No. 11-60065

In the United States Court of Appeals for the Ninth Circuit

IN RE: WILSHIRE COURTYARD,
Debtor.

WILSHIRE COURTYARD; JEROME H. SNYDER GROUP I, LTD.; LEWIS P. GEYSER REVOCABLE TRUST; GEYSER CHILDREN'S TRUST, FBO JENNIFER GEYSER, LEWIS P. GEYSER, TRUSTEE; WENDY K. SNYDER; JEROME H. SNYDER; GEYSER CHILDREN'S TRUST, FBO DANIEL GEYSER, LEWIS P. GEYSER, TRUSTEE; RUSSELL & RUTH KUBOVEC, DECEASED, KUBOVEC FAMILY TRUST, RITA FARMER, TRUSTEE; WILLIAM N. SNYDER; JOAN SNYDER; GEYSER CHILDREN'S TRUST, FBO DOUGLAS GEYSER, LEWIS P. GEYSER, TRUSTEE; LON J. SNYDER; SNYDER CHILDREN'S TRUST, FBO WILLIAM N. SNYDER, LEWIS P. GEYSER, TRUSTEE,
Appellants,

v.

CALIFORNIA FRANCHISE TAX BOARD,
Appellee.

On Appeal from the United States Bankruptcy Appellate Panel for the United States Court of Appeals for the Ninth Circuit

OPENING BRIEF FOR APPELLANTS WILSHIRE COURTYARD ET AL.

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INTRODUCTION

This case involves a dispute between the California Franchise Tax Board and a partnership about the tax effects of a transaction consummated in 1998 as part of a bankruptcy reorganization plan. That transaction involved a substantial discharge of debt. Under controlling provisions of federal law—specifically, provisions of the *Bankruptcy Code*—that discharged debt cannot be taxed by any state or local government. 11 U.S.C. 346(a), (j)(1), 1146(d) (2000 ed.). But, according to California, that discharged debt (for purposes of California law, and contrary to federal law) should be characterized as a capital gain and thus subject to California taxes. In the decision below, the Bankruptcy Appellate Panel (BAP), reversing the bankruptcy court, held there was no jurisdiction, under 28 U.S.C. 1334(b), for a bankruptcy court to adjudicate a dispute over the effect of federal bankruptcy law on taxation of this core bankruptcy transaction. That decision was incorrect and should be reversed.

In initiating these proceedings, the partnership invoked the bankruptcy court's jurisdiction to apply the operative sections of the Bankruptcy Code that govern this case: under 11 U.S.C. 346 (2000 ed.), Congress declared that the "forgiveness or discharge" of debt in a bankruptcy shall not be subject to state taxes, and any contrary state law is preempted. In a companion section of Title 11, Congress expressly authorized bankruptcy courts to "declare" the "tax effects, under

Section 346," of any Chapter 11 transaction, and provided that this declaration (in an actual controversy) would bind the States. 11 U.S.C. 1146(d) (2000 ed.).[1]

In the decision below, however, the BAP held that bankruptcy courts, post-confirmation, lack jurisdiction to determine the tax consequences of Chapter 11 transactions. The BAP acknowledged that an action to enforce a right "arise[s] under title 11" for purposes of 28 U.S.C. 1334(b)—and therefore is within the jurisdiction of the bankruptcy court "when a right to relief is created by title 11." But the panel's decision then refused to acknowledge Section 346 in any way: as the BAP saw it, this entire dispute was exclusively a matter of "state tax law, not the bankruptcy code"—and state courts could always adjudicate the tax consequences arising from these federal proceedings. Indeed, according to the BAP, "[n]o provision of the bankruptcy code dealing with state tax consequences" was even "*at issue*."

The proper resolution of this appeal is thus apparent from the BAP's own framing of the case: if the Bankruptcy Code provides the rule of decision for the

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[1] Both 11 U.S.C. 346 and 11 U.S.C. 1146 were amended in 2005 by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, 119 Stat. 23, 131, 133. All citations in this brief are to the versions in effect in 1997 (the versions in the 2000 edition of the United States Code). It is undisputed that the version of Section 346 in effect in 1997 applies to this case. As for Section 1146, there is no need to decide which version of the statute applies to this case: Section 1146(b) (2006 ed.), which is in effect today, is the same as Section 1146(d) (2000 ed.), which was in effect in 1997.

state tax treatment of the plan transactions, then the federal courts are unquestionably vested with jurisdiction to resolve the dispute. Where the BAP went wrong, however, was its perplexing failure to recognize the very Code section that was the focus of the initial complaint, the centerpiece of the bankruptcy court's opinion, and the core of the dispute presented to the BAP itself: Section 346 provides that the discharge of debt during a bankruptcy constitutes non-taxable income for all purposes—and that any state tax law to the contrary is preempted. This means that California is powerless to invoke state law to impose a tax on the discharge of debt during a bankruptcy, and Congress ensured that the bankruptcy court would have jurisdiction to make that determination and enforce its preemptive effect.

In holding otherwise, the BAP's opinion read a core statutory section straight out of the Code. It refused to recognize the proper sweep of a preemptive federal law. It frustrated Congress's objectives in securing uniform and predictable tax treatment for debtors (and those bound up with debtors) and their estates—and hence also frustrated Congress's efforts to ensure a uniform and fair disposition of assets in bankruptcy. It also neglected a directly related provision (Section 1146), which clearly reflects Congress's intent to have bankruptcy courts decide precisely the issues they were asked to decide here.

Because this proceeding asks the bankruptcy court to decide the effects of a provision of the Bankruptcy Code, it plainly "arises under" Title 11, and at a minimum is "related to" a bankruptcy proceeding. The contrary holding below should be reversed.

JURISDICTIONAL STATEMENT

1. Pursuant to 28 U.S.C. 158(b), the BAP had jurisdiction to review the bankruptcy court's final judgment. The BAP concluded, wrongly, that the bankruptcy court lacked subject-matter jurisdiction over this proceeding; as explained below, the bankruptcy court's jurisdiction was in fact properly invoked under 28 U.S.C. 1334(b). This Court now has jurisdiction under 28 U.S.C. 158(d).

2. The notice of appeal was timely filed on September 28, 2011, after entry of the BAP's judgment on September 19, 2011.

STATEMENT OF THE ISSUES

At the time this bankruptcy case originally commenced, 11 U.S.C. 346 expressly preempted any state law purporting to tax, as income, the cancellation of debt in a Chapter 11 proceeding: "notwithstanding any State or local law imposing a tax," "income is not realized by the estate, the debtor, or a successor to the debtor by reason of forgiveness or discharge of indebtedness in a case under this title." 11 U.S.C. 346(a), (j)(1). Congress also explicitly authorized bankruptcy courts to "declare" the "tax effects, under Section 346," of any Chapter 11 transaction, and made that declaration binding on state taxing authorities in an actual controversy. 11 U.S.C. 1146(d).

The questions presented are as follows:

1. a. Whether the BAP was correct that this proceeding did not "arise under title 11," for purposes of 28 U.S.C. 1334, because "[n]o provision of the bankruptcy code dealing with state tax consequences is at issue" (E.R. 14)—even though the entire dispute turns on two sections of the Bankruptcy Code (Sections 346 and 1146), and those two sections directly govern the state tax treatment of consummated transactions under the reorganization plan.

b. Whether, at a minimum, such a proceeding "relate[s] to" the bankruptcy case (28 U.S.C. 1334(b)), because (i) the "statutorily defined tax effects of a bankruptcy plan are unquestionably 'related to' the bankruptcy case in which that plan is filed," *Maryland* v. *Antonelli Creditors' Liquidating Trust*, 123 F.3d 777, 784 (4th Cir. 1997); and (ii) the State's efforts to tax this transaction as a "sale" (and *not* discharged debt) are impossible to square with the bankruptcy court's determination that the transaction involved discharged debt (and *not* a "sale").

2. Whether the non-debtor general partners of the debtor partnership could invoke the bankruptcy court's jurisdiction because (i) the *partners'* interests are wholly derivative of the *partnership's* interests; and (ii) it is thus impossible to tax the partners without recharacterizing plan transactions at the partnership level—and to do so in a way that ignores Section 346 and flouts Congress's express preemption of conflicting state law.

RELEVANT STATUTORY PROVISIONS

Section 1334 of Title 28, United States Code, vests the federal courts with jurisdiction to adjudicate disputes involving bankruptcy cases, and provides in relevant part:

> (b) * * * [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.

The operative 1997 version of Section 346 of Title 11, United States Code, set forth the federally defined tax effects of the bankruptcy transactions at issue here, and provides in relevant part:

> (a) [S]ubsection[] * * * (j) of this section appl[ies] notwithstanding any State or local law imposing a tax * * * .
>
> (j)(1) [I]ncome is not realized by the estate, the debtor, or a successor to the debtor by reason of forgiveness or discharge of indebtedness in a case under this title.

Section 1146 of Title 11, United States Code, as in effect in 1997 (see note 1, *supra*), authorizes bankruptcy courts to declare the tax effects of plan transactions, and provides in relevant part:

> (d) 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 subjection; or
>
> (2) 270 days after such request.

STATEMENT OF THE CASE

On May 27, 2009, Wilshire filed an ex parte motion to reopen the bankruptcy proceedings in order (i) to hold the California Franchise Tax Board in contempt for violating 11 U.S.C. 346 and the bankruptcy court's confirmation order; and (ii) to determine, as necessary, "the tax effects of the confirmed Plan" under 11 U.S.C. 1146. E.R. 93-96. The court granted the motion to reopen on June 4, 2009 (E.R. 54), and subsequently issued an order on August 12, 2009, to show cause why the state agency should not be held in contempt (E.R. 52).

After the Wilshire parties were added to the proceeding (at California's prompting, the court's encouragement, and the partners' acquiescence, see E.R. 50, 67-70), Wilshire moved for summary judgment (BAP E.R. 173).[2] After full briefing, the bankruptcy court determined that it had jurisdiction to decide the dispute, and that the State was improperly seeking to recharacterize the plan transactions. E.R. 47-48. At the same time, the court ordered further briefing on whether the Wilshire partners (as opposed to the Wilshire partnership) were entitled to any relief. E.R. 49.

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[2] "BAP E.R." refers to the excerpts of record filed with the Bankruptcy Appellate Panel in the proceedings below.

After that issue was fully briefed, the court held a hearing (BAP E.R. 1448) and determined that the taxing authorities should be held in contempt, ordering them to cease and desist any efforts to collect state taxes preempted by federal law (BAP E.R. 1478-1479). The California Franchise Tax Board then filed a notice of appeal. E.R. 62-63.

The bankruptcy court thereafter issued an opinion. E.R. 40-46. The court determined that, under 11 U.S.C. 346, California had no power to tax discharged debt under the plan transactions. E.R. 42, 44-45. It accordingly ordered California to "cease its efforts to collect taxes." E.R. 46. The court, however, refused to hold California in contempt at that time. E.R. 45.

Following this opinion—and the reassignment of the case following retirement of the initial judge (Bufford, J.)—the bankruptcy court (per Zurzolo, J.) issued a final order granting summary judgment. E.R. 37-39. That order required the California Franchise Tax Board to vacate its assessments against the Wilshire partners, and otherwise reaffirmed the holdings in the earlier opinion on summary judgment. See *ibid.*

California then filed another notice of appeal to the BAP. E.R. 59-61. The BAP issued an opinion and judgment reversing the bankruptcy court's judgment on the ground that the bankruptcy court lacked jurisdiction under 28 U.S.C. 1334(b). E.R. 1. Wilshire filed a timely notice of appeal to this Court.

STATEMENT OF FACTS

1. a. A central component of any ordinary Chapter 11 bankruptcy reorganization is the discharge or forgiveness of indebtedness. Congress provided an express, and exclusive, federal rule for the tax consequences of such discharged debt: "income is not realized by the estate, the debtor, or a successor to the debtor by reason of forgiveness or discharge of indebtedness in a case under this title." 11 U.S.C. 346(j)(1). To avoid state or local interference with this federal command, Congress also expressly preempted conflicting state and local laws in this area: "subsection[] * * * (j) of this section appl[ies] notwithstanding any State or local law imposing a tax." 11 U.S.C. 346(a).

Congress authorized federal courts (including federal bankruptcy courts) to adjudicate "actual controvers[ies]" between plan proponents and state or local taxing authorities over the consequences of plan transactions: "[i]n the event of an actual controversy, the court may declare" the "tax effects, under section 346 of this title and under the law imposing such tax, of the plan." 11 U.S.C. 1146(d); see also 11 U.S.C. 106(a)(1) ("sovereign immunity is abrogated as to a governmental unit to the extent set forth in this section with respect to * * * Sections 346[and] 1146").

Congress specifically confirmed in the Bankruptcy Code that the same taxing rules applicable elsewhere also apply in the case of a partnership reorganization: "The commencement of a case under this title concerning a corporation or a *partnership* does not effect a change in the status of such corporation or *partnership* for the purposes of any State or local law imposing a tax on or measured by income." 11 U.S.C. 346(c)(1) (emphases added). Congress further ensured a uniform and coherent disposition of a partnership's estate by binding up the partners' interests with those of the partnership: "the provisions of a confirmed plan bind * * * any * * * general partner in the debtor, whether or not the claim or interest of such * * * general partner is impaired under the plan and whether or not such * * * general partner has accepted the plan." 11 U.S.C. 1141(a).

b. Congress accompanied the Bankruptcy Code's substantive and procedural provisions with a broad jurisdictional grant: "the 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." 28 U.S.C. 1334(b). The district courts, in turn, "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). And those bankruptcy 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, referred under subsection (a) of this section, and may enter appropriate orders and judgments." 28 U.S.C. 157(b).

Congress also authorized bankruptcy courts to reopen cases after an estate is otherwise administered and the case closed: "A case may be reopened in the court in which such case was closed to administer assets, to *accord relief to the debtor*, or *for other cause*." 11 U.S.C. 350(b) (emphases added).

2. This case arises out of a Chapter 11 bankruptcy involving the substantial reorganization of a general partnership holding two commercial buildings in the mid-Wilshire area of Los Angeles. There were two liens on this property for approximately $350 million. E.R. 95. Wilshire defaulted on the first lien in July 1996, and the lien holder scheduled a foreclosure sale in July 1997. *Ibid.*

Wilshire responded by entering Chapter 11 bankruptcy. At the time of the bankruptcy, the property was valued at only $123 million. E.R. 94, 115. Wilshire negotiated a joint plan with the first lender and its general partners. E.R. 159. As part of that plan, the second lien—worth approximately $220 million—would be extinguished entirely in exchange for $2.5 million; the remainder of the indebtedness would be discharged. E.R. 78, 95, 133, 174, 219. The first lien would be satisfied by reorganizing Wilshire from a general partnership into a Delaware limited-liability company. E.R. 95. The first lien holder would contribute $23 million to the new Wilshire and assume 99% ownership of the entity; that capital contribution would be used to secure a new loan of $100 million, which would be used to satisfy part of the first loan (with the $40 million remainder of the first lien indebtedness discharged); and the Wilshire partners would retain the remaining 1% ownership (in addition to receiving $3.5 million in cash and a $450,000 loan). E.R. 95, 174-175, 220-221.

The authority for the Joint Plan—according to the plan itself—was premised entirely on restructuring the debtor's ownership interests and preexisting indebtedness; the plan did *not* invoke the authority under the Code for selling any part of the estate or the debtor's assets. E.R. 138, 140, 220-221, 227-228. And, in confirming the reorganization plan, the court specifically held that the reorganization did not constitute the liquidation of all or a substantial part of the estate. E.R. 117. According to the express language of both the plan and the confirmation order, the bankruptcy reorganization resulted in the substantial discharge of debt, and both documents also recognized that the transactions did not constitute a sale. E.R. 150, 180, 194, 227-228; see also 38-39.

Although the California taxing authorities received notice of the bankruptcy filing at the outset (E.R. 239-240), and notice of the entry of the confirmation order (E.R. 107-108), they did not object at any point while the bankruptcy was pending or after the plan's conditions were satisfied and the case dismissed.

3. a. Years later, the California Franchise Tax Board audited the Wilshire partnership and attempted to tax the plan transactions. E.R. 95-96. According to the California taxing authorities, the legal determinations in the plan itself, and the

order authorizing that plan, were incorrect: the reorganization, under California law, did not involve any discharged debt, but instead constituted a *disguised sale*. E.R. 40. Because such a sale (as a matter of California law) gave rise to income, it was subject to California tax as a capital gain. E.R. 6. And, even if the income was not "realized" at the partnership level, the State asserted that it was still "realized" at the partner level. E.R. 44-45. The state taxing authorities accordingly assessed taxes on the Wilshire partners of approximately $13 million. E.R. 6.

b. In response, Wilshire moved to reopen the bankruptcy proceedings. E.R. 93. It filed a motion seeking to hold the California taxing authorities in contempt for violating Section 346 and taking positions incompatible with the legal conclusions in the reorganization plan and the confirmation order. E.R. 88-92. Wilshire also sought a determination, as necessary, under Section 1146 for the bankruptcy court to "declare" the "tax effects" of the plan transactions. E.R. 91, 96; see also BAP E.R. 70-71.

4. a. After rounds of briefing and multiple hearings, the bankruptcy court ultimately issued an opinion concluding that California's efforts were preempted by Section 346 and fundamentally incompatible with the plan transactions. E.R. 40-46.

The court first concluded that it had jurisdiction, post-confirmation, over the partnership because "the determination whether FTB's actions violate the confirmation order involves the interpretation of the confirmed plan." E.R. 41; see also *ibid.* ("this court retains subject matter jurisdiction to interpret and enforce the chapter 11 plan and the confirmation order"). The court also concluded that it had jurisdiction over the "non-debtor partners" because "this case involves income tax attributes at the individual partner level that derive directly from the plan confirmation order"—"to make a determination with respect to the income of non-debtor partners, the court must first determine the nature of income at the partnership level." E.R. 41-42.

The bankruptcy court next rejected California's various efforts to evade the consequences of the completed bankruptcy: (i) California had the constitutionally required notice of the bankruptcy proceeding, because "[i]t is uncontested that FTB was served with both a case commencement notice and a notice of entry of the confirmation order" (E.R. 41); (ii) California is not a "post-confirmation creditor," for purposes of its taxing efforts, because "FTB's claim clearly arises from the plan itself, and does not qualify as a post-confirmation claim"—"the plan itself resulted in the ultimate transfer of partnership interests to the LLC, and the confirmation order specified that the transaction was not a sale of all or substantially all of the debtor's estate (which would trigger tax consequences)" (E.R. 43); and (iii) any tardy attempt to revoke the confirmation order now is barred—"[b]ecause FTB is bound by the plan, it is also bound by [11 U.S.C.] 1144, which allows for revocation of an order of confirmation only '[o]n request of a party in interest at any time before 180 days after the date of the entry of the order of confirmation'" (E.R. 44).

The bankruptcy court accordingly addressed the "tax effects" of the Bankruptcy Code on the plan transactions, and held that California's law was preempted. Specifically, the court held that "[p]ursuant to § 346(a), § 346(j)(1) applied to [cancellation-of-debt income] for state tax purposes" (E.R. 44); accordingly, "[p]ursuant to the plan and consistent with § 346, debtor received [cancellation-of-debt income] but did not realize the [cancellation-of-debt income] as income" (E.R. 44). Because California's position would impermissibly "change" discharged debt "into capital gain"—and thereby "alter debtor's characterization of the Plan Transactions that was adopted in the plan confirmation order"—it was precluded by federal law. *Ibid.*

Nevertheless, the court concluded that "contempt is not the appropriate remedy at this time," because there was "no court order" specifically "mandating that [California] do anything." E.R. 45. It instead declared that California's "attempt to recharacterize the [discharged debt] as a disguised sale at either the debtor-partnership or individual partner level constitutes an improper collateral attack upon the confirmation order." E.R. 45-46. It therefore "ordered" California to "cease its efforts to collect taxes from debtor or the partners on the claim that the Plan Transactions constituted a sale." E.R. 46.

b. The corresponding order on summary judgment underscored these determinations. That order reaffirmed the bankruptcy court's jurisdiction to "interpret" the plan and the confirmation order, "as well as to determine the applicability of 11 U.S.C. § 346(a) and (j) (1997) to the transaction implemented pursuant to the Plan." E.R. 38. It declared, as a matter of law, that "the transaction implemented under the Plan is not a sale or exchange for any purpose" (*ibid.*), and that the second lien "in the amount of approximately $221,000,000 * * * is released and discharged solely in exchange for the payment of $2,500,000" (E.R. 38-39). The court accordingly concluded that "the FTB's assessments * * * constitute an impermissible collateral attack on the Confirmation Order and Plan," and that California "shall vacate the assessments." E.R. 39.

5. The BAP reversed. E.R. 1-35. Focusing exclusively on jurisdiction, the BAP held that no provision of any federal statute authorized the bankruptcy court to exercise its power to adjudicate this dispute. The BAP repeatedly and exhaustively discussed a variety of potential bases for jurisdiction, yet never confronted what this case is actually about: Section 346 and Section 1146. In fact, the BAP failed even to *mention* those sections at every turn of its analysis, even though

those sections were the driving force of the decision below and the focus of the parties' presentations.

The BAP began by holding that "arising under" jurisdiction was lacking because "[n]o provision of the bankruptcy code dealing with state tax consequences is at issue." E.R. 14. According to the BAP, "this contest is at bottom a tax dispute between the Wilshire Partners and CFTB arising under California state tax law, not the bankruptcy code." E.R. 15-16. In declaring that this dispute was "not [under] the bankruptcy code," the BAP made no mention of Section 346 or Section 1146.

The BAP likewise rejected the contention that this dispute required the bankruptcy court "to interpret and enforce" the plan provisions, a factor that the BAP otherwise acknowledged would give rise to jurisdiction. E.R. 15 n.11. The BAP declared that the reorganization plan here "makes no mention * * * of the state tax consequences to the Wilshire Partners of confirmation of that plan." *Ibid.* In so concluding, the BAP did not confront Section 346 or explain the self-executing character of that section—which not only "mentions," but *dictates*, the "state tax consequences" of the plan transactions.

The BAP also refused to invoke "related to" jurisdiction for similar reasons. E.R. 18. Because the BAP saw nothing in the Code dictating the tax effects of plan transactions, it also saw nothing in this dispute that could affect "the implementation of the plan." E.R. 19. "[T]he central issues in the Wilshire Partners-CFTB dispute," as the BAP understood it, "concern application of California's tax laws, *not bankruptcy law*, to the transactions effected by the confirmed plan." E.R. 26 (emphasis added). The BAP once again reached this conclusion without citing or addressing Section 346 or Section 1146.

Finally, the BAP held that supplemental or ancillary jurisdiction was inappropriate because that power "should only be used 'when necessary to resolve bankruptcy issues, not to adjudicate state law claims that can be adjudicated in state court.'" E.R. 29 (quoting *In re Ray*, 624 F.3d 1124, 1136 (9th Cir. 2010)). The BAP did not hold, however, that Section 346 (which again went unaddressed) was not a "bankruptcy issue[]," or explain how the specific procedure articulated in Section 1146—permitting *federal* courts to declare the "tax effects" of plan transactions—might be administered in state court.

Because the BAP determined that the bankruptcy court lacked jurisdiction, it vacated the orders below and remanded with instructions to dismiss. E.R. 35.

6. This appeal followed.

SUMMARY OF ARGUMENT

This is a simple appeal with a straightforward answer: because this dispute turns on the application of the Bankruptcy Code to core transactions in Wilshire's reorganization plan, the BAP erred in holding that the bankruptcy court lacked jurisdiction.

1. a. Section 346 says that the discharge of debt during bankruptcy is not subject to state income tax, and any state law to the contrary is preempted. This dispute arises directly under that section of the Bankruptcy Code. Had the BAP even acknowledged that section, it would have concluded that the bankruptcy court was right to exercise jurisdiction. But the BAP, inexplicably, ignored Section 346 in its entirety. It correctly recognized that jurisdiction would exist if a "provision of the bankruptcy code" was at issue, but concluded—without mentioning, much less explaining, Section 346—that this was exclusively a matter of "state tax law, not the bankruptcy code." E.R. 14, 15-16. By posing the right question but supplying the wrong answer, the BAP effectively wrote Section 346 straight out of the books. Its decision should be reversed on that ground alone.

b. But its errors continued in multiple other respects. The BAP also failed to acknowledge Section 1146 and its specific authorization for bankruptcy courts to "declare" the "tax effects" of plan transactions under Section 346. Section 1146 thus emphatically confirms Congress's intent to empower bankruptcy courts to make precisely the kind of determination that the bankruptcy court made in this case. The BAP cannot possibly be correct that Congress conferred a power in Section 1146 to bankruptcy judges but not the jurisdiction for them to exercise it.

2. Even if "arising under" jurisdiction were somehow lacking, "relates to" jurisdiction would fill the void. Congress sweepingly authorized bankruptcy courts to adjudicate any dispute with a "close nexus" to a bankruptcy plan, and the requisite connection is present whenever the dispute requires the interpretation, enforcement, implementation, or administration of the plan.

a. Here, there is little doubt that the "statutorily defined tax effects" of the plan, under Section 346, are related to the bankruptcy case. Section 346 is self-executing—it applies automatically to each and every plan the instant the plan arises, whether or not that provision is explicitly referenced anywhere in the plan documents. There was no need for the parties or the court to reiterate what Congress already declared directly in the Code: any cancellation of debt is not subject to any state tax based on income, and any contrary state law is preempted. The plan thus not only provided for the discharge of debt, but also preempted state efforts to tax that discharge. Because California's belated efforts to unwind this mandated feature of the plan directly frustrate the correct enforcement and execution of the plan transactions, the bankruptcy court had the power to adjudicate the issue.

b. Besides being incompatible with Section 346, California's position is also incompatible with the legal conclusions found in Wilshire's plan and the judicial order confirming it. Whether California believes the transactions in question gave rise to a sale is irrelevant: the plan itself, and the confirmation order, emphatically reject that characterization. That legal determination is binding, and California's efforts could succeed only if those determinations were properly set aside. Because California did not pursue relief before the appropriate deadlines had passed, however, it is now bound by the language in the plan. The bankruptcy court plainly had jurisdiction to police this collateral attack on the central document in the bankruptcy.

3. California cannot evade this result, or shield its actions from federal review, by ignoring the partnership and pursuing the partners. Because the partners' interests are wholly derivative of the partnership's interests, they cannot gain anything more or less than what the partnership gained. The tax effects of any plan transactions apply to each equally. California accordingly would have to redefine the partnership's discharged debt—and say that income that "is *not* realized" (under Section 346) suddenly became income that "*is* realized" (notwithstanding Section 346)—in order to impose a tax on the partners. But California cannot convert non-taxable income into taxable income without flouting governing federal bankruptcy law. Under the Code, the partners accept the burdens of the reorganization plan and they receive the benefits of the reorganization plan. They accordingly are entitled to invoke the bankruptcy court's protection in enforcing Sections 346 and 1146 in this case.

STANDARD OF REVIEW

This Court reviews *de novo* whether the bankruptcy court had subject-matter jurisdiction over this post-confirmation dispute. See, *e.g.*, *In re Ray*, 624 F.3d 1124, 1130 (9th Cir. 2010); *In re Harris*, 590 F.3d 730, 736 (9th Cir. 2009).

ARGUMENT

Under 28 U.S.C. 1334(b), Congress granted federal courts jurisdiction to decide "all civil proceedings arising under title 11, or arising in or related to cases under title 11." That sweeping grant of power was "meant, not to distinguish between different matters, but to identify collectively a broad range of matters subject to the bankruptcy jurisdiction of federal courts." *In re Wood*, 825 F.2d 90, 92 (5th Cir. 1987). Section 1334(b)'s "references operate conjunctively to define the scope of jurisdiction." *In re Wolverine Radio Co.*, 930 F.2d 1132, 1141 (6th Cir. 1991). Because the parties' request to apply and enforce Section 346 (via Section 1146) clearly "arises under" the Bankruptcy Code, and at the very least "relates to" the bankruptcy case, the BAP's decision should be reversed.

I. THE BANKRUPTCY COURT HAD JURISDICTION TO DECLARE THE "TAX EFFECTS" OF WILSHIRE'S REORGANIZATION PLAN UNDER TWO SECTIONS OF THE BANKRUPTCY CODE, 11 U.S.C. 346 AND 11 U.S.C. 1146

A. Because This Proceeding "Arises Under" The Bankruptcy Code, The Bankruptcy Court Had Jurisdiction Under Section 1334

1. a. Federal courts have jurisdiction over any "civil proceeding[] arising under title 11." 28 U.S.C. 1334(b). All sides agree that Congress used that phrase "'to describe those proceedings that involve a cause of action *created or determined* by a statutory provision'" in the Bankruptcy Code. *In re Harris Pine Mills*, 44 F.3d 1431, 1435 (9th Cir. 1995) (quoting *In re Wood*, 825 F.2d at 96) (emphasis added); see also *In re Harris*, 590 F.3d at 737; *Haw. Airlines, Inc.* v. *Mesa Air Group, Inc.*, 355 B.R. 214, 217 (D. Haw. 2006) ("A case 'arising under title 11' means essentially the cause of action is created by title 11 or that the right to relief *necessarily depends upon resolution of a substantial question of bankruptcy law*.") (internal quotation marks omitted) (emphasis added). That controlling standard was satisfied here.

The dispute below is directly "determined" by 11 U.S.C. 346. That section is entitled "**Special tax provisions.**" It begins by stating its own primacy over state law:

> (a) Except to the extent otherwise provided in this section, [specified] subsections * * * [including] (j) of this section apply notwithstanding any State or local law imposing a tax * * * .

It continues by, among other things, stating a precise, preemptive, federal rule for the state-tax treatment of forgiveness or discharge of indebtedness in a bankruptcy case:

> (j)(1) [I]ncome is *not* realized by the estate, the debtor, or a successor to the debtor *by reason of forgiveness or discharge of indebtedness in a case under this title*. [Emphasis added.]

This case is about the state-tax treatment of forgiveness of indebtedness in a bankruptcy case. Congress could not have spoken any more plainly in subsection (a) in making such tax treatment a concern of federal law to the exclusion of state law. And Congress could not have spoken any more plainly in subsection (j)(1) in stating that the very thing the California Franchise Tax Board wants to do as a matter of state law—force the realization of income by the debtor by reason of forgiveness of indebtedness in a bankruptcy case—is precluded by federal law, specifically the Bankruptcy Code. Thus, contrary to the BAP's conclusion, a provision of the Bankruptcy Code is very much at issue—it states dispositively that the California Franchise Tax Board *may not* do what it is attempting to do.

This statutory mandate applies automatically to any debt forgiven in a bankruptcy, and it displaces any state law that stands in the way. 11 U.S.C. 346(a); see also, *e.g.*, *Perez* v. *Campbell*, 402 U.S. 637, 638, 652 (1971) (the Bankruptcy Code may preempt conflicting state law). Notwithstanding this federal mandate, California's taxing authorities have elected to invoke their own administrative process in an attempt to unwind the final consequences of the Wilshire bankruptcy that concluded years earlier. The state authorities can succeed in those efforts—imposing a tax on forgiven debt—only by the wholesale disregard of federal bankruptcy law that assigns exactly the opposite tax effects to the core transactions in Wilshire's reorganization plan. Because this dispute is thus "determined" by 11 U.S.C. 346, it plainly arises under Title 11 for purposes of Section 1334.

b. The BAP held otherwise *not* because it disagreed with the applicable jurisdictional standard, and *not* because it construed Section 346 to mean something other than what it plainly says, but instead because it declared, inexplicably, that "no provision of the bankruptcy code" is at issue. E.R. 14. Only by ignoring Section 346 could the BAP proceed to make such statements as "this contest is at bottom a tax dispute * * * arising under California state tax law" (E.R. 15) and "the central issues in the Wilshire Partners-CFTB dispute concern application of California's tax laws, not bankruptcy law, to the transactions effected by the confirmed plan" (E.R. 26).

This is puzzling on multiple levels. For one, it simply cannot be squared with Section 346—which unquestionably *is* a "provision of the bankruptcy code," and unquestionably *was* at issue below. Indeed, that "'statutory provision of title 11,'" *In re Harris Pine Mills*, 44 F.3d at 1435, was the focus of the motion to reopen (E.R. 96), the centerpiece of the bankruptcy court's opinion (E.R. 44-46), and the central dispute presented to BAP itself (see, *e.g.*, FTB Opening Br., Dkt. 16, at vii (table of authorities listing Section 346(j)(1) as "*passim*")). Section 346 also undergirded Wilshire's explicit request, in its motion to reopen, for a "determination under [11 U.S.C.] 1146([d]) regarding the tax effects of the confirmed Plan." E.R. 96; see also 11 U.S.C. 1146(d) (authorizing the court to declare "the tax effects, *under section 346 of this title* and under the law imposing such tax, of the [bankruptcy] plan") (emphasis added). It is impossible to understand how Section 346 was therefore *not* at issue when Section 1146 (a vehicle for adjudicating claims under Section 346) was specifically invoked in Wilshire's operative pleading as an independent way of securing relief.

Moreover, the BAP's conclusion—that this is "at bottom a tax dispute * * * under California state tax law, not the bankruptcy code" (E.R. 15-16)— mischaracterizes this proceeding as simply another pedestrian disagreement over state taxes. The state tax sought here targets the forgiveness of debt that constituted the core of the reorganization plan. This was not some random transaction, involving the debtor, that just happened to take place (fortuitously) while the bankruptcy was pending. On the contrary, the feasibility of any reorganization in this case—which is the entire point of Chapter 11 proceedings—was contingent on the cancellation of debt. And, when Congress spoke to the very tax issue in this dispute, it provided an answer, *explicitly in the Bankruptcy Code*, that forbade state efforts to tax "income * * * by reason of forgiveness or discharge of indebtedness." 11 U.S.C. 346(j)(1). Because that section is self-executing, see *Maryland* v. *Antonelli Creditors' Liquidating Trust*, 123 F.3d 777, 781 (4th Cir. 1997), it automatically becomes part and parcel of any order discharging debt—if the debt is discharged, Section 346 says the discharged debt cannot be taxed. When a dispute centers on efforts to tax that debt, as it does here, the Bankruptcy Code is thus implicated to the same extent as if the State tried to reinstate the discharged debt itself. Cf. *Perez* 402 U.S. at 650-651. It blinks reality to say that these core bankruptcy issues, governed by sections of the Bankruptcy Code, somehow fail to "arise under" Title 11 for purposes of Section 1334.

c. There is, in short, a reason that Congress created bankruptcy *courts* and not simply a bankruptcy *code*. Federal jurisdiction is at times necessary to safeguard a debtor's rights and to protect the bankruptcy process from undue interference from state courts in 50 different jurisdictions, all seeking to apply state law to inherently federal transactions. Cf. *In re T.H. Orlando Ltd.*, 391 F.3d 1287, 1292 (11th Cir. 2004) (Alarcon, J.) ("If bankruptcy courts were divested of jurisdiction in any case in which a state sought to impose a stamp tax or similar tax on a non-debtor, states could circumvent the exemption provided under § 1146(c) by shifting the tax burden entirely to third parties even in those transactions involving the debtor."). In the event a State attempts to declare the critically important tax consequences of bankruptcy transactions in a way that conflicts with federal law, Congress ensured that bankruptcy courts would have the power to decide any issues arising under the Code. Cf., *e.g.*, *In re Franklin*, 802 F.2d 324, 326 (9th Cir. 1986) ("bankruptcy courts must retain jurisdiction to construe their own orders if they are to be capable of monitoring whether those orders are ultimately executed in the intended manner"; "[r]equests for bankruptcy courts to construe their own orders must be considered to arise under title 11 if the policies underlying the Code are to be effectively implemented").

Because Wilshire had properly invoked its right *not* to have a State treat debt discharged in bankruptcy as realized income for tax purposes—and that right is created expressly by Title 11—this dispute falls squarely within the federal court's "arising under" jurisdiction. *In re Harris*, 590 F.3d at 737; see also, *e.g.*, *In re T.H. Orlando Ltd.*, 391 F.3d at 1292 ("The adjudication of substantive entitlements created by bankruptcy law falls squarely within the core jurisdiction of bankruptcy courts."); *In re Housecraft Indus. USA, Inc.*, 310 F.3d 64, 70 (2d Cir. 2002) (identifying "arising under" jurisdiction where claims "invoke substantive rights created by bankruptcy law," or "'a cause of action [is] * * * determined by'" the Code).

2. If there were any doubt that Congress wanted bankruptcy courts deciding disputes under Section 346, the plain text of 11 U.S.C. 1146 ends the debate. Un-

der that provision, Congress specifically authorized bankruptcy courts to "declare" a reorganization plan's "tax effects[] under Section 346 of this title." 11 U.S.C. 1146(d). Congress created an express device, in bankruptcy, for declaring state tax liabilities (in light of preemptive federal law), yet the BAP insisted that this is "a dispute arising under California state tax law" (E.R. 15) because "[n]o provision of the bankruptcy code dealing with state tax consequences is at issue" (E.R. 14).

"A matter 'arises under' the Bankruptcy Code if its existence depends on a substantive provision of bankruptcy law, that is, if it involves a cause of action created or determined by a statutory provision of the Bankruptcy Code." *In re Ray*, 624 F.3d at 1131. The BAP cannot possibly be correct that Congress took the time to spell out a substantive right in the Bankruptcy Code (Section 346) and a procedural right to enforce it (Section 1146) and yet did not consider enforcement of either provision to "arise under" the Code. See, *e.g.*, *In re Middlesex Power Equip. & Marine, Inc.*, 292 F.3d 61, 68 (1st Cir. 2002) ("an order that can only be issued by a bankruptcy court * * * is one that arises in a case under title 11 or perhaps arises under title 11").

* * * * *

The BAP's holding can stand only if there truly is no provision of the Bankruptcy Code dealing with the state "tax effects" of plan transactions. There are *two* such provisions, however, written in plain language and found directly in the Code.

See 11 U.S.C. 346(a), (j)(1); 11 U.S.C. 1146(d). Each was invoked by Wilshire in the dispute below, and each was then ignored by the BAP—for unexplained and inexplicable reasons.

This is possibly the reason that the leading treatise in this area has already singled out the decision below as "confused." 11 *Collier on Bankruptcy* ¶ TX12.02[2][b], at TX12-10 (Myron M. Sheinfeld, Fred T. Witt & Milton B. Hyman, 16th ed. Dec. 2011). As the treatise explained, the BAP's decision emphatically underscores the errors that courts occasionally make in this area:

> The BAP admitted there would be subject matter jurisdiction if there was a provision of the bankruptcy code dealing with state income tax consequences. In fact, as the [bankruptcy court] found, section 346 provides the state tax rules governing a debtor partnership's debt reduction—the [discharged debt] is exempt from state taxation. Thus, the right to relief, both procedurally and as a matter of substantive law, is found in title 11. There can be no clearer evidence of "arising under" jurisdiction.

Id. at TX12-11 (footnote omitted). Because, contrary to the BAP's views, it is indeed difficult to imagine a more compelling basis for "arising under" jurisdiction, the decision below should be reversed.

B. At A Minimum, This Proceeding "Relates To" A Case Under Title 11 Because It Seeks To Enforce The Federally Mandated Tax Effects Of Plan Transactions Under The Controlling Interpretation Of The Plan

Even if this dispute somehow did not "arise under" the Code, it at least "relates to" a case under Title 11. 28 U.S.C. 1334(b). Congress crafted this "very broad" jurisdictional grant to include "'nearly every matter directly or indirectly related to the bankruptcy.'" *In re Sasson*, 424 F.3d 864, 868-869 (9th Cir. 2005) (quoting *In re Mann*, 907 F.2d 923, 926 n.4 (9th Cir. 1990)). This grant was "comprehensive" by design; it permits bankruptcy courts to "efficiently and expeditiously" handle "*all matters* connected with the bankruptcy estate." *Celotex Corp.* v. *Edwards*, 514 U.S. 300, 308 (1995) (quoting *Pacor, Inc.* v. *Higgins*, 743 F.2d 984, 994 (3d Cir. 1984)) (emphasis added).

Jurisdiction accordingly extends beyond "simply proceedings involving the property of the debtor or the estate," *id.* at 307-308, and sweeps in any matter with a "close nexus" to the bankruptcy, *In re Pegasus Gold Corp.*, 394 F.3d 1189, 1194 (9th Cir. 2005). That "close nexus" is found where a dispute "affects the interpretation, implementation, consummation, execution, or administration of the confirmed plan." *In re Resorts Int'l, Inc.*, 372 F.3d 154, 167 (3d Cir. 2004); see also *Travelers Indem. Co.* v. *Bailey*, 129 S. Ct. 2195, 2205 (2009) ("the Bankruptcy Court plainly had jurisdiction to interpret and enforce its own prior orders"); *In re Petrie Retail, Inc.*, 304 F.3d 223, 230 (2d Cir. 2002) ("A bankruptcy court retains post-confirmation jurisdiction to interpret and enforce its own orders, particularly when disputes arise over a bankruptcy plan or reorganization.").

The dispute below clearly revealed a qualifying "close nexus." Wilshire sought (i) to enforce the federally mandated tax effects of the plan transactions;

and (ii) to preclude California from supplanting the legal determinations in the confirmed plan and confirmation order (as set by controlling federal law) with the *opposite* legal determinations (as set by *preempted* California law). Because each issue involved the "interpretation, implementation, consummation, execution, [and] administration of the confirmed plan," *In re Pegasus Gold*, 372 F.3d at 1194, the BAP was mistaken that the bankruptcy court lacked jurisdiction.

1. There is jurisdiction over any dispute with a "close nexus" to the confirmed plan, and here that "close nexus" is obvious: "The statutorily defined tax effects of a bankruptcy plan are unquestionably 'related to' the bankruptcy case in which that plan is filed." *Maryland* v. *Antonelli Creditors' Liquidating Trust*, 123 F.3d 777, 784 (4th Cir. 1997). The BAP's contrary decision, if allowed to stand, would place this Court in direct conflict with the Fourth Circuit.

As that circuit explained in *Antonelli*, the Code sections prescribing the tax treatment for plan transactions are self-executing: these provisions bind all parties not because they are rewritten directly into a plan, but because "the federal government has power under the Bankruptcy Clause of the Constitution, art. I, § 8, cl. 4, to enact such a provision, and any bankruptcy provision enacted within constitutional authority applies directly to a bankruptcy estate and takes precedence over conflicting state provisions." 123 F.3d at 781. The confirmed plan here did not reiterate what Section 346 already provides because such "surplusage" (*ibid.*) is unnecessary: "The force of such legislative enactments is not derived from a court order or prior adjudication, but from the legislative enactments themselves." *Ibid.*

The implication of this principle is plain: because Section 346 is automatically part of every confirmed plan, a State cannot set aside its mandate without setting aside a central feature of the plan itself. According to Section 346, the "cancellation or forgiveness of indebtedness" includes both the debt and any taxes from income otherwise "realized" as a result. 11 U.S.C. 346(j)(1). An attempt to reinstate the *tax* is thus every bit as forbidden as an attempt to reinstate the *debt*.

This illustrates why the BAP once again posed the right question but responded with the wrong answer. According to the BAP, "a need for plan interpretation support[s] post-confirmation jurisdiction" under the related-to test if "the results of plan interpretation would have a demonstrable impact on the * * * confirmed plan of reorganization." E.R. 22. California's attempt to undo the "statutorily defined tax effects" (*Antonelli*, 123 F.3d at 784) of Wilshire's bankruptcy transactions has just such a demonstrable impact. The "outcome of [this] dispute" will consequently "produce some effect on the * * * confirmed plan" (E.R. 21): a plan "implement[ed]" by preempting state tax law is markedly different from one *not* preempting an 8-figure tax liability imposed on partners, through the debtor partnership, who are inextricably bound up with the benefits and burdens of the confirmed plan. See 11 U.S.C. 1141(a). Because Section 346 is effectively part of that plan, an attempt to enforce that section has an obvious "close nexus" to the plan itself. This was sufficient to confer jurisdiction on the bankruptcy court under Section 1334(b), and the BAP was wrong to hold otherwise. See *In re Pegasus Gold*, 394 F.3d at 1194.

2. California's position is also fundamentally incompatible with the legal conclusions in the confirmed plan, and it is much too late for the State's taxing authorities to revisit those determinations at this time.

As noted above, bankruptcy courts have "related to" jurisdiction to decide disputes that have a "close nexus" to the bankruptcy and that require the "interpretation, implementation, consummation, execution, or administration" of the confirmed plan. *In re Resorts Int'l, Inc.*, 372 F.3d at 167. A dispute over an attempt to unwind that plan entirely—and replace its legal conclusions with the *opposite* legal conclusions, carrying different legal consequences—fits comfortably within this jurisdictional grant.

California's argument simply cannot be squared with what the confirmed plan actually provides. Wilshire's plan specifically invoked a series of Code sections to justify the proposed reorganization. E.R. 220 ("The Proponents propose to implement and consummate the Joint Plan through the means contemplated by sections 1123(a)(5)(A), (E), (F), (G), and (H) and 1123 (b)(1), (b)(2), (b)(3), (b)(5) and (b)(6) of the Code."). These sections importantly include the authority to discharge debt (see, *e.g.*, 11 U.S.C. 1123(a)(5)(E))—which was consistent with the plan's statements, in plain language, that the transactions would involve the substantial discharge of indebtedness respecting both the first lien and the second lien. See, *e.g.*, E.R. 180 ("As a result of the Joint Plan, there will be a discharge of part of the liabilities of the Debtor to the extent the Creditors receive less than the amount of the loans."); E.R. 150 ("[T]he debt burden on the Property will be cut by more than 70%. Approximately $360 million in principal amount will be reduced to $100 million."); E.R. 137; E.R. 38-39. And, of course, the plan conspicuously did *not* include anywhere in its long list of authority any mention of the Code sections authorizing the "sale of all or any part of the property of the estate." See 11 U.S.C. 1123(a)(5)(D); see also 11 U.S.C. 1123(b)(4) (authorizing a plan to "provide for the sale of all or substantially all of the property of the estate").

The confirmation order likewise included (explicitly) the statutory disclaimer that the proposed transactions did *not* involve a sale: "The Joint Plan and the agreements, settlement, transactions and transfers contemplated thereby do not provide for, and when consummated will not constitute, the liquidation of all or substantially all of the property of the Debtor's Estate under Bankruptcy Code section 1141(d)(3)(A)." E.R. 117; see also E.R. 41; E.R. 38 (construing various provisions of the confirmation order "to establish that the transaction implemented under the Plan is not a sale or exchange for any purpose," and "that the transfers and transaction implemented under the Plan is not a sale of partnership interests by the existing Partners").

The only way to say that the transactions *did* constitute a sale (and did *not* discharge debt) is to say that the order was incorrect that the transactions did *not* constitute a sale (and *did* discharge debt). California may now disagree with the plan and the legal conclusions embodied in the bankruptcy court's order. But those determinations are *legal* determinations; they provided the statutory underpinnings of the plan and the legal authority for the confirmation order. If the initial determinations were incorrect, California had an obligation to object at the appropriate time. See, *e.g.*, 11 U.S.C. 1144 (setting a 180-day deadline for requests to revoke a confirmation order). But "once the [past] Orders became final on direct review (whether or not proper exercises of bankruptcy court jurisdiction and power), they became res judicata." *Travelers Indem.*, 129 S. Ct. at 2205; see also *Antonelli*, 123 F.3d at 782 ("While they certainly were not required to challenge the plan, they cannot later seek to challenge it collaterally.").

The time for challenging the court's order has long since passed. Once that window closed, the order became final, and California's collateral attack is now "procedurally barred." *Antonelli*, 123 F.3d at 782; see also *Travelers Indem.*, 129 S. Ct. at 2206 ("So long as respondents or those in privity with them were parties to the Manville bankruptcy proceeding, and were given a fair chance to challenge the Bankruptcy Court's subject-matter jurisdiction, they cannot challenge it now by resisting enforcement of the 1986 Orders."). Because the bankruptcy court had the power to prevent this undue interference with the "interpretation, implementation, consummation, execution, or administration of [its] confirmed plan" (E.R. 22), the BAP erred in refusing to recognize its jurisdiction.

C. The BAP's Reasoning Was Wrong, And The Cases It Cited As Support Were Both Inapposite And Misconstrued

The BAP's primary errors were ignoring the sections of the Bankruptcy Code that were squarely at issue, and refusing to credit the profound effect California's recharacterization of plan transactions would have on the execution and implementation of the plan itself. These errors alone, as explained above, produced its "confused" decision. *Collier on Bankruptcy*, *supra*, ¶ TX12.02[2][b], at TX12-10. To the limited extent the BAP tried to identify circuit cases supporting its views, moreover, it extended those decisions far more broadly than their language or logic permits.

The BAP, for example, understood *In re Ray*, 624 F.3d 1124 (9th Cir. 2010), as precluding Wilshire's position in this case. See E.R. 24-26. But *Ray* involved exclusively state-law issues, and the only nexus to the bankruptcy case (or the Bankruptcy Code) was the mere fortuity that certain aspects of the dispute happened to arise during the bankruptcy period. See, *e.g.*, 624 F.3d at 1131 ("Because the theory of its claim is a state law contract action independent of the bankruptcy case, BG Plaza's claim against the Sellers is not one 'arising under' the Bankruptcy Code."); *see also id.* at 1132 ("BG Plaza sought to bring a breach-of-contract claim created under Washington law based on a right of first refusal agreement entered into entirely independently of the bankruptcy action").

Here, by contrast, the entire dispute is inextricably bound up with the bankruptcy plan and the bankruptcy order. The legal issues are determined by the Bankruptcy Code: Section 346 provides the substantive rule of decision, and Section 1146 provides a procedural mechanism for enforcing Section 346's substantive command. In *Ray*, by contrast, the breach-of-contract action "did not necessarily depend upon resolution of a substantial question of bankruptcy law." 624 F.3d at 1135. The events in question here, moreover, did not arise during the bankruptcy by mere happenstance. On the contrary, the entire point of the bankruptcy proceeding was to discharge debt and reorganize the debtor, which is precisely what the plan (according to the plan itself) accomplished. Congress confronted the very type of "forgiveness or discharge of indebtedness" at issue—unlike, for example, the purely state-law contract rights at issue in *Ray*—and determined that a discharge of indebtedness in bankruptcy would not be subject to "any State or local tax" by reason of "income * * * realized" as a result of the discharge. 11 U.S.C. 346(a), (j)(1). That is a substantive command, in the Bankruptcy Code, that attaches federal consequences to central bankruptcy transactions—forgiving debt.

Ray simply confirmed the unremarkable proposition that not every state-law question decided under the umbrella of a bankruptcy proceeding is automatically one arising under the Code. It has no bearing at all on a case that arises at the core of bankruptcy law in multiple respects.

The BAP likewise erred in relying upon *In re Valdez Fisheries Develop. Ass'n, Inc.*, 439 F.3d 545 (9th Cir. 2006). See E.R. 24-25. That case involved a dispute between creditors, and its connection to the bankruptcy arose "only fortuitously." 439 F.3d at 548. The dispute here, by contrast, arose because the debtor discharged debt—by design of the reorganization plan—and California is seeking to assign consequences to that discharge that flouts controlling bankruptcy law. Had the BAP acknowledged that the Bankruptcy Code was not merely at issue—but was *the* issue—it surely would also have had to acknowledge that decisions like *Ray* and *Valdez Fisheries* provide no support for its disposition at all.

II. BECAUSE THE *PARTNERS'* INTERESTS ARE WHOLLY DERIVATIVE OF THE *PARTNERSHIP'S* INTERESTS, THE PARTNERS HAVE THE SAME RIGHT TO INVOKE THE COURT'S JURISDICTION AS THE PARTNERSHIP ITSELF

Because the Bankruptcy Code makes clear what California cannot do to the debtor *partnership*, California instead seeks (as an apparent fallback) to unwind the reorganization plan at the *partner* level. E.R. 41-42. It accordingly argues that even if Section 346 preempts a state tax on "income * * * realized" by the partnership, that does not mean it preempts a state tax, targeting the identical "forgiveness or discharge of indebtedness," imposed on the partners instead. E.R. 41-42, 44-45. California, it seems, believes that controlling federal law suddenly evaporates once the focus is removed from the debtor, and shifted to the debtor's core constituents—even if the income in question is the same income that Congress has declared wholly *non-taxable* by the state in governing sections of the Code. See 11 U.S.C. 346(a), (j)(1). The BAP did not directly reach this issue, but it is clear that California is mistaken.

A. California is wrong to assume that the *non-debtor partners* can be taxed without reconstituting (in direct contravention of Section 346) the character of the income "realized" by the *debtor partnership*. It is well settled that partners do not assume any income or loss directly; the partnership is the "conduit[] through which the taxpaying obligation passes to the individual partners." *United States* v. *Basye*, 410 U.S. 441, 448 & n.8 (1973). Here, however, there is *no* "taxpaying obligation" to pass along to anyone; under Section 346, "income is not realized" from discharged debt (11 U.S.C. 346(j)(1)), and hence the partnership (as the conduit) has a sum of *zero* taxable income to "ascertain[] and report[]" or "pass[] to the individual partners." *Basye*, 410 U.S. at 448 & n.8.

Contrary to California's contentions, income that is "*not* realized" does not become income that "*is* realized" whenever the debtor in a Chapter 11 proceeding happens to be a partnership. Congress specifically confirmed that a partnership's "commencement of a case under [Title 11] * * * does not effect a change in the status of such * * * partnership for the purposes of any State or local law imposing a tax on or measured by income." 11 U.S.C. 346(c)(1). The rules applicable to partnerships and partners *pre*-bankruptcy are thus the same rules that apply *post*-bankruptcy: "[p]artnership income or loss is determined at the partnership level and not at the level of the individual partners," *Thompson* v. *CIR*, 631 F.2d 642, 649 (9th Cir. 1980). The only way that California can thus seek to identify taxable income for the partners is to identify taxable income for the partnership—but Congress has already specified that States may *not* create taxable income at the partnership level from discharged debt. See 11 U.S.C. 346(a), (j)(1). If "income is not realized" at the partnership level, there is no taxable income to pass through to the partners.

California's efforts are accordingly an obvious backdoor attack on Wilshire's reorganization plan. If "the interests of the partners are wholly derivative from the status of the property in the partnership," as they assuredly are, then the State "cannot recharacterize the plan transactions at the partner level without recharacterizing them at the partnership level as well." E.R. 40-41. And the federally mandated tax effects at the partnership level are clear. Because Section 346 precludes any tax based on the "forgiveness or discharge of indebtedness" for the partnership, it automatically precludes the same tax on the same forgiven debt for the partners. Those partners are bound by the plan "whether or not the[ir] claim or interest is impaired under the plan" and "whether or not * * * [the] partner[s] ha[ve] accepted the plan." 11 U.S.C. 1141(a). Congress did not ask the partners to bear the plan's burdens without also being entitled to accept the plan's benefits. Because income at the partnership level was tax-exempt, then income at the partner level was tax-exempt as well.[3]

The bankruptcy court had the same grounds for invoking its jurisdiction to protect the partners as it did to protect the partnership. It was well within that court's authority, in the face of forbidden state action, to apply the Bankruptcy Code and enforce the bankruptcy plan. Cf. *In re Prudential Lines Inc.*, 928 F.2d

[3] In its briefing below, California relied upon *American Principles Leasing Corp.* v. *United States*, 904 F.2d 477 (9th Cir. 1990), for the proposition that the bankruptcy court could never exercise jurisdiction to determine the tax effects of any transaction, under any provision of the Code, for non-debtor partners. California was mistaken. The holding in *American Principles* was tethered to the statute at issue in *American Principles*—11 U.S.C. 505—and that statute had been construed *not* to cover any rights of non-debtor parties. 904 F.2d at 481-482. In this case, by contrast, the partners' liability *is* the partnership's liability; the state tax was preempted by Congress in a provision of the Bankruptcy Code; and the bankruptcy court had the explicit power, under Section 1146, to determine the "tax effects" of the plan transactions if requested by any "plan proponent"—which describes Wilshire Courtyard exactly.

565, 575 (2d Cir. 1991) ("Having properly exercised jurisdiction, the bankruptcy court may enter an injunction that affects derivative rights of a non-debtor.").

B. Even if the partners somehow independently lacked the power to proceed under Section 1334(b), that says nothing about Wilshire's separate right to invoke the court's jurisdiction. And Wilshire's claims, of course, are exactly the same as the Wilshire partners' claims. Given the identical constellation of facts, the bankruptcy court had authority to exercise supplemental jurisdiction under 28 U.S.C. 1367 (after accepting Wilshire's dispute) even if it could not exercise jurisdiction over the partners directly under Section 1334(b). See, *e.g.*, *In re Sasson*, 424 F.3d at 869.

CONCLUSION

The judgment of the Bankruptcy Appellate Panel should be reversed.

STATEMENT OF RELATED CASES

Wilshire is not aware of any related cases pending before this Court.

Respectfully submitted.

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CERTIFICATE OF COMPLIANCE WITH TYPE-VOLUME LIMITATION, TYPEFACE REQUIREMENTS, AND TYPE STYLE REQUIREMENTS

1. This brief complies with the type-volume limitation of Fed. R. App. P. 32(a)(7)(B) because it contains 10,266 words, as determined by the word-count function of Microsoft Word 2010, excluding the parts of the brief exempted by Fed. R. App. P. 32(a)(7)(B)(iii).

2. This brief complies with the typeface requirements of Fed. R. App. P. 32(a)(5) and the type style requirements of Fed. R. App. P. 32(a)(6) because it has been prepared in a proportionally spaced typeface using Microsoft Word 2010 in 14-point Times New Roman font.

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CERTIFICATE OF SERVICE

I hereby certify that on January 20, 2012, an electronic copy of the foregoing Opening Brief was filed with the Clerk of Court for the U.S. Court of Appeals for the Ninth Circuit, using the appellate CM/ECF system. I further certify that all parties in the case are represented by lead counsel who are registered CM/ECF users and that service will be accomplished by the appellate CM/ECF system.

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