Just because the bankruptcy court has jurisdiction to determine tax disputes under section 505 of the Bankruptcy Code, and because this power may extend to determinations regarding the federal income tax consequences of Chapter 11 plans, does not mean that the bankruptcy court must exercise its jurisdiction. In certain circumstances, the bankruptcy court may determine that it would be in the best interests of the debtor to defer the tax matter to the tax court. [204] Some of the factors that bankruptcy courts should consider when deciding whether or not to exercise jurisdiction in a particular tax matter were addressed by the court in *In re Hunt*. [205] The *Hunt* court listed the following factors as significant: (1) the bankruptcy court's need to administer the case in orderly and efficient manner; [206] (2) the complexity of the tax issues involved; [207] (3) judicial economy and efficiency, *e.g.*, the length of time required for trial and decision; [208] (4) the shorter appeal route from tax courts; [209] and (5) prejudice to the debtor versus the prejudice to the IRS. [210] Once full consideration has been given to these factors, the bankruptcy court should be able to determine whether administration of the Chapter 11 case would be best served by having the federal income tax consequences of the reorganization plan determined by it or by the tax court. [211]

IV. Proposed Legislative Changes

Section 1146(d) is the procedural vehicle which permits an expedited declaration of the state and local tax effects of a Chapter 11 reorganization plan. [212] Although one may argue that bankruptcy courts may or should be able to make such determinations in the federal income tax area via section 505(a)(1) of the Bankruptcy Code, this author proposes that section 1146(d) be amended to include determinations relating to the federal income tax consequences of Chapter 11 plans. Under this proposed amendment, as under section 505(a)(1) of the Bankruptcy Code, the bankruptcy court would have the option of either entering a final order or referring the matter to the tax court for a final order.

Several policy reasons support the proposed amendment. The expansion of section 1146(d) to include federal income tax determinations would provide a more definitive mechanism for determining the federal income tax consequences of reorganization plans than does the present IRS letter ruling process. Moreover, the proposed change would enhance judicial economy in many cases. For instance, if the IRS currently issues an unfavorable private letter ruling to a Chapter 11 plan proponent regarding the federal income tax consequences of its reorganization plan, the proponent does not have the ability to challenge the IRS's legal analysis immediately and obtain a court ruling on matters of law. [213] The Declaratory Judgment Act would not be immediately available to the plan proponent because the general rule barring declaratory judgments with respect to federal tax issues would apply, unless the bankruptcy court were willing to consider the issue under section 505(a)(1) of the Bankruptcy Code. [214]

In addition, expansion would provide a uniform method for plan proponents to utilize at the federal, state and local taxing levels when dealing with the tax consequences of a reorganization plan−that is, all levels of governmental taxing authorities would be bound to respond within the same time frame. Although Chapter 11 plan proponents may find it more effective to deal with state and local taxing authorities on an informal basis in certain circumstances, uniformity would provide for more orderly and efficient administration of Chapter 11 cases.

In opposition to amending section 1146(d) to include federal income tax determinations, it may be argued that federal income tax law is a complex area best left to interpretation by the IRS and the tax court rather than the bankruptcy courts. Likewise, expansion of section 1146(d) may be opposed on the basis that it would provide bankruptcy judges with too much discretion in determining questions of federal income tax law and that those determinations could have an adverse impact on the uniform application and administration of the federal income tax laws. Currently, however, bankruptcy courts make federal tax determinations under sections 1129(a)(11) and 505 of the Bankruptcy Code, and the frequency of those determinations is increasing. If bankruptcy courts are competent to determine all of the tax issues contemplated by section 505, as Congress has clearly authorized, [215] then bankruptcy courts should be equally competent to make determinations of the federal income tax consequences of Chapter 11 plans of reorganization when they follow the procedural requirements of section 1146(d). One must remember that under section 1146(d), the IRS is provided the first opportunity to determine the tax consequences of the plan. [216] Thus, if section 1146(d) were amended as proposed, the bankruptcy court's authority would be limited to questions of federal income tax law where the plan proponent has received an adverse ruling from the IRS or where the IRS has failed to issue a determination.

Because the current wording of section 1146(d) is not explicit regarding the circumstances under which the IRS would be made a party to the bankruptcy court's declaratory judgment litigation, [217] certain procedural rules would need to be

implemented in conjunction with the proposed amendment. A question arises concerning whether the IRS should be made a party to any subsequent bankruptcy court declaratory judgment litigation over the federal income tax effects of a reorganization plan where the IRS has initially failed to issue a determination within the time limits of section 1146(d). Clearly, if the IRS makes a timely adverse initial ruling and the plan proponent chooses to pursue a declaratory judgment action in the bankruptcy court, then the IRS should be a party to the declaratory judgment action.

However, if the IRS does not respond to the plan proponent's request for a determination within the time frame set forth in section 1146(d) and does not request additional time to respond to the request, it is arguable that the IRS should be held to have permanently waived its opportunity to issue a ruling on the specific tax issues raised in the plan proponent's request. If this were so, there would be no reason to permit the IRS to become a party to the plan proponent's subsequent declaratory judgment action before the bankruptcy court. The Chapter 11 plan proponent would in effect obtain a default judgment against the IRS on those tax matters raised in its initial request without the IRS ever having standing to challenge those matters in a court of law. In support of this rather harsh result, it could be argued that without foreclosing the IRS's ability to later be made a party to the declaratory judgment action there would be no reason for the IRS to issue timely rulings under section 1146(d). Without providing incentive for the IRS to respond timely to the requests of plan proponents, one of the proposed amendment's major goals−the timely administration and confirmation of Chapter 11 reorganizations− would be seriously frustrated.

On the other hand, it seems that, as part of general due process principles, the IRS should be able to elect to be made a party to the declaratory judgment litigation even if it has not timely responded to the plan proponent's request for a determination. Should the IRS make such an election, it would have the opportunity to respond to the tax issues raised in the determination request in a court of law prior to the entry of a default judgment against it. However, to provide the IRS with an incentive to make timely responses to determination requests by Chapter 11 plan proponents, the author proposes that the weight given by the bankruptcy court (or the tax court if the bankruptcy court referred the matter there) to the IRS's response be the same that the court would give to any other nongovernmental party. In other words, the IRS would not be afforded its usual deference with respect to the questions of federal tax law at hand; [218] rather, the court would view the questions of tax law as if they were part of a tax dispute between two private parties. This change is intended to strike a balance by providing the IRS with a procedure to obtain its day in court while, at the same time, prompting timely IRS responses to tax determination requests by Chapter 11 plan proponents that were previously authorized by a bankruptcy court.

Conclusion

Chapter 11 debtors need to have the ability to reorganize in an efficient and orderly manner. Because successful corporate restructuring in bankruptcy often depends upon the favorable tax consequences of that restructuring, there should be a uniform method for Chapter 11 debtors to obtain binding rulings regarding the tax effects of their reorganization plans. Currently, the Bankruptcy Code does not explicitly provide such a method for federal income tax determinations.

This Article does not propose that the current exceptions from the Declaratory Judgment Act granted to bankruptcy courts regarding federal taxes should be construed so broadly as to create a "second tax court." [219] Rather, this Article proposes the expansion of section 1146(d) of the Bankruptcy Code to provide the bankruptcy court with the explicit power to finally decide, or in its discretion refer to the tax court for a final determination, those issues of law where there is an actual controversy regarding the federal income tax effects of a proposed plan of reorganization. Bankruptcy courts currently make determinations regarding federal income taxes when deciding issues of feasibility and exercise broad authority in tax matters under section 505 of the Bankruptcy Code. Expanding the scope of section 1146(d) of the Bankruptcy Code to include federal income tax determinations is a logical step that would enhance the efficient administration and confirmation of Chapter 11 reorganizations.

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**FOOTNOTES:**

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Law, 1985. The views expressed in this Article are those of the author and do not necessarily reflect those of the FDIC. The author wishes to express his gratitude to Professor William T. Vukowich, Georgetown University Law Center, for his critical review and guidance in preparing this Article.Back To Text

[1] Bankruptcy Reform Act of 1978, Pub. L. No. 95−598, 92 Stat. 2549 (codified as amended at 11 U.S.C. §§ 101−1330 (1994)).Back To Text

[2] 11 U.S.C. §§ 1101−1146 (1994). There has been a surge in Chapter 11 filings nationwide. The number of Chapter 11 filings in 1990 was three times that in 1980. Nina Martin, Boom Times for Bankruptcy, 77 A.B.A. J. 82, 83 (Dec. 1991). *But see* Jagdeep S. Bhandari and Lawrence A. Weiss, The Increasing Bankruptcy Filing Rate: An Historical Analysis, 67 Am. Bankr. L.J. 1, 11 (1993) (suggesting that while Bankruptcy Code made it easier for firms to reorganize, increase in debt is primary reason for increase in filings).Back To Text

[3] A detailed discussion of the numerous tax ramifications of business reorganizations under the Bankruptcy Code is beyond the scope of this Article. However, two excellent sources for information regarding the tax consequences of bankruptcy are: (1) Gordon Henderson & Stuart J. Goldring, Failing and Failed Businesses (1993); and (2) Robert E. Ginsberg et al., Bankruptcy ¶¶ 15,001−15,623 (1986).Back To Text

[4] 11 U.S.C. § 1146(d) (1994). No similar provision was included in pre−1978 bankruptcy law. *See* H.R. Rep. No. 595, 95th Cong., 1st Sess. 5 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 5966 (discussing combination of four chapters into one chapter under the Bankruptcy Code in order to facilitate business reorganizations). Back To Text

[5] Accordingly, this Article is limited to a discussion of those kinds of taxes based on or measured by income, *e.g.*, income taxes, capital gains, net operating loss carryovers, withholding taxes.Back To Text

[6] 11 U.S.C. § 1146(d) (1994).Back To Text

[7] H.R. Rep. No. 595, supra note 4, at 5, *reprinted in* 1978 U.S.C.C.A.N. at 6377. The House Report describes what originally was intended to be § 1146(d) as follows:

> Subsection (d) permits the court to authorize the proponent of a plan to request a taxing authority to declare the tax effects of such plan. In the event of an actual controversy, the court may declare the tax effects of the plan of reorganization at any time after the earlier of action by such taxing authority or 270 days after the request. Such a declaration, unless appealed, becomes a final judgment and binds *any* tax authority that was requested by the proponent to determine the tax effects of the plan.

Id. (emphasis added).Back To Text

[8] *See* 124 Cong. Rec. 32,418 (1978). Prior to the final passage of the 1978 Bankruptcy Code, the sponsors of the legislation agreed to amend the House Bill and the Senate Bill to delete reference to federal taxes, thereby obviating the necessity of the Senate Bill being referred to the House Ways and Means Committee; *see also* 5 Collier on Bankruptcy ¶ 1146.01 n.1 (Lawrence P. King ed., 15th ed. 1995). Subsection (d) of § 1146 is at variance with H.R. 8200 to the extent that the House Bill covered all governmental units, including the Internal Revenue Service ("IRS"), whereas the Bankruptcy Code covers only state and local governmental units. Id.Back To Text

[9] Federal income taxes and the issues related to them arise at various times before and after a company files for bankruptcy. For example, in a typical Chapter 11 case, federal income taxes may arise during four distinct time frames: (1) before the filing of the bankruptcy petition; (2) after the filing of the bankruptcy petition and prior to the confirmation of a plan of reorganization; (3) upon confirmation of the plan of reorganization; or (4) after confirmation and as a result of a postconfirmation event which was contemplated by the confirmed plan. Generally, federal income taxes arising prepetition and the issues related to them are dealt with through the claims litigation process. The IRS files a bankruptcy proof of claim and participates as a creditor in the bankruptcy case with respect to the allowed amount of its prepetition taxes. *See* 11 U.S.C. §§ 501, 1111(a) (1994); Fed. R. Bankr. P. 3003(c)(2). In general, many unsecured tax claims with respect to taxable years for which the tax return was due within three years before the

bankruptcy filing date will be granted priority status in bankruptcy. 11 U.S.C. § 507(a)(8) (1994). Postpetition taxes are treated as administrative expenses and, to the extent incurred in the ordinary course of the debtor's business, are payable currently. 11 U.S.C. §§ 503(b), 507(a)(1) (1994). Accordingly, the taxes and related issues that arise before confirmation of a reorganization plan are not the primary focus of this Article. Rather, this Article focuses on the confirmation and postconfirmation time frames.Back To Text

[10] The background material contained in this subpart generally relates to bankruptcy court jurisdiction over federal income tax issues that arose before the filing of a bankruptcy petition. Although the primary focus of this Article is on federal income tax consequences related to the confirmation and postconfirmation time frames, *see* supra note 9, this brief overview of the bankruptcy courts' jurisdiction regarding prebankruptcy filing tax claims demonstrates a long−standing policy that the bankruptcy courts are competent to make significant determinations regarding complex tax issues and that such determinations promote the efficient administration of bankruptcy cases. Back To Text

[11] Ch. 541, 30 Stat. 544, *amended by* Act of June 22, 1938, ch. 575, 52 Stat. 840, *repealed by* Bankruptcy Reform Act of 1978, Pub. L. No. 95−598, 92 Stat. 2549.Back To Text

[12] Bankruptcy Act of 1898, § 64a(4), 30 Stat. at 563 (emphasis added).Back To Text

[13] Id.; In re Raflowitz, 37 F. Supp. 202, 206 (D. Conn. 1941) (acknowledging application of this provision to all taxes); 3 Collier on Bankruptcy, supra note 8, ¶ 505.01, at 505−2 to −3.Back To Text

[14] 3A Collier on Bankruptcy ¶ 64.407[1], at 2205 (James Wm. Moore et al. eds., 14th ed. 1975); *see* Cohen v. United States, 115 F.2d 505, 506 (1st Cir. 1940) ("[T]he purpose of Section 64, sub. a, is to aid the prompt administration of bankrupt estates."); In re Kravitz, 198 F. Supp. 315, 317 (E.D. Pa. 1961).Back To Text

[15] 313 U.S. 132 (1941).Back To Text

[16] 3 Collier on Bankruptcy, supra note 8, ¶ 505.01, at 505−3; *see* Cohen, 115 F.2d at 505 (dealing with federal income taxes); In re Gustav, 103 F.2d 237 (6th Cir.) (involving county taxes), cert. denied, 308 U.S. 579 (1939); Dickinson v. Reily, 86 F.2d 385 (8th Cir. 1936) (regarding county taxes); Board of Directors v. Kurn, 98 F.2d 394 (8th Cir.) (dealing with specialized local taxes), cert. denied, 305 U.S. 647 (1938).Back To Text

[17] 3 Collier on Bankruptcy, supra note 8, ¶ 505.01, at 505−5.Back To Text

[18] Arkansas Corp., 313 U.S. at 137−38.Back To Text

[19] Id. at 138.Back To Text

[20] In re Missouri Pac. R. Co., 33 F. Supp. 728 (E.D. Mo.), *aff'd sub nom.* Arkansas Corp. Comm'n v. Thompson, 116 F.2d 179 (8th Cir. 1940), rev'd, 313 U.S. 132 (1941).Back To Text

[21] Arkansas Corp., 313 U.S. at 142−43. It has been argued that,

> [t]he Supreme Court seemed to have settled . . . [that] the bankruptcy court did not have the power to redetermine that claim or to alter the amount of the tax unless the taxing authority had made an improper arithmetical computation, an exception stated in the *Arkansas Commission* case itself, or the taxing authority had acted beyond its legal authority, or the assessment had been tainted by obvious illegality . . . .

3 Collier on Bankruptcy, supra note 8, ¶ 505.01, at 505−6 (footnotes omitted).Back To Text

[22] 3 Collier on Bankruptcy, supra note 8, ¶ 505.01.Back To Text

[23] Act of July 5, 1966, Pub. L. No. 89−496, 80 Stat. 270 (codified at 11 U.S.C. §§ 1, 11, 35, 104, 107, 110 (Supp. V 1970) (repealed 1978)). "The latter part of the new § 2a(2A) enacts the premise underlying the actual holding of

*Arkansas Corp.*, that a trustee or receiver can prosecute an appeal or review of a determination of a tax question contested before a tribunal of competent jurisdiction . . . ." Frank R. Kennedy, The Bankruptcy Amendments of 1966, 1 Ga. L. Rev. 149, 175 (1967). Section 2a(2A) became the predecessor to § 505 of the current Bankruptcy Code, 11 U.S.C. § 505 (1994).Back To Text

[24] *See* Act of July 5, 1966 § 3 (repealed 1978).Back To Text

[25] 11 U.S.C. § 11(a)(2a) (1970) (repealed 1978).Back To Text

[26] 3 Collier on Bankruptcy, supra note 8, ¶ 505.01, at 505−8. Congress placed § 2(a)(2a) in the jurisdictional grant section of the Bankruptcy Code to clarify the bankruptcy courts' authority in Chapter X (business) and railroad reorganization cases. Id. *See generally* Kennedy, supra note 23, at 173 (maintaining § 2a(2A) clearly authorizes bankruptcy courts to determine amount and legality of taxes).Back To Text

[27] 28 U.S.C. § 2201 (1977) (current version at 28 U.S.C. § 2201 (1988 & Supp. V 1993)).Back To Text

[28] Id. (emphasis added).Back To Text

[29] *See, e.g.*, Bostwick v. United States (In re Bostwick), 521 F.2d 741 (8th Cir. 1975).Back To Text

[30] Id.Back To Text

[31] Id. at 744; *see also* Gwilliam v. United States (In re Gwilliam), 519 F.2d 407, 410 (9th Cir. 1975) (holding that bankruptcy court had jurisdiction to determine bankrupt's federal tax liability notwithstanding absence of prior claim by IRS); In re Century Vault Co., 416 F.2d 1035, 1041 (3d Cir. 1969) (maintaining § 2a(2A) gives bankruptcy court power to determine any question regarding amount of any unpaid tax if question was not contested prior to bankruptcy); In re Durensky, 377 F. Supp. 798, 802 (N.D. Tex. 1974) (authorizing bankruptcy court to determine dischargeability of federal taxes); Warren's U−Joint Sales, Inc. v. United States (*In re* Warren's U−Joint Sales, Inc.), 41 A.F.T.R.2d (P−H) 78−946, 78−947 (S.D. Tex. 1977) (holding bankruptcy court has power to render declaratory judgment in tax matter).Back To Text

[32] I.R.C. § 7421(a) (1976) (current version at I.R.C. § 7421(a) (1988)) (prohibiting suits to restrain assessment or collection of any tax).Back To Text

[33] 28 U.S.C. § 2201 (1977) (current version at 28 U.S.C. § 2201 (1988 & Supp. V 1993)).Back To Text

[34] Bostwick v. United States (In re Bostwick), 521 F.2d 741, 744 (8th Cir. 1975).Back To Text

[35] 465 F.2d 978 (5th Cir. 1972).Back To Text

[36] Id. at 980. In *Statmaster*, the trustee in bankruptcy did not file a tax return. Instead, he attached it to a petition to the bankruptcy court for an order to show cause why he should not be discharged from all federal income tax liability arising from his administration of the estate. Id. at 979. The court held that requests for declaratory judgments in tax matters were barred by the Declaratory Judgment Act and noted that the prohibition against declaratory judgments was part of the statutory pattern that gives the IRS the right to make the first determination of possible tax liability. Id. at 980. This view stemmed from the Fifth Circuit's earlier ruling in United States v. Brock (In re Wingreen Co.), 412 F.2d 1048 (5th Cir. 1969), which addressed determinations by reorganization courts of the tax consequences of proposed plans of reorganization. Id. at 1051.Back To Text

[37] Wingreen, 412 F.2d at 1050.Back To Text

[38] Id.Back To Text

[39] Id.Back To Text

[40] Id.Back To Text

[41] Id.Back To Text

[42] Wingreen, 412 F.2d at 1050.Back To Text

[43] Id. at 1051.Back To Text

[44] Id.Back To Text

[45] Id.Back To Text

[46] Id.Back To Text

[47] Pre−Code courts generally did not have jurisdiction over requests for declaratory action in tax matters. *See* Jolles Found. Inc. v. Moysey, 250 F.2d 166, 169 (2d Cir. 1957) (holding courts are without jurisdiction to enter declaratory judgments in federal tax matters); Carmichael v. United States, 245 F.2d 676, 678 (5th Cir. 1957) (declaring district court lacked jurisdiction to determine federal tax liability).Back To Text

[48] *See, e.g.*, Allis−Chalmers Corp. v. Goldberg (In re Hartman Material Handling Sys., Inc.), 141 B.R. 802, 813 (Bankr. S.D.N.Y. 1992) (stating reorganization plan proponent could only obtain determination of tax effects of plan from state or local taxing authorities).Back To Text

[49] *See* 28 U.S.C. § 2201 (1976), *as amended by* Bankruptcy Reform Act of 1978, Pub. L. No. 95−598, § 249, 92 Stat. 2549, 2672.Back To Text

[50] 11 U.S.C. § 505 (1994) (setting forth rules regarding determinations of tax liabilities by bankruptcy courts); *see* discussion infra notes 56−110 and accompanying text (discussing 11 U.S.C. § 505(a)).Back To Text

[51] 11 U.S.C. § 1146 (1994) (relating to special tax provisions in Bankruptcy Code); *see* discussion infra notes 111−135 and accompanying text (regarding 11 U.S.C. § 1146).Back To Text

[52] The Declaratory Judgment Act now reads:

> In a case of actual controversy within its jurisdiction, *except with respect to Federal taxes other than* actions brought under section 7428 of the Internal Revenue Code of 1986, *a proceeding under section 505 or 1146 of title 11*, . . . any court of the United States, upon the filing of an appropriate pleading, may declare the rights and other legal relations of any interested party seeking such declaration, whether or not further relief is or could be sought. Any such declaration shall have the force and effect of a final judgment or decree and shall be reviewable as such.

28 U.S.C. § 2201(a) (1988 & Supp. V 1993) (emphasis added).Back To Text

[53] Id.; *see also* Henderson & Goldring, supra note 3, ¶ 1011.03, at 1709.Back To Text

[54] *See* Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98−353, 98 Stat. 333; Bankruptcy Judges, United States Trustees and Family Farmer Bankruptcy Act of 1986, Pub. L. No. 99−554, 100 Stat. 3088; Bankruptcy Reform Act of 1994, Pub. L. No. 103−394, 108 Stat. 4106 (codified as amended at 11 U.S.C. §§ 101−1330 (1994)).Back To Text

[55] 11 U.S.C. §§ 505, 1146 (1994).Back To Text

[56] Id. § 505(a)(1).Back To Text

[57] Id. This provision is based on former § 2a(2A) of the Bankruptcy Act. See Act of July 5, 1966, Pub. L. No. 89−496, 80 Stat. 270 (codified at 11 U.S.C. § 11 (Supp. V 1970) (repealed 1978)).Back To Text

[58] As an example of its breadth, it has been held that once the bankruptcy court decides a debtor corporation's tax liability under 11 U.S.C. § 505 that decision is not subject to relitigation in any tribunal. *See, e.g.,* Florida Peach Corp. v. Commissioner, 90 T.C. 678, 683 (1988) (holding decision binding even though Chapter 11 case subsequently dismissed); *see* S. Rep. No. 1035, 96th Cong., 2d Sess. 47 (1980), *reprinted in* 1980 U.S.C.C.A.N. 7017, 7060. Section 505(a) "give[s] the bankruptcy court in effect the authority to determine whether the tax liability issue should be decided in the bankruptcy court or in U.S. Tax Court." Id.Back To Text

[59] *See* United States v. Wilson, 974 F.2d 514, 516−17 (4th Cir. 1992) (holding concurrent jurisdiction of tax court did not deprive bankruptcy court of jurisdiction to resolve unadjudicated tax claim), cert. denied, 113 S. Ct. 1352 (1993); Kreidle v. IRS (In re Kreidle), 143 B.R. 941, 944 (D. Colo. 1992) (concluding bankruptcy court has jurisdiction in bankruptcy cases over prepetition and postpetition taxes); In re Hunt, 95 B.R. 442, 445 (Bankr. N.D. Tex. 1989) (stating bankruptcy court must balance several factors in determining whether it should yield to tax court); In re Fiedel County Day Sch., 55 B.R. 229, 231 (Bankr. E.D.N.Y. 1985) (maintaining bankruptcy court has jurisdiction to redetermine postpetition taxes owed even if debtor does not contest taxes under state law).Back To Text

[60] 11 U.S.C. § 505 (1994).Back To Text

[61] *See, e.g.,* Quattrone Accountants, Inc. v. IRS, 895 F.2d 921, 924−25 (3d Cir. 1990) (concluding language and purpose of § 505 was to clarify bankruptcy court's jurisdiction over tax claims); American Principals Leasing Corp. v. United States, 904 F.2d 477, 481 (9th Cir. 1990) (finding legislative history permits bankruptcy court to determine unpaid tax liability of debtor); MDFC Equip. Leasing Corp. v. Robbins (In re Interstate Motor Freight Sys.), 62 B.R. 805, 808−09 (Bankr. W.D. Mich. 1986) (stating that without recourse to legislative history, § 505 makes bankruptcy courts a second tax court system).

When examining the legislative history to the Bankruptcy Code, it is important to keep in mind that Congress took the unusual step of having joint statements read on the floor of the House and Senate, so that agreeing statements of intent would be available. 124 Cong. Rec. 32,350 (1978) (statements of Rep. Edwards); 124 Cong. Rec. 33,990 (1978) (statement of Sen. DeConcini). The agreed character and intended use of this legislative history to influence judges has provoked some judges, led by Justice Scalia, to doubt the reliability of such traditional sources of legislative history. *See* Blanchard v. Bergeron, 489 U.S. 87, 98−100 (1989) (Scalia, J. concurring) (arguing against giving legislative force to each piece of analysis and every case citation in committee reports). *Compare* In re Sinclair, 870 F.2d 1340, 1341−44 (7th Cir. 1989) (holding that text of statute prevails over conflicting legislative history) *with* Stackhouse v. Hudson (In re Hudson), 859 F.2d 1418, 1420−24 (9th Cir. 1988) (determining that legislative history outweighs language of statute). *See also* Richard Aaron, 1990 Bankruptcy Law Handbook § 102[3] (1990).Back To Text

[62] 930 F.2d 1132 (6th Cir. 1991), cert. dismissed, 503 U.S. 978 (1992).Back To Text

[63] 62 B.R. 805 (Bankr. W.D. Mich. 1986).Back To Text

[64] 11 U.S.C. § 505(a)(1) (1994).Back To Text

[65] Wolverine, 930 F.2d at 1139 (citing *Motor Freight*, 62 B.R. at 809).Back To Text

[66] 11 U.S.C. § 505(a)(1) (1994).Back To Text

[67] *See* In re Original Wild West Foods, Inc., 45 B.R. 202, 206 (Bankr. W.D. Tex. 1984) (holding bankruptcy court has jurisdiction because third party tax issue affects reorganization); Jon Co. v. United States (In re Jon Co.), 30 B.R. 831, 833 (D. Colo. 1983) (finding bankruptcy court has jurisdiction over third party since § 505 does not indicate otherwise); H&R Ice Co. v. United States (In re H&R Ice Co.), 24 B.R. 28, 31 (Bankr. W.D. Mo. 1982) (finding § 505 broad enough to encompass third parties); *see also* Karen Skeens, 11 U.S.C. § 505*: Does It Allow the Bankruptcy*

*Court to Determine a Third Party's Tax Liability?*, 77 Ky. L.J. 463, 467 (1988) (discussing interpretation of § 505).Back To Text

[68] Brandt AirFlex Corp. v. Long Island Trust Co. (In re Brandt AirFlex Corp.), 843 F.2d 90, 96 (2d Cir. 1988) (determining bankruptcy court did not have jurisdiction to decide tax liabilities of nondebtors); United States v. Huckabee Auto Co., 783 F.2d 1546, 1549 (11th Cir. 1986) (maintaining bankruptcy court has no jurisdiction over nondebtors); In re Cadillac Recreation, Inc., 159 B.R. 244, 246−47 (C.D. Ill. 1993) (holding § 505 does not grant bankruptcy court jurisdiction to determine tax liability of nondebtor); Gennari v. United States Dep't of Treasury (In re Educators Inv. Corp.), 59 B.R. 910, 913 (Bankr. D. Nev. 1986) (finding bankruptcy court lacks ability to hear unrelated proceeding to determine tax liability of third party).Back To Text

[69] *See* Holly's, Inc. v. Kentwood (In re Holly's, Inc.), 172 B.R. 545, 556−60 (Bankr. W.D. Mich. 1994) (using 28 U.S.C. §§ 1334 and 157 to establish that postconfirmation tax issue is related to Chapter 11 case), aff'd, 178 B.R. 711 (W.D. Mich. 1995); Unsecured Creditors' Comm. of Goldblatt Bros. v. United States (In re Goldblatt Bros.), 106 B.R. 522, 524−30 (Bankr. N.D. Ill. 1989) (finding § 157 allows court to hear tax matters).Back To Text

[70] 28 U.S.C. § 1471 (1982), *repealed by* Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98−353, 98 Stat. 343.Back To Text

[71] 458 U.S. 50 (1982). Back To Text

[72] Id. at 87.Back To Text

[73] Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98−353, 98 Stat. 333.Back To Text

[74] 28 U.S.C. § 1334 (1988 & Supp. V 1993), *as amended by* Bankruptcy Reform Act of 1994, 28 U.S.C.A. § 1334 (West Supp. 1995). Section 1334(b) states in pertinent part that: "[T]he district courts shall have original but not exclusive jurisdiction of all civil proceedings arising under title 11, or arising in or related to cases under title 11." Id. According to 28 U.S.C. § 151, bankruptcy judges constitute a "unit of the district court" in each judicial district. 28 U.S.C. § 151 (1988).Back To Text

[75] 28 U.S.C. § 157 (1988), *as amended by* Bankruptcy Reform Act of 1994, 28 U.S.C.A. § 157 (West Supp. 1995). Section 157(a) provides: "Each district court may provide that any or all cases under title 11 and any or all proceedings arising under title 11 or arising in or related to a case under title 11 shall be referred to the bankruptcy judges for the district." 28 U.S.C. § 157(a) (1988).Back To Text

[76] Section 157(b)(1) provides in part that "[b]ankruptcy judges may hear and determine all cases under title 11 and all core proceedings arising under title 11, or arising in a case under title 11." 28 U.S.C.

§ 157(b)(1). An illustrative list of core proceedings is provided in 28 U.S.C. § 157(b)(2)(A)−(O). Back To Text

[77] Section 157(c)(1) states in pertinent part that "[a] bankruptcy judge may hear a proceeding that is not a core proceeding but that is otherwise related to a case under title 11. In such proceeding, the bankruptcy judge shall submit proposed findings of fact and conclusions of law to the district court . . . ." 28 U.S.C. § 157(c)(1).Back To Text

[78] 28 U.S.C. § 157(b)(1).Back To Text

[79] Id. § 157(c)(1).Back To Text

[80] Professor Lawrence King has argued that § 157(b)(2) contains at least four catch−all phrases and that almost anything could be included under clauses (A) ("matters concerning the administration of the estate") and (O) ("other proceedings affecting the liquidation of the assets of the estate or the adjustment of the debtor−creditor or the equity security holder relationship, except personal injury tort or wrongful death claims"). Lawrence P. King, Jurisdiction and Procedure Under the Bankruptcy Amendments of 1984, 38 Vand. L. Rev. 675, 687−88 (1985). King concludes

that "[t]hese clauses alone appear to give the bankruptcy courts all the pervasive jurisdiction formerly granted by section 1471(b) and (c)." Id. at 688.Back To Text

[81] 6 Collier Bankruptcy Practice Guide ¶ 93.03[1][c], at 93−16 to −17 (Asa S. Herzog & Lawrence P. King eds. 1992).Back To Text

[82] 11 U.S.C. § 505(a)(1) (1994).Back To Text

[83] 124 Cong. Rec. 32,414 (1978) (indicating that amendment "authorizes the bankruptcy court to rule on the merits of any tax *claim*") (emphasis added); 3 Collier on Bankruptcy, supra note 8, ¶ 505.03[1], at 505−16.Back To Text

[84] As support for this position, it could be argued that § 505(a)(1)'s reach is defined by the types of tax issues addressed in other parts of § 505. For instance, § 505(a)(2) limits the bankruptcy court's determinations regarding the amount or legality of a tax if it was contested and adjudicated *before* the commencement of the bankruptcy case. 11 U.S.C. § 505(a)(2) (1994) (emphasis added). Section 505(b) allows the trustee to request a bankruptcy court determination of any unpaid liability of the estate for any tax incurred *during the administration* of the case. Id. § 505(b) (emphasis added). Both of these sections limit the bankruptcy court's determinations regarding tax issues to those that arose prior to confirmation. On the other hand, it could be argued that because specific limiting language similar to that found in §§ 505(a)(2) and 505(b) is not found in § 505(a)(1), the application of § 505(a)(1) was intended to be broader than that of §§ 505(a)(2) and 505(b). Therefore, § 505(a)(1) is not limited to preconfirmation tax claims and extends to bankruptcy court determinations of confirmation and postconfirmation tax issues. As additional support for this position, § 505 is included as an exception to the Declaratory Judgment Act's prohibition on declaratory judgments in federal tax matters, and there is nothing limiting § 505's Declaratory Judgment Act exception to determinations of preconfirmation tax claims. *See* supra notes 49−55 and accompanying text (discussing Declaratory Judgment Act). Back To Text

[85] *See* H.R. Rep. No. 8200, 95th Cong., 2d Sess. (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5963 (indicating inevitability of bankruptcy court's expansion in § 505 to declare tax liabilities and ramifications). Back To Text

[86] *See* 6 Collier Practice Guide, supra note 81, ¶ 93.03[1][c], at 93−16 to 17.Back To Text

[87] 106 B.R. 522 (Bankr. N.D. Ill. 1989).Back To Text

[88] Id. at 523.Back To Text

[89] Id. at 525.Back To Text

[90] Id. at 526.Back To Text

[91] Id. at 529.Back To Text

[92] Goldblatt Bros., 106 B.R. at 526.Back To Text

[93] 129 B.R. 538 (Bankr. N.D. Ill. 1991).Back To Text

[94] Id. at 539.Back To Text

[95] Id. at 540.Back To Text

[96] Id.Back To Text

[97] Id.Back To Text

[98] Kilen, 129 B.R. at 540−41.Back To Text

[99] Id. at 541. A "claim" under the Bankruptcy Code includes "right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured." 11 U.S.C. § 101(5)(A) (1994). The Bankruptcy Code's definition of claim was drafted to expand the Bankruptcy Act's definition of "claim" and to make it clear that "all legal obligations of the debtor, no matter how remote or contingent, will be dealt with in the bankruptcy case. It provides the broadest possible relief in the bankruptcy court." H.R. Rep. No. 595, supra note 4, *reprinted in* 1978 U.S.C.C.A.N. at 6206; *see* Ohio v. Kovacs, 469 U.S. 274, 279 (1984) ("[I]t is apparent that Congress desired a broad definition of a `claim.'") (footnote omitted). Thus, it seems clear that under the Bankruptcy Code's definition of "claim," the IRS in *Kilen* held prepetition claims that were subject to adjudication by the bankruptcy court. Because the IRS's claims are unmatured, contingent and/or unliquidated, at first glance they may appear as if they present no case or controversy for the bankruptcy court to decide. However, bankruptcy courts often adjudicate remote, unliquidated, unmatured and contingent prepetition claims in order to provide the debtor with a fresh start. *See*, *e.g.*, Grady v. A.H. Robins Co., 839 F.2d 198, 203 (4th Cir.) ("A broad reading of the word `claim' [is] required by the legislative history."), cert. denied, 487 U.S. 1260 (1988). For further analysis of the case or controversy issue see infra notes 136−65 and accompanying text.Back To Text

[100] Kilen, 129 B.R. at 541, n.7.

> Lest there be any doubt, it is our contention that a determination by Congress to allow the bankruptcy courts to adjudicate tax liabilities never raised in any way or even investigated by the IRS would in fact be unconstitutional in view of the appealability of § 505 determinations to the district courts and beyond.

Id.Back To Text

[101] Id. at 550.Back To Text

[102] Id.Back To Text

[103] *Cf.* Gwilliam v. United States (In re Gwilliam), 519 F.2d 407, 409 (1975) (holding immaterial whether proof of claim had been filed).Back To Text

[104] Kilen, 129 B.R. at 546.Back To Text

[105] Id. at 547.Back To Text

[106] Id. at 549.Back To Text

[107] 28 U.S.C. § 1334 (1988 & Supp. V 1993), *as amended by* Bankruptcy Reform Act of 1994, 28 U.S.C.A. § 1334 (West Supp. 1995).Back To Text

[108] 28 U.S.C. § 157 (1988), *as amended by* Bankruptcy Reform Act of 1994, 28 U.S.C.A. § 157 (West Supp. 1995).Back To Text

[109] 11 U.S.C. § 505(a)(1) (1994).Back To Text

[110] Henderson & Goldring, supra note 3, ¶ 1013.3 (stating that bankruptcy courts may make declaratory judgments regarding federal tax issues if actual controversy exists).Back To Text

[111] 11 U.S.C. § 1146(d) (1994).Back To Text

[112] Id. No similar provision existed under the Bankruptcy Act. According to the remarks of the sponsors made at the time of enactment,

> The House amendment retains the State and local rules in the House bill with one modification. Under the House amendment, 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 taxfree status under State or local tax rules, but it could not declare the dollar amount of any tax attributes that survive the reorganization.

124 Cong. Rec. 32,418 (1978) (statement of Rep. Edwards).Back To Text

[113] Myron M. Sheinfeld & James W. Caldwell, Taxes: An Analysis of the Tax Provisions of the Bankruptcy Code and the Bankruptcy Tax Act of 1980, 55 Am. Bankr. L.J. 97, 129 (1981).Back To Text

[114] Id. at 129−30 (referring to 11 U.S.C. § 1146(d)).

> It is speculated that many requests for rulings will be litigated. Many areas for prospective litigation exist. Some of these areas are as follows: What is a question of law? What are the taxing units to which a proper determination request can be made? When in fact does a controversy exist? May the 270−day limitation period be extended? What in fact is a response to the request for determination? May every proponent of each plan of reorganization independently request a determination from the taxing unit? Who is bound by the response of the taxing unit?

Id.Back To Text

[115] Allis−Chalmers Corp. v. Goldberg (In re Hartman Material Handling Systems, Inc.), 141 B.R. 802, 813 n.16 (Bankr. S.D.N.Y. 1992) (discussing § 1146(d)'s inapplicability to issues before court).Back To Text

[116] Id. (stating ruling applicable to state or local taxing authorities, not to IRS).Back To Text

[117] 11 U.S.C. § 1231(d) (1994).Back To Text

[118] *See* Henderson & Goldring, supra note 3, ¶ 1102 (stating proponents of Chapter 11 plan may request rulings from state or local taxing authorities only with bankruptcy court's approval).Back To Text

[119] George M. Treister et al., Fundamentals of Bankruptcy Law § 10.02 (3d ed. 1993).Back To Text

[120] *See* supra note 8 and accompanying text (discussing revisions to § 1146(d) prior to its enactment).Back To Text

[121] In describing the deletion of federal taxes from the scope of §§ 346, 738 and 1146, Representative Edwards of California explained:

> The House Ways and Means Committee and the Senate Finance Committee did not have time to process a bankruptcy tax bill during the 95th Congress. It is anticipated that early in the 96th Congress, and before the effective date of the Bankruptcy Code, the tax committees of Congress will have an opportunity to consider action with respect to amendments to the Internal Revenue Code and the special provisions in Title 11.

124 Cong. Rec. 32,395 (1978), *reprinted in* 1978 U.S.C.C.A.N. at 6443; *see* Robert A. Jacobs, The Bankruptcy Court's Emergence as Tax Arbiter of Choice, 45 Tax Law 971, 991 (1992) (discussing legislative history behind § 1146). Back To Text

[122] Pub. L. No. 96−589, 94 Stat. 3389. Back To Text

[123] Ch. 591, 68A Stat. 3 (codified as amended at I.R.C. §§ 1−9722 (1988 & Supp. V 1993)).Back To Text

[124] *See* id. Back To Text

[125] 28 U.S.C. § 2201(a) (Supp. V 1993).Back To Text

[126] 11 U.S.C. § 1146(d) (1994).Back To Text

[127] H.R. Rep. No. 595, supra note 4, at 284, *reprinted in* 1978 U.S.C.C.A.N. at 6241.Back To Text

[128] Id.Back To Text

[129] *See* supra notes 7−9, 121 and accompanying text (explaining that deletion of federal tax references in final 1978 bankruptcy bill was done for legislative convenience, rather than as indication of deliberate change in congressional intent).Back To Text

[130] Congress has imposed other time periods on the IRS and other taxing authorities via the Bankruptcy Code, during which they must make certain tax determinations or risk having a bankruptcy court make them. For example, 11 U.S.C. § 505(a)(2)(B) imposes a 120 day period for the IRS and other taxing authorities to respond to a bankruptcy estate's request for a tax refund before the bankruptcy court is allowed to make a final determination in the matter. According to the legislative history to § 505(a)(2)(B), the 120 day time limitation on refund claims was imposed "[b]ecause of the bankruptcy aim to close the estate as expeditiously as possible." 124 Cong. Rec. 32,414 (1978) (statements of Rep. Edwards), *reprinted in* 1978 U.S.C.C.A.N. at 6490.Back To Text

[131] *See* 28 U.S.C. § 2201 (1988 & Supp. V 1993).Back To Text

[132] On the other hand, it could be argued that the current reference to § 1146 in the Declaratory Judgment Act as an exception to the prohibition on issuing declaratory judgments in federal tax matters merely reflects congressional oversight in making the amendments necessary to conform the Declaratory Judgment Act with the final provisions of the 1978 Bankruptcy Code. United States v. Rutherford, 442 U.S. 544, 554 n.10 (1979) (stating that it may not always be proper to interpret congressional silence as approval).Back To Text

[133] *See* supra notes 7−9, 121 and accompanying text.Back To Text

[134] *See* supra text accompanying notes 56−110. Back To Text

[135] *See* supra notes 50−52 and accompanying text.Back To Text

[136] U.S. Const. art. III, § 2 (granting judiciary power to decide only matters involving case or controversy).Back To Text

[137] 129 B.R. 538 (Bankr. N.D. Ill. 1991).Back To Text

[138] Id. at 542.Back To Text

[139] Id.Back To Text

[140] Id.Back To Text

[141] *See, e.g.*, In re American Energy, Inc., 49 B.R. 420, 423 (Bankr. D.N.D. 1985) (holding bankruptcy courts have no authority to render advisory opinions).Back To Text

[142] 8 B.R. 327 (Bankr. D.P.R. 1980).Back To Text

[143] Id. at 330 (footnote omitted). Back To Text

[144] Maryland Casualty Co. v. Pacific Coal & Oil Co., 312 U.S. 270, 273 (1941).Back To Text

[145] *See* 10A Charles A. Wright et al., Federal Practice and Procedure § 2757 (1983) (maintaining that whether there is actual controversy is question which turns on facts of individual case).Back To Text

[146] Id.Back To Text

[147] 129 B.R. 538 (Bankr. N.D. Ill. 1991).Back To Text

[148] Id. at 541.Back To Text

[149] Id. at 548.Back To Text

[150] Wright, supra note 145.Back To Text

[151] Kilen, 129 B.R. at 545.Back To Text

[152] Bruhn v. STP Corp., 312 F. Supp. 903, 906 (1970) (quoting E. Borchard, Declaratory Judgments 57 (2d ed. 1941)).Back To Text

[153] *See* infra notes 189−195 and accompanying text.Back To Text

[154] *In re* Franklin, No. 90−0780 CV−W−5, 1990 U.S. Dist. LEXIS 16402 (W.D. Mo. Nov. 21, 1990).Back To Text

[155] 11 U.S.C. §§ 701−766 (1994).Back To Text

[156] *Franklin*, 1990 U.S. Dist. LEXIS at *4.Back To Text

[157] Id. at *2.Back To Text

[158] Id. at *4.Back To Text

[159] Id. at *7.Back To Text

[160] Id. at *11. Accordingly, the allocation of tax liabilities was held to be a core proceeding in which the bankruptcy court had jurisdiction to enter a final order under 28 U.S.C. § 157(b)(2)(A) (1988), *as amended by* Bankruptcy Reform Act of 1994, 28 U.S.C.A. § 157 (West Supp. 1995). *See supra* notes 76−80 and accompanying text.Back To Text

[161] *See Franklin*, 1990 U.S. Dist. LEXIS at *5−8.Back To Text

[162] 11 U.S.C. § 505(b) provides in part that the bankruptcy trustee:

> [M]ay request a determination of any unpaid liability of the estate for any tax incurred during the administration of the case by submitting a tax return for such tax and a request for such a determination to the governmental unit charged with responsibility for collection or determination of such tax.

11 U.S.C. § 505(b) (1994). The IRS asserted that § 505(b) set forth the proper method for tax determinations and that under that section the Chapter 7 trustee was required to file a tax return. Without the trustee filing a tax return or the IRS filing a proof of claim, the IRS argued that sovereign immunity had not been waived. Therefore, the bankruptcy court lacked jurisdiction to determine the potential tax liability owed by the bankruptcy estate and Ms. Franklin. *Franklin*, 1990 U.S. Dist. LEXIS at *10.Back To Text

[163] 521 F.2d 741 (8th Cir. 1975) (holding bankruptcy court had jurisdiction to discharge estate's tax first even though United States had not yet filed tax claim).Back To Text

[164] 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. § 505(b) would provide the proper method for determining the amount of a tax claim. In this case, the liability of the nondebtor is sufficiently related to the bankruptcy case to permit the Bankruptcy Court's jurisdiction.

*Franklin*, 1990 U.S. Dist. LEXIS at *10−11.Back To Text

[165] *See* id.Back To Text

[166] *See* United States v. Wilson, 974 F.2d 514, 516 (4th Cir. 1992) (holding that bankruptcy court had jurisdiction over Chapter 11 reorganization under 28 U.S.C. § 157(a)), cert. denied, 113 S. Ct. 1352 (1993); *see* In re Laminating, Inc., 148 B.R. 259, 260 (Bankr. S.D. Tex. 1992) (maintaining court has jurisdiction over proceeding for Chapter 11 reorganization pursuant to 28 U.S.C. §§ 157(a), (b)(2)(A), (L), 1334(b)).Back To Text

[167] This statement presumes that the bankruptcy court has previously determined that § 505(a)(1) provides the bankruptcy court with a statutory basis for making determinations regarding reorganization plan tax issues and does not limit the court's determinations to preconfirmation tax claims. *See* supra notes 56−110 and accompanying text.Back To Text

[168] *See* In re Kilen, 129 B.R. 538, 545−46 (Bankr. N.D. Ill. 1991) (holding court had jurisdiction to determine federal tax liability even though no financial factors had yet been assessed); *see also* In re Dakota Indus., Inc., 131 B.R. 437, 442 (Bankr. D.S.D. 1991) (citing *Kilen* for holding bankruptcy court may make tax adjudications where there has not yet been an assessment).Back To Text

[169] 11 U.S.C. § 1129(a)(11) (1994).Back To Text

[170] Id.Back To Text

[171] *E.g.*, In re Future Energy Corp., 83 B.R. 470, 503 (Bankr. S.D. Ohio 1988) (denying confirmation of plan because all of § 1129(a)'s criteria were not met).Back To Text

[172] Id. (acknowledging that federal tax matters must be included in feasibility test); *see* Teamsters Nat'l Freight Indus. Negotiating Comm. v. U.S. Truck Co. (In re U.S. Truck Co.), 800 F.2d 581, 589 (6th Cir. 1986) (using factors to determine likelihood of liquidation of corporation in bankruptcy); In re Landmark At Plaza Park, Ltd., 7 B.R. 653, 659 (Bankr. D.N.J. 1980) (same).Back To Text

[173] In re Prudential Energy Co., 58 B.R. 857, 863−64 (Bankr. S.D.N.Y. 1986) (stating reorganization plan should have included effect of tax legislation on debtor's ability to implement plan); *accord* In re Montgomery Court Apartments, Ltd., 141 B.R. 324, 346 (Bankr. S.D. Ohio 1992) (holding debtor did not provide enough evidence to assess financial reorganization value within plan).Back To Text

[174] *See* 11 U.S.C. § 1125 (1994).Back To Text

[175] In order to meet the adequate disclosure requirement of 11 U.S.C. § 1125(a), it may be necessary to make calculated predictions regarding future events and their impact on the reorganization plan. "Although it is guesswork, some prediction of future volume and profitability is probably necessary to persuade the court and the creditors of the basis upon which the plan is founded." 4 Cowans Bankruptcy Law and Practice § 20.17, at 73 (6th ed. 1994).Back To Text

[176] 77 B.R. 728 (Bankr. D.N.D. 1987).Back To Text

[177] Id. at 730.Back To Text

[178] Id. at 734.Back To Text

[179] Id. at 730.Back To Text

[180] Id. at 734.Back To Text

[181] Wandler, 77 B.R. at 734.Back To Text

[182] *See* supra notes 171−181 and accompanying text.Back To Text

[183] H.R. Rep. No. 595, supra note 4, at 6312; *see* In re Diez, 45 B.R. 137, 139 (Bankr. S.D. Fla. 1984). The court "may and should abstain from hearing the controversy where no bankruptcy purpose is served which would outweigh the importance of uniformity of assessment." Id.Back To Text

[184] Gary W. Carter, The Commissioner's Nonacquiescence: A Case for a National Court of Tax Appeals, 59 Temp. L.Q. 879, 891 & n.83 (1986) (citing *Hearings Before the House Committee on Ways and Means*, 68th Cong., 2d Sess. 869, 926 (1925); 67 Cong. Rec. 3749−50 (1926)).Back To Text

[185] U.S. Const. art. I, § 8 (establishing powers of legislative branch).Back To Text

[186] *See* Michael I. Saltzman, IRS Practice and Procedure ¶ 1.05[2][a] (2d ed. 1991). Actions can only be commenced in the U.S. District Court and the U.S. Claims Court in situations where the taxpayer has already *paid* the tax in question and is now seeking a refund. Id. In the Tax Court, the taxpayer seeks a redetermination of a tax not yet paid. Id. ¶ 1.05[2][b]. Almost 95% of tax litigation is initiated in the Tax Court. Id.Back To Text

[187] 54 T.C. 742 (1970), aff'd, 445 F.2d 985 (10th Cir.), cert. denied, 404 U.S. 940 (1971).Back To Text

[188] Id. at 757.Back To Text

[189] *See* Rev. Proc. 95−1, 1995−1 I.R.B. 9 (setting forth procedural guidelines for requesting ruling).Back To Text

[190] I.R.C. § 6110(j)(3) (1988).Back To Text

[191] Treas. Reg. § 601.201(a) (as amended in 1983); *see* Saltzman, supra note 186, ¶ 3.03[3]. The IRS will only rule on prospective transactions or transactions that are completed before the return is filed. Id. ¶ 3.03[3][a][ii]. The IRS will not issue a ruling on a hypothetical situation or on alternative plans for a proposed transaction. Id. ¶ 3.03[3][a][iv].Back To Text

[192] *See* Saltzman, supra note 186, ¶ 3.03[3][a], [c]. If time is of the essence in a transaction or it must be consummated before a certain date, the inherent delay in the ruling process may be unacceptable. Id.

¶ 3.03[3][b]. Under certain circumstances, however, the taxpayer can request expedited treatment. *See* Treas. Reg. § 601.201(e)(12). Expedited treatment will be granted only if the IRS believes there is a clear need for it. Id. Examples of what the IRS does *not* consider sufficient grounds for expedited treatment include the scheduling of a closing date for a transaction or the possible effect of fluctuation in the market price of stock. Rev. Proc. 95−1, § 8.02(4), 1995−1 I.R.B. 9.Back To Text

[193] 171 B.R. 603 (Bankr. S.D. Ohio 1994).Back To Text

[194] *See* Disclosure Statement and Third Amended Plan of Reorganization, *Federated Dep't Stores* (Consol. No. 1−90−00130).Back To Text

[195] Id. According to the Wall Street Journal, counsel for an unidentified party in the *Federated Dep't Stores* case stated, "[t]he tax treatment of this reorganization is crucial, and you want to know how the Internal Revenue Service is going to treat it." Jeffrey A. Tractenberg, *Campeau's Federated and Allied Stores Take Step Toward Leaving Chapter 11*, Wall St. J., Oct. 29, 1991, at A5. It was not known when any IRS letter would be received. Id.Back To Text

[196] *See* supra notes 54−110 and accompanying text.Back To Text

[197] Kilen, 129 B.R. at 538.Back To Text

[198] Id. at 546.Back To Text

[199] Id. at 550.Back To Text

[200] *See, e.g.*, Gwilliam v. United States (In re Gwilliam), 519 F.2d 407, 409 (9th Cir. 1975) (discussing "fresh start" policy).Back To Text

[201] *See* supra notes 186−188 and accompanying text.Back To Text

[202] *See* Bostwick v. United States, 521 F.2d 741, 744 (8th Cir. 1975) (stating that overriding policy of Bankruptcy Act is rehabilitation of debtor); In re Major Dynamics, Inc., 14 B.R. 969, 970 (Bankr. S.D. Cal. 1981) (same).Back To Text

[203] *See* R.P. Williams v. United States Fidelity & Guar. Co., 236 U.S. 549, 554−55 (1915) (discussing purpose "to relieve honest debtor from the weight of oppressing indebtedness, and permit him to start afresh free from the obligations and responsibilities consequent upon business misfortunes").Back To Text

[204] *See* In re Hunt, 95 B.R. 442, 448 (Bankr. N.D. Tex. 1989) (indicating that court will defer to tax court if good reasons are present).Back To Text

[205] Id. at 445.Back To Text

[206] Id. Back To Text

[207] Id. Back To Text

[208] Id.Back To Text

[209] Hunt, 95 B.R. at 448. Appeals of bankruptcy court decisions go to the United States District Court, and then, if necessary, the United States Court of Appeals. Id.; *see also* 28 U.S.C. § 158(a), (d) (1988 & Supp. V 1993), *as amended by* Bankruptcy Reform Act, 28 U.S.C.A. § 158 (West Supp. 1995). In contrast, appeals from the Tax Court go directly to the United States Court of Appeals. Hunt, 95 B.R. at 448; *see also* I.R.C. § 7482(a)(1) (1988).Back To Text

[210] Hunt, 95 B.R. at 445.Back To Text

[211] Id. Back To Text

[212] *See* 11 U.S.C. § 1146(d) (1994).Back To Text

[213] *See* Saltzman, supra note 186, ¶ 3.04[3][g][i].Back To Text

[214] *See* 28 U.S.C. § 2201 (1988 & Supp. V 1993).Back To Text

[215] *See* 11 U.S.C. § 505(a)(1) (1994).Back To Text

[216] *See* id. § 1146(d).Back To Text

[217] Id.Back To Text

[218] *See, e.g.*, Ferman v. United States, 790 F. Supp. 656, 661 (D. La. 1992) (stating that IRS's pronouncements regarding application of tax laws deserve deference), aff'd, 933 F.2d 485 (5th Cir. 1993), cert. denied, 114 S. Ct. 2704 (1994); Hill v. United States, 720 F. Supp. 95, 99 (W.D. Mich. 1989) (stating IRS tax law interpretations entitled to deference).Back To Text

[219] *See* MDFC Equip. Leasing Corp. v. Robbins (In re Interstate Motor Freight Sys.) 62 B.R. 805, 809 (Bankr. W.D. Mich. 1986) (stating that without recourse to legislative history, § 505 appears to make bankruptcy courts second tax court system).Back To Text