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

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TABLE OF CONTENTS

Page

Introduction 1

Argument.. 2

I. Wilshire is a proper party with standing to press these issues 2

II. 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 6

A. Because this proceeding "arises under" the Bankruptcy Code, the bankruptcy court had jurisdiction under Section 1334 6

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 17

III. 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 19

IV. California cannot avoid federal jurisdiction by invoking constitutional arguments (which are wrong) or the Tax Injunction Act (which is irrelevant) 24

A. Under the Bankruptcy Clause, Congress had the enumerated power to enact Section 346, extend it to this setting, and apply it to the States, and California's contrary contentions are both incorrect and foreclosed by settled precedent 24

B. Because Section 346 is a law targeting state taxes, the Tax Injunction Act has no relevance here 27

Conclusion 30

TABLE OF AUTHORITIES

Page(s)

Cases:

American Bicycle Ass'n, *In re*, 895 F.2d 1277 (9th Cir. 1990) 29

American Principals Leasing Corp. v. *United States*, 904 F.2d 477 (9th Cir. 1990) 20, 21

Bell v. *Hood*, 327 U.S. 678 (1946) 7

Cent. Va. Cmty. Coll. v. *Katz*, 546 U.S. 356 (2006) 25, 26, 27

City of N.Y. v. *Comm'r*, 70 F.3d 142 (D.C. Cir. 1995) 6

Clark v. *Martinez*, 543 U.S. 371 (2005) 24

Diaz, *In re*, 647 F.3d 1073 (11th Cir. 2011) 27

Dickerson v. *New Banner Inst., Inc.*, 460 U.S. 103 (1983) 9, 10

Ellett, *In re*, 254 F.3d 1135 (9th Cir. 2001) 28, 30

Florida Dep't of Revenue v. *Piccadilly Cafeterias, Inc.*, 554 U.S. 33 (2008) 13, 18, 25

Global Indus. Techs., Inc., *In re*, 645 F.3d 201 (3d Cir. 2011) 6

Hall v. *United States*, 132 S. Ct. 1882 (2012) 1, 14

Harris Pine Mills, *In re*, 44 F.3d 1431 (9th Cir. 1995) 7, 8

Hechinger Inv. Co. of Del., Inc., *In re*, 335 F.3d 243 (3d Cir. 2003).................... 28, 29

J.J. Re-Bar Corp., Inc., *In re*, 644 F.3d 952 (9th Cir. 2011) 29

Jacoby-Bender, Inc., *In re*, 758 F.2d 840 (2d Cir. 1985) 25

Jerome v. *United States*, 318 U.S. 101 (1943) 1, 9

Johnson v. *United States*, 130 S. Ct. 1265 (2010)....................8

Kmart Corp. v. *Ill. Dep't of Revenue*, 2012 WL 1744708 (Bankr. N.D. Ill. May 15, 2012) 14, 15

TABLE OF AUTHORITIES
(continued)

Page(s)

Maryland v. *Antonelli Creditors' Liquidating Trust*, 123 F.3d 777 (4th Cir. 1997) .... *passim*

Massachusetts v. *EPA*, 549 U.S. 497 (2007) 6

Mississippi Band of Choctaw Indians v. *Holyfield*, 490 U.S. 30 (1989) 9

NLRB v. *Natural Gas Utility Dist. of Hawkins County, Tenn.*, 402 U.S. 600 (1971) 9

Pegasus Gold Corp., *In re*, 394 F.3d 1189 (9th Cir. 2005) 18

Penasquitos, Inc. v. *Superior Ct.*, 812 P.2d 154 (Cal. 1991) 4

Pomeroy's Lessee v. *State Bank of Ind.*, 68 U.S. (1 Wall.) 23 (1863) 4

Ray, *In re*, 624 F.3d 1124 (9th Cir. 2010) 18, 24

Sasson, *In re*, 424 F.3d 864 (9th Cir. 2005) 18

Sprint Commc'ns Co., L.P. v. *APCC Servs., Inc.*, 554 U.S. 269 (2008) 5

T.H. Orlando Ltd., *In re*, 391 F.3d 1287 (11th Cir. 2004) 22, 23

Taylor v. *United States*, 495 U.S. 575 (1990) 9

Tennessee Student Assistance Corp. v. *Hood*, 541 U.S. 440 (2004) 7, 26

Thorpe Insulation Co., *In re*, 677 F.3d 869 (9th Cir. 2012) 23

Travelers Indem. Co. v. *Bailey*, 129 S. Ct. 2195 (2009) 12, 15

United States v. *Basye*, 410 U.S. 441 (1973) 19, 23, 26

United States v. *Mendoza-Morales*, 347 F.3d 772 (9th Cir. 2003) 9

United States v. *Students Challenging Regulatory Agency Procedures*, 412 U.S. 669 (1973) 6

United States v. *Turley*, 352 U.S. 407 (1957) 9

Valdez Fisheries Develop. Ass'n, Inc., *In re*, 439 F.3d 545 (9th Cir. 2006) 18

Valley Health Sys., *In re*, 2012 WL 851619 (9th Cir. BAP Mar. 13, 2012) 19

TABLE OF AUTHORITIES
(continued)

Page(s)

White Mountain Paper Co. v. *Morse & Co.*, 127 F. 643 (1st Cir. 1904) 4

Wood, *In re*, 825 F.2d 92 (5th Cir. 1987) 7

Constitution:

U.S. Const., Art. I, § 8, Cl. 4 (Bankruptcy Clause) 9, 24, 25, 26

Statutes:

11 U.S.C. 105(a) 29

11 U.S.C. 106 25

11 U.S.C. 346 (2000 ed.) .... *passim*

11 U.S.C. 346(a) (2000 ed.) .... *passim*

11 U.S.C. 346(c)(1) 19, 20

11 U.S.C. 346(j)(1) (2000 ed.) .... *passim*

11 U.S.C. 350(b) 23

11 U.S.C. 505(a)(1) 20, 21, 28

11 U.S.C. 1109(b) 23

11 U.S.C. 1123(a)(5)(D) 12

11 U.S.C. 1123(a)(5)(E) 12

11 U.S.C. 1141(a) 19, 22

11 U.S.C. 1144 12

11 U.S.C. 1146 (2000 ed.) .... *passim*

11 U.S.C. 1146(a) 13, 14

11 U.S.C. 1146(c) 21, 28

26 U.S.C. 108(d)(6) 8, 10, 11

TABLE OF AUTHORITIES
(continued)

Page(s)

28 U.S.C. 1334(b) .... *passim*

28 U.S.C. 1341 .... 2, 27, 28, 30

28 U.S.C. 1367 24

Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, 119 Stat. 23 11

Cal. Corp. Code 16802(a) 3

Cal. Corp. Code 16803(c) 3

Rules:

Fed. R. Civ. P. 17(b)(3)(A) 4

Fed. R. Bankr. P. 7017 4

Miscellaneous:

48 Cal. Jur. 3d P'ship 4

11 *Collier on Bankruptcy* (Myron M. Sheinfeld, Fred T. Witt & Milton B. Hyman, 16th ed. Dec. 2011) 1

Fed. R. Bankr. P. 3022 advisory committee's notes to 1991 amendment 18

S. Rep. No. 989, 95th Cong., 2d Sess. 46 (1978) 7, 19

9 Witkin, Summ. of Cal. Law, P'Ship (10th Ed. 2005) 3, 5

INTRODUCTION

California's attempt to tax the core transaction in a bankruptcy reorganization violates an unambiguous Bankruptcy Code provision that preempts that very tax. The BAP nevertheless declared that the dispute did not "arise under" the Code or even "relate to" the bankruptcy case. The BAP inexplicably refused to acknowledge Wilshire's invocation of Sections 346 and 1146. In its opening brief, Wilshire explained why a "leading bankruptcy treatise" (*Hall* v. *United States*, 132 S. Ct. 1882, 1889 (2012)) labeled the BAP's decision "confused" and concluded "[t]here can be no clearer evidence of 'arising under' jurisdiction" (11 *Collier on Bankruptcy* ¶ TX12.02[2][b], at TX12-10 (Myron M. Sheinfeld, Fred T. Witt & Milton B. Hyman, 16th ed. Dec. 2011)).

Unlike the BAP, California at least acknowledges that those sections exist. But California, using four main tactics, argues that the decision below is correct anyway. First, California insists that the dispute in this case is solely between the non-debtor partners and the State. We show in Point I below that California is mistaken because the debtor partnership is a proper party, with standing. Second, California argues that it wins under its "correct" construction of Section 346 and that Section 1146 does not provide a procedure to raise the Section 346 argument. We refute those arguments in Point II below. Third, California argues that the non-debtor partners have no rights in this proceeding (even though they were made

parties below, E.R. 50-51). We refute that argument in Point III below. Fourth, California makes arguments under the Constitution and the Tax Injunction Act, which we refute in Point IV below.

The specifics aside, it is worth pausing to consider what California asks this Court to do. California asks this Court to affirm a judgment saying that a bankruptcy court lacked jurisdiction to enter an order enforcing Section 346 of the Code because, according to the BAP, no provision of the Code was even "at issue." Beyond that anomaly, California asks this Court to hold that, somehow, *no* party was entitled to invoke Section 346 before the bankruptcy court, throwing up various technical arguments that try to gain advantage from either the fact that partnerships are pass-through entities for tax purposes or the fact that the debtor partnership has been reorganized and has ceased to exist for some purposes. One way or another, California argues, the appropriate forum to address the federal tax effects of a core bankruptcy transaction is a state court, despite a sweeping preemption provision in the Bankruptcy Code. Such a holding would have no legal support and make little sense.

ARGUMENT

I. WILSHIRE IS A PROPER PARTY WITH STANDING TO PRESS THESE ISSUES

A. California insists that the only "Wilshire Courtyard" in this matter is the reorganized Wilshire Courtyard LLC, not the "former debtor Wilshire Courtyard

[partnership]," which "no longer exists." Cal. Br. 4, 34; Br. 1-2 n.2. That argument fails.

The record reveals that the partnership survived, for limited purposes, post-bankruptcy. This is apparent from the plan itself, which imposes certain specific obligations on the debtor (*i.e.*, the *partnership*) even after reorganization. See E.R. 229; see also E.R. 213 (the partnership "may exist following the [plan's] Effective Date"). It is also apparent from California's own actions. The Franchise Tax Board audited the *partnership*, not the LLC—and did so years after the bankruptcy. See BAP E.R. 204. The State, correctly, accepted that the partnership retained its vitality for limited purposes.

The partnership's survival tracks settled California law, and nothing in federal law demands otherwise. A California partnership, even after it has fully dissolved, still exists to the extent necessary to "wind[] up" its affairs. 9 Witkin, Summ. of Cal. Law, P'Ship, § 48, at 622-623 (10th Ed. 2005). "[A] person winding up the partnership business may perform any necessary act including * * * [p]rosecut[ing] and defend[ing] actions and proceedings." *Ibid.*; see also Cal. Corp. Code 16802(a) ("[t]he partnership is terminated when the winding up of its business is complete"); Cal. Corp. Code 16803(c) ("[a] person winding up a partnership's business may * * * prosecute and defend actions and proceedings, whether civil, criminal, or administrative"). The dissolution, accordingly, is

viewed as the end of the going concern for *conducting business*—*not* a dissolution for all purposes. *Penasquitos, Inc.* v. *Superior Ct.*, 812 P.2d 154, 160 (Cal. 1991) ("the effect of dissolution is not so much a change in the corporation's status as a change in its permitted scope of activity"). This is why a dissolved or merged partnership can still sue and be sued, and still pursue its legal rights and defend itself against claims. See 48 Cal. Jur. 3d P'ship § 141; see also *White Mountain Paper Co.* v. *Morse & Co.*, 127 F. 643, 645 (1st Cir. 1904).

The dispute below puts Wilshire—the *partnership*—squarely within this rule: Wilshire is asserting its interests and rights, under federal law, that it obtained by virtue of the Chapter 11 proceeding. Nothing in federal or state law precludes the partnership from protecting itself after its core interests were reorganized. See, *e.g.*, *Pomeroy's Lessee* v. *State Bank of Ind.*, 68 U.S. (1 Wall.) 23, 25 (1863). Nor is there any reason to permit a State to exploit a dissolved debtor, and ignore its federal rights, simply because that debtor was reorganized in a federal proceeding. See, *e.g.*, Fed. R. Civ. P. 17(b)(3)(A) (a partnership without capacity to sue or be sued under pertinent state law "may sue or be sued in its common name to enforce a substantive right existing under the United States Constitution or laws"); accord Fed. R. Bankr. P. 7017 (adopting Rule 17).

In any event, had the partnership somehow disappeared for all purposes, the reorganized debtor would inherit its predecessor's rights and responsibilities, and

hence would be entitled to assert the same interests that the Wilshire partnership asserts here. "An entity that converts into another entity is 'for all purposes' the same entity that existed before the conversion." 9 Witkin, *supra*, § 54, at 629; see also *ibid.* (the "converting entity's rights and property remain vested in the converted entity" and "[p]ending actions or proceedings by or against the converting entity may be continued as if no conversion occurred").

B. California also argues (Br. 35) that, because Wilshire has no "economic stake in the case," it lacks standing. But partnerships are pass-through entities for tax purposes (both federal and California), and no rule or reason denies such entities standing to litigate tax consequences at the partnership level.

There is no constitutional requirement that a pass-through entity retain economic benefits of successful litigation to have standing. In *Sprint Communications Co., L.P.* v. *APCC Services, Inc.*, 554 U.S. 269 (2008), the Supreme Court found standing for an entity that would pass through all the proceeds of litigation to its constituents. "[F]ederal courts," the Court reasoned, "routinely entertain suits which will result in relief for parties that are not themselves directly bringing suit." *Id.* at 287.

California's tax treatment affects, directly, the characterization of "income" that Wilshire receives and passes along to its partners. Just as an entity has a concrete interest in offering tax-exempt bonds (see, *e.g.*, *City of N.Y.* v. *Comm'r*, 70

F.3d 142, 143-144 (D.C. Cir. 1995)), Wilshire has a concrete interest in passing along tax-exempt income. The nature of the income it passes through affects Wilshire's value. (This is why, all things equal, tax-exempt bonds are more attractive than non-tax-exempt bonds.) And maximizing value is critical to reorganization efforts—both to induce consent during the bankruptcy process and to avoid challenges post-confirmation. When an entity complains about how its own income is characterized, it "alleges a 'specific, "identifiable trifle" of injury.'" *In re Global Indus. Techs., Inc.*, 645 F.3d 201, 210 (3d Cir. 2011) (en banc) (quoting *United States* v. *Students Challenging Regulatory Agency Procedures*, 412 U.S. 669, 689 n.14 (1973)). This dispute has the qualifying "'concrete adverseness,'" *Massachusetts* v. *EPA*, 549 U.S. 497, 517 (2007), to support standing.

II. 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

California insists that no provision of the Bankruptcy Code is at issue, because this bankruptcy dispute is resolved exclusively under California law. For multiple reasons, California's position cannot be squared with Section 346's text, its purpose, controlling precedent, or common sense.

This dispute is plainly "'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 92, 96 (5th Cir. 1987)), because Section 346 provides the "statutorily defined tax effects" of consummated transactions in Wilshire's reorganization plan (*Maryland* v. *Antonelli Creditors' Liquidating Trust*, 123 F.3d 777, 784 (4th Cir. 1997)). Congress preempted "*any* State * * * law imposing a tax" on the "forgiveness or discharge of indebtedness in a case under this title," 11 U.S.C. 346(a), (j)(1), and California's law is no exception.[1]

1. As for raw power, federal courts have jurisdiction to decide this dispute. Even if California's reading of Section 346 ultimately prevails, federal jurisdiction is not limited to cases where a plaintiff *wins*: "it is well settled that the failure to state a proper cause of action calls for a judgment on the merits and not for a dismissal for want of jurisdiction." *Bell* v. *Hood*, 327 U.S. 678, 682 (1946).

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[1] California maintains that Wilshire's forgiven debt was *not* forgiven because there was no global discharge at the bankruptcy's termination. See Cal. Br. 11, 16 n.13. The absence of a global discharge, however, is irrelevant. As California acknowledges later in its brief, Section 346 applies whenever debt is forgiven under a reorganization plan: "'The terms "forgiveness" and "discharge" are redundant, but are used to clarify that "discharge" in the context of a special tax provision in title 11 includes forgiveness of indebtedness *whether or not such indebtedness is "discharged" in the bankruptcy sense*.'" Cal. Br. 31 n.21 (quoting S. Rep. No. 989, 95th Cong., 2d Sess. 46 (1978)) (emphasis added).

Wilshire's case is premised on the substantive rights that Congress created in Section 346, which Wilshire invoked below. E.R. 93-96. If Section 346 means what it says, then California law is preempted—and accordingly has *no* role in deciding this question. Congress said, explicitly, that the Bankruptcy Code applies "notwithstanding any State or local law imposing a tax." 11 U.S.C. 346(a). The dispute therefore arises under Section 346, and it will be "determined by" the Bankruptcy Code, not California law, which is all that Section 1334(b) requires. *Harris Pine Mills*, 44 F.3d at 1435.

2. On the merits, California has misconstrued Section 346 in multiple respects. Specifically, contrary to California's position, (a) Section 346's terms must be construed according to federal and not state law; (b) Section 346(j), at the relevant time, did not cross-reference or incorporate Section 108 of the Internal Revenue Code, which states a different tax rule for cancellation of indebtedness than Section 346(j)'s broad and simple rule; and (c) Section 346(j)'s application to this matter is straightforward and preempts California's attempt to tax the forgiveness of indebtedness under a confirmed plan.

a. California argues that California state law defines what it means to "forgive" or "discharge" debt under 11 U.S.C. 346(j)(1). Cal. Br. 28-29. But this is a federal statute, and its terms are defined by "federal law, not state law." *Johnson* v. *United States*, 130 S. Ct. 1265, 1269 (2010); see also *Dickerson* v. *New Banner*

Inst., Inc., 460 U.S. 103, 111-112 (1983). "[W]e must generally assume, in the absence of a plain indication to the contrary, that Congress when it enacts a statute is not making the application of the federal act dependent on state law." *Jerome* v. *United States*, 318 U.S. 101, 104 (1943); see also, *e.g.*, *NLRB* v. *Natural Gas Utility Dist. of Hawkins County, Tenn.*, 402 U.S. 600, 603 (1971); *United States* v. *Turley*, 352 U.S. 407, 411 (1957); *United States* v. *Mendoza-Morales*, 347 F.3d 772, 777 (9th Cir. 2003).

The rule that the terms of federal statutes are defined by federal law has particular force in this setting. The Bankruptcy Clause empowers Congress to make "*uniform* Laws on the subject of Bankruptcies *throughout the United States*." U.S. Const., Art. I, § 8, Cl. 4 (emphases added). In drafting such a uniform law, "Congress could hardly have intended the lack of nationwide uniformity that would result from state-law definitions." *Mississippi Band of Choctaw Indians* v. *Holyfield*, 490 U.S. 30, 45 (1989); see also *Taylor* v. *United States*, 495 U.S. 575, 591 (1990). Nowhere did Congress hint that it intended 50 different States to fill Section 346 with 50 different definitions, with a resulting "'patchwork'" of tax treatment of transactions carried out under the supervision of a federal court. *Mississippi Band of Choctaw Indians*, 490 U.S. at 44; see also *Dickerson*, 460 U.S. at 112. Nor is there any obvious advantage to a system where multistate debtors reorganize to find discharged debt taxable in one State but not in another.

California's position is also inconsistent with the statutory objective. The point of Section 346(a) is to *preempt* state law. Congress forbade state taxation of the forgiveness or discharge of debt in bankruptcy in order to avoid interference with the bankruptcy process. It would make little sense to set aside state law if States could unilaterally define the scope of the preempted field—that would be "too easy a route to follow in order to circumvent the federal statute." *Dickerson*, 460 U.S. at 117.

b. California wishes not to grapple with the breadth and simplicity of the text of Section 346(j)(1) in effect at the relevant time. So California invokes a different statute—Section 108 of the Internal Revenue Code—in order to introduce multiple complexities. According to California, Wilshire's position is "contrary to federal tax law," because 26 U.S.C. 108(d)(6) (unlike Section 346) requires "tax exclusion[s]" for forgiven debt to be "applied at the *partner* level, not at the partnership level." Cal. Br. 26-27 (emphasis omitted). California thus urges this Court to construe Section 346(j)(1) "consistently" with 26 U.S.C. 108. Cal. Br. 31-32.

Fortunately, this Court need not grapple with such complexities. Congress did amend Section 346(j)(1) to incorporate aspects of Section 108, but only years *after* the tax year at issue. Until 2005, the text of Section 346(j)(1), in its entirety, was this: "Except as otherwise provided in this subsection, 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." In 2005, that text was replaced with the following: "For purposes of any State or local law imposing a tax on or measured by income, income is not realized by the estate, the debtor, or a successor to the debtor by reason of discharge of indebtedness in a case under this title, *except to the extent, if any, that such income is subject to tax under the Internal Revenue Code of 1986*." Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, 119 Stat. 23, 131, 133 (emphasis added).

Until the addition of the "except" clause, Section 346 and Section 108 did not operate in the same fashion. Congress used text, not judicial inference, when it wanted to harmonize Section 346 and Section 108 in 2005, and the post-2005 version of the statute is very different from the version applicable to Wilshire's bankruptcy in 1997 and its reorganization plan in 1998.

That *applicable* version quickly disposes of California's argument: the text of Section 346(j)(1) makes it unambiguous that the "tax exclusion" applies at the *partnership* level in a debtor partnership's bankruptcy: "income is not realized by * * * *the debtor* * * * by reason of forgiveness or discharge of indebtedness in a case under this title." 11 U.S.C. 346(j)(1) (emphasis added).

c. Once the effort to complicate matters by bringing in concepts from the Internal Revenue Code is rejected, applying Section 346's simple text to this case is straightforward. California argues that not all cancellation of indebtedness re-

sults in cancellation-of-indebtedness *income*, and implies that—for unexplained reasons—the cancellation of debt in *this* case was not truly forgiven debt but a capital gain. Cal. Br. 31-32. But this case does indeed involve the "forgiveness or discharge of indebtedness." Wilshire claimed forgiven debt, not capital gain, because both the plan and confirmation order *said it was forgiven debt, not capital gain*. E.R. 38, 41. See also note 1, *supra*. This is why the plan was justified by statutory authority to "discharge debt" and was *not* justified by statutory authority for "'the sale of all or any part of the property of the estate.'" Opening Br. 34-35 (citing 11 U.S.C. 1123(a)(5)(D), (E)). This is also why the confirmation order reaffirmed that there was no "liquidation"—which means no *sale*—and refused to overturn the explicit plan disclosures regarding substantial discharged debt. Opening Br. 35-36 (citing E.R. 117, 150, 180).

Those formal legal conclusions provided essential underpinnings for Wilshire's plan and confirmation order. If California wished to challenge them, it had an obligation to act before the statutory deadline expired. Opening Br. 36 (citing 11 U.S.C. 1144). Although California "w[as] not required to challenge the plan, [California] cannot later seek to challenge it collaterally." *Antonelli*, 123 F.3d at 782; see also *Travelers Indem. Co.* v. *Bailey*, 129 S. Ct. 2195, 2205 (2009).

3. For multiple reasons, California submits that Wilshire cannot invoke Section 1146, but California is mistaken.

a. California errs in suggesting that "no plan proponent[]" sought relief below. Br. 34, 35-36. As previously explained (at pp. 2-5), the Wilshire that reopened the proceedings was the same Wilshire that initiated the original proceedings as the debtor. That entity was and is the plan proponent, with the right to seek a declaration of the plan's tax effects under Section 1146. In addition, even had Wilshire LLC sought relief, California is wrong (Br. 35-36) that the reorganized debtor forfeits rights it inherited from Wilshire—or that it would be proceeding as a "reorganized debtor" rather than asserting the *debtor's* rights.

b. Contrary to California's contention (Br. 36-38), Section 1146 is available "after plan confirmation." California's argument is odd given that the Supreme Court has already read an *adjacent* provision—11 U.S.C. 1146(a)—as applying *exclusively* post-confirmation and even "inapplicable to *preconfirmation*" events. *Florida Dep't of Revenue* v. *Piccadilly Cafeterias, Inc.*, 554 U.S. 33, 47 (2008). In any event, Section 1146, textually, applies whenever a "proponent of the plan" seeks a declaration of the plan's "tax effects." It does *not* say "proposed plan"; it just says *plan*, which includes *confirmed* plans. And it does not say a *current* proponent, but just *proponent*, which includes *past* proponents. The section, in short, gives no textual indication that its terms are restricted to the pre-confirmation context. Indeed, Section 1146 is in a post-confirmation subchapter—compelling evidence that it applies after plan confirmation. *Piccadilly Cafeterias*, 554 U.S. at 47

(attaching significance to "[t]he placement of § 1146(a) within a subchapter expressly limited to postconfirmation matters").

California cites snippets of legislative history as supporting a pre-confirmation-only reading. Br. 37. But, if Congress did "intend[] that result, it did not so provide in the statute," which is dispositive. *Hall*, 132 S. Ct. at 1893.

c. California has called the Court's attention to *Kmart Corp.* v. *Ill. Dep't of Revenue*, 2012 WL 1744708 (Bankr. N.D. Ill. May 15, 2012), but that out-of-circuit decision is not binding, wrongly decided, and distinguishable. *Kmart* held that (i) Section 1146 was the *exclusive* means of seeking any relief under Section 346; and (ii) Section 1146 was only available pre-confirmation. *Id.* at *4-*7. The latter is wrong for the reasons set forth above, and the former is wrong for the reasons below.

Even if Section 1146 provides the only procedure for pre-confirmation declarations of a plan's tax effects, it does not follow that *there is no procedure* for post-confirmation declarations. It only follows that the procedure is not specified in Section 1146. That section, after all, is a procedural—not a jurisdictional—section. For jurisdiction, what matters is that the proceeding "arises under" the Bankruptcy Code, specifically Section 346.

Indeed, *Kmart* overlooked why Congress might have crafted Section 1146 without intending to occupy the field. In the pre-confirmation world, there is no

obvious mechanism for resolving tax disputes without Section 1146; in the post-confirmation world, however, the court already has jurisdiction to enforce the "statutorily defined tax effects" of the plan itself. *Antonelli*, 123 F.3d at 784. Nothing suggests that Congress silently repealed federal jurisdiction to enforce, post-confirmation, a specific, preemptive provision of the Bankruptcy Code and left enforcement of that federal bankruptcy provision to state courts in 50 different States.

Moreover, under "related to" jurisdiction, "the Bankruptcy Court plainly ha[s] jurisdiction to interpret and enforce its own prior orders." *Travelers*, 129 S. Ct. at 2205. In *Kmart*, it was not even arguable that the plan itself had the effect of resolving the tax dispute that arose later. Here, however, Wilshire has argued—and the bankruptcy court has held—that Wilshire's plan does have the effect of resolving the tax dispute.

d. Finally, California argues that Section 1146 "does not apply to nondebtors" (Br. 39-40), which is both wrong and irrelevant. Wilshire *is* the debtor, and Wilshire's ability to seek relief is sufficient to justify the bankruptcy court's judgment. California's theory is also textually unsupportable: Section 1146 authorizes the declaration of the "tax effects * * * *of the plan*" without limitation. Congress could have said that courts may declare the plan's tax effects *for debtors*, but Con-

gress had every reason to ensure that *all* parties interested in a plan would have the security of understanding its important tax effects.

In any event, Section 1146 (whether or not directly applicable) stands as irrefutable proof that Congress intended bankruptcy courts to make precisely the determinations, under Section 346, that the bankruptcy court made here. It is passing strange to think that Congress crafted Section 1146 at the same time it believed federal courts would lack any power to enforce Section 346 against non-compliant States.

* * * * *

California repeatedly maintains that the federal judiciary lacks jurisdiction because this is simply a "state tax dispute" (Br. 7), not a federal question under the Bankruptcy Code. This is wrong. Section 346 alone confirms that this is not a "state tax dispute." It is a dispute over the meaning and application of a provision of federal law, found in the Bankruptcy Code, and that provision preempts any state tax standing in the way. California cannot undermine the protective exercise of federal jurisdiction by refusing to acknowledge the primacy of federal law and assuming the answer (*i.e.*, that its own conflicting law controls) to the very question the federal courts have jurisdiction to decide.

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 does not "arise under" federal law, it "relates to" the bankruptcy case (Opening Br. 30-37), and California is incorrect to suggest otherwise.

According to California, Wilshire's proceeding was unnecessary to "'effectuate the terms of [the plan]," had "'no impact on any integral aspect of the bankruptcy plan,'" and could not "'affect the implementation and execution of the plan.'" Br. 44-50. Yet, to explain how undoing the "statutorily defined tax effects of a bankruptcy plan" (*Antonelli*, 123 F.3d at 784) has "no conceivable effect on the plan" (Cal. Br. 45), California says—nothing.

Section 346 is self-executing and automatically applies to Wilshire's plan—there was no need to include "surplusage" that reiterates what it already provides. *Antonelli*, 123 F.3d at 781. California therefore cannot set aside the "statutorily defined tax effects" without setting aside a core feature of the plan itself. *Id.* at 784. This proceeding therefore involves the "interpretation, implementation, consummation, execution, [and] administration of the confirmed plan." *In re Pegasus*

Gold Corp., 394 F.3d 1189, 1194 (9th Cir. 2005).[2] Section 1334(b)'s "very broad" jurisdictional grant (*In re Sasson*, 424 F.3d 864, 868-869 (9th Cir. 2005)) exists to block efforts to interfere with a bankruptcy plan and unwind its effects, and bankruptcy courts have no less power to enforce *Congress's* terms in a plan than the terms of private parties.

In addition, there is nothing "vague or hypothetical" (Cal. Br. 45) about the nexus between this case and the confirmed plan. California can prevail only by disavowing the specific legal findings in the reorganization plan and the order confirming it, which is precisely what the bankruptcy court held California was trying to do. See E.R. 38-39. A dispute over an attempt to replace the plan's legal conclusions with the *opposite* legal conclusions fits comfortably within Section 1334(b)'s jurisdictional grant. See also Fed. R. Bankr. P. 3022 advisory committee's notes to 1991 amendment ("[a] final decree closing the case * * * does not deprive the court of jurisdiction to enforce or interpret its own orders").[3]

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[2] Indeed, Section 346 is in subchapter III, "ADMINISTRATION," of Chapter III, "CASE ADMINISTRATION," of the Bankruptcy Code. Cf. *Piccadilly Cafeterias*, 554 U.S. at 47 (finding "informative" the title of the subchapter within which Section 1146 appears). This proceeding certainly involves the "administration" of the confirmed plan within the meaning of *Pegasus*.

[3] Wilshire has explained why *In re Ray*, 624 F.3d 1124 (9th Cir. 2010), and *In re Valdez Fisheries Develop. Ass'n, Inc.*, 439 F.3d 545 (9th Cir. 2006), are inapposite. Opening Br. 37-39. Suffice it to say that this case, unlike *Valdez Fisheries*,

[Footnote continued on next page]

III. 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

A. 1. California contends that Wilshire's non-debtor partners cannot invoke any rights under Section 346(j)(1), because that section "by its clear language is limited to 'the estate, the debtor, or a successor to the debtor,'" not *non-debtor* partners. Br. 18, 23-24. This misses the point entirely. The non-debtor partners have federal rights, enforceable under Section 346, because the *debtor partnership* has federal rights enforceable under Section 346: the partners may receive only what the *partnership* receives, *United States* v. *Basye*, 410 U.S. 441, 448 & n.8 (1973); Opening Br. 40-42, and the partnership here *is* "the debtor," 11 U.S.C. 346(j)(1). See also 11 U.S.C. 346(c)(1); S. Rep. No. 989, 95th Cong., 2d Sess. 45 (1978).

Because Congress required non-debtor partners to accept the benefits and burdens of the partnership's reorganization plan, 11 U.S.C. 1141(a), it is no answer to say that Section 346(j)(1) is textually limited to the debtor partnership. Con-

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could "affect the implementation and execution of the plan," 439 F.3d at 548, and this case, unlike *Ray*, *does* "necessarily depend upon resolution of a substantial question of bankruptcy law," 624 F.3d at 1135. The BAP itself has since recognized that the decision below went past *Ray*. *In re Valley Health Sys*., 2012 WL 851619, at *9 n.9 (9th Cir. BAP Mar. 13, 2012).

gress devised a system, explicitly, that provides non-debtor rights *by virtue of the debtor partnership's rights*. See 11 U.S.C. 346(c)(1), 1141(a). When California says that, under California law, the partners *are* realizing income, it is necessarily using California law to reconstitute the character of the income at the partnership level, in direct violation of Section 346(j)(1)'s preemptive federal rule. California even admits as much in its "notice of proposed assessment" to the non-debtor partners: "This revision is based on a field auditor's examination report of *the Wilshire Courtyard partnership's return* for the taxable year 1998. *As a result of the 1998 partnership flow-through adjustment*, the taxpayer's carryover items were adjusted." Cal. S.E.R. 92 (emphases added; capitalization altered).

2. California is incorrect that *American Principals Leasing Corp.* v. *United States*, 904 F.2d 477 (9th Cir. 1990), undercuts the court's jurisdiction. Br. 24-26. The statute at issue in *American Principals* authorized bankruptcy courts to "determine the amount or legality of *any* tax." 11 U.S.C. 505(a)(1) (emphasis added). The panel refused to read that expansive language to reach the tax liabilities of non-debtor partners arising from pre-petition lease transactions—which the IRS challenged under tax law having nothing to do with bankruptcy—to avoid the "absurd result of turning the bankruptcy courts into a second tax court system." 904 F.2d at 481.

That decision has no application here, where Section 346 rather than Section 505 is at issue. *American Principals* nowhere said that non-debtor partners may *never* invoke the court's jurisdiction for any tax issue under any Code provision. That case involved pre-petition transactions, and construing Section 505 to give the bankruptcy court jurisdiction to address partners' taxes merely because the partnership later ended up in bankruptcy would indeed have created a second tax court system. This case, by contrast, is an effort to enforce a provision of the Bankruptcy Code that determines the "tax effects" of a core transaction of a bankruptcy reorganization plan. The bankruptcy court gave effect to the command of Section 346(j)(1) that income not be "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." Because applying that specific command of the Bankruptcy Code means that Wilshire—the debtor partnership—did not realize income by reason of the plan's forgiveness of indebtedness, there were important tax consequences for the Wilshire partners (via the *bankruptcy plan*), but that is not the same thing as granting "the bankruptcy courts authority to determine the tax consequences for third parties of a debtor's *activities*" outside of bankruptcy, which is what was at stake in *American Principals*. 904 F.2d at 481 (emphasis altered).

The Eleventh Circuit, in a case involving 11 U.S.C. 1146(c), rejected the theory that California presses here: Section 505(a) by necessity is limited to debt-

ors, but that hardly suggests the court's jurisdiction is always limited when non-debtors assert rights conferred "under *federal bankruptcy law*." *In re T.H. Orlando Ltd.*, 391 F.3d 1287, 1292 (11th Cir. 2004) (Alarcon, J.) (emphasis in original). "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." *Ibid.*

In a bankruptcy case involving a partnership (a pass-through entity for tax purposes), as in any other bankruptcy case, there are compelling reasons for a bankruptcy court to establish, definitively, the tax effects resulting from transactions at the core of a reorganization plan. "The adjudication of substantive entitlements created by bankruptcy law falls squarely within the core jurisdiction of bankruptcy courts." *T.H. Orlando*, 391 F.3d at 1292.

B. Contrary to California's contention (Br. 54-55), the non-debtor partners have not invoked some new category of "'derivative jurisdiction.'" The primary source of jurisdiction for the partners' case is 28 U.S.C. 1334(b), and they have a *direct*, not derivative, right to invoke judicial power under that section. Indeed, it is hard to imagine that Congress would *bind* the general partners to the partnership's plan (11 U.S.C. 1141(a)), but then leave those same partners exposed without any jurisdiction to assert the plan's rights and protections.

In crafting the Bankruptcy Code, Congress guaranteed that bankruptcy courts would remain "open to all 'parties in interest'" (*In re Thorpe Insulation Co.*, 677 F.3d 869, 884 (9th Cir. 2012)): "A party in interest * * * may raise and may appear and be heard on *any* issue in a case under this chapter." 11 U.S.C. 1109(b) (emphasis added). This standard has been "construed broadly" to sweep in "'any-one who has a legally protected interest that could be affected by a bankruptcy proceeding.'" *Thorpe Insulation Co.*, 677 F.3d at 884.

The non-debtor partners have exactly such a protected interest. The partners' rights are dictated by the reorganization plan; that plan provides for the discharge of indebtedness at the partnership level; a State may not treat discharged debt as realized income under Section 346; and that non-realized income is then "ascertained and reported" and "passe[d] to the individual partners," *Basye*, 410 U.S. at 448 & n.8. It follows that the partners have a right, under Section 346, to have a State not treat discharged debt as realized income for tax purposes.

Once California refused to honor this federal directive, the bankruptcy court had the power to "reopen" the case (11 U.S.C. 350(b)) and "adjudicate[e the] substantive entitlements created by bankruptcy law." *T.H. Orlando*, 391 F.3d at 1292. Nothing in Section 1334(b), Section 1109(b), or Section 346 withdraws jurisdiction simply because the non-debtor partners' rights are established by the court's treatment of the pass-through partnership entity.

C. It is true, of course, that the partners may also invoke the court's supplemental jurisdiction because the court already had jurisdiction over Wilshire's claims: the identical constellation of facts makes this an easy question under 28 U.S.C. 1367. See Opening Br. 43. But that separate basis of jurisdiction is the only "derivative" jurisdiction at issue. The non-debtor partners have their own standalone right, as interested parties asserting Section 346's protection, to ask the bankruptcy court to reopen the case and adjudicate this quintessential federal question "arising under" the Code. *Ray*, 624 F.3d at 1131.

IV. CALIFORNIA CANNOT AVOID FEDERAL JURISDICTION BY INVOKING CONSTITUTIONAL ARGUMENTS (WHICH ARE WRONG) OR THE TAX INJUNCTION ACT (WHICH IS IRRELEVANT)

A. Under The Bankruptcy Clause, Congress Had The Enumerated Power To Enact Section 346, Extend It To This Setting, And Apply It To The States, And California's Contrary Contentions Are Both Incorrect And Foreclosed By Settled Precedent

California contends that the canon of constitutional avoidance supports its reading of Section 346 (Br. 42 & n.27), but California is incorrect. Constitutional avoidance is appropriate only where one interpretation raises "*serious* constitutional questions." *Clark* v. *Martinez*, 543 U.S. 371, 380-382 (2005) (emphasis added). There are no such questions here.

First, California says, without explanation, that Section 346 "exceed[s] Congress'[s] power under the Bankruptcy Clause," because "Congress may not

provide a tax exemption to nondebtor partners of a debtor partnership." Br. 40. Yet the Bankruptcy Clause extends Congress's enumerated powers to any law on the "*subject* of Bankruptcies." U.S. Const., Art. I, § 8, Cl. 4 (emphasis added). A law that directly governs the tax effects of forgiven debt, in a bankruptcy, under a central provision of a bankruptcy reorganization plan, is plainly a law on the *subject of bankruptcies*. It is also plainly a rational way to implement this enumerated power: "'the debtor is to be afforded relief from certain taxation to facilitate the implementation of the reorganization plan.'" *Piccadilly Cafeterias*, 554 U.S. at 52; see also *In re Jacoby-Bender, Inc.*, 758 F.2d 840, 841 (2d Cir. 1985).

Nor is California correct that Congress "lacks the authority under the Bankruptcy Clause * * * to nullify state tax laws *as to nondebtors*." Cal. Br. 19 (emphasis added). Textually, this is wrong: the Constitution does not restrict Congress's Article I authority to passing laws on the "subject of *debtors* in Bankruptcies," but speaks more categorically—"its coverage encompasses the *entire* 'subject of Bankruptcies.'" *Cent. Va. Cmty. Coll.* v. *Katz*, 546 U.S. 356, 370 (2006) (emphasis added).[4] And California's proposed line between debtors and non-

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[4] In *Katz*, the Court held that the enactment of 11 U.S.C. 106 was "not necessary to authorize the Bankruptcy Court's jurisdiction over" *in rem* bankruptcy proceedings in which a State asserted a sovereign-immunity defense, because the Constitution's Bankruptcy Clause "reflects the States' acquiescence in a grant of congressional power to subordinate to the pressing goal of harmonizing bankruptcy law

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debtors is especially unworkable in the partnership context. The feasibility of a partnership's reorganization depends substantially on the partners' cooperation—and the final result must ultimately bind the partners in order to "effectuate the *in rem* jurisdiction of the bankruptcy courts." *Id.* at 378. Because the partnership is the "conduit[] through which the taxpaying obligation passes to the individual partners," *Basye*, 410 U.S. at 448 & n.8, the non-debtors receive what the debtor receives; Congress is not powerless, when legislating on this "subject," to extend both burdens *and* benefits of a reorganization plan to non-debtor partners. U.S. Const., Art. I, § 8, Cl. 4.

Second, California is *twice* incorrect (Br. 40) that Section 346, properly construed, "violate[s] the [S]tates' sovereign immunity": (i) "the exercise of [a bankruptcy court's] *in rem* jurisdiction to discharge a debt does not infringe state sovereignty," *Tennessee Student Assistance Corp.* v. *Hood*, 541 U.S. 440, 448 (2004); and in any event (ii) "States agreed in the plan of the Convention not to assert any sovereign immunity defense * * * in proceedings brought pursuant to 'Laws on the subject of Bankruptcies,'" *Katz*, 546 U.S. at 377. Here, the bankruptcy court de-

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sovereign immunity defenses that might have been asserted in bankruptcy proceedings." 546 U.S. at 362. It is nevertheless noteworthy that in Section 106(a) Congress expressly abrogated sovereign immunity "with respect to" specified sections of the Code, including Sections 346 and 1146.

termined the rights associated with the discharge of debt (and disposition of the *res*), which falls squarely within *Hood*'s protection; and the proceedings below, under Sections 346 and 1146, were "brought pursuant to 'Laws on the subject of Bankruptcies,'" which falls squarely within *Katz*'s protection.

California, however, asserts (Br. 42) that enforcing Section 346 is irrelevant to Wilshire's bankruptcy, because it somehow has no effect on the reorganization plan or its confirmation. To the contrary, there is an obvious effect on the plan when a State insists on ignoring its "statutorily defined tax effects." *Antonelli*, 123 F.3d at 784. "[S]ome exercises of bankruptcy courts' powers * * * unquestionably involve[] more than mere adjudication of rights in a res," and the States waived their immunity for "any proceedings necessary to effectuate the *in rem* jurisdiction of the bankruptcy courts." *Katz*, 546 U.S. at 378. Because this proceeding is designed to effectuate the court's jurisdiction over the plan and to enforce the Bankruptcy Code, *In re Diaz*, 647 F.3d 1073, 1084 (11th Cir. 2011), California's assertion of sovereign immunity is unsound.

B. Because Section 346 Is A Law Targeting State Taxes, The Tax Injunction Act Has No Relevance Here

Contrary to California's contention (Br. 51-54), the Tax Injunction Act, 28 U.S.C. 1341, has no role in this case. It is "well established" that the Act "does not prevent a Bankruptcy Court from enforcing the provisions of the Bankruptcy Code that affect the collection of state taxes." *In re Hechinger Inv. Co. of Del., Inc.*, 335

F.3d 243, 247 n.1 (3d Cir. 2003) (Alito, J.). Here, the point of Section 346 is to preempt the collection of state taxes, and Section 1146(d) would be meaningless if the Tax Injunction Act *forbade* federal courts, including bankruptcy courts, from performing the single task it authorizes: "declar[ing]" the "tax effects, under Section 346," of bankruptcy reorganization plans. 11 U.S.C. 1146(d); see also *In re Ellett*, 254 F.3d 1135, 1148 (9th Cir. 2001) (explaining that the authority under 11 U.S.C. 505 to "determine the amount and legality of any tax" survives the Tax Injunction Act). "[T]he general dictates of the [Tax Injunction] Act do not defeat the specific powers Congress has bestowed upon the federal courts under the Bankruptcy Code." *Ellett*, 254 F.3d at 1148.

The State concedes this is the correct standard, but says that "the relief sought is not necessary to the enforcement of specific Bankruptcy Code provisions." Cal. Br. 52. This argument is apparently premised on the belief that California will prevail on its construction of Section 346(j)(1) as allowing California's tax-collection efforts. California's construction is wrong, but even if it were right the Tax Injunction Act would still be irrelevant. That was exactly the situation in *In re Hechinger Investment*, and the Third Circuit (Alito, J.) still exercised jurisdiction: notwithstanding its eventual holding that 11 U.S.C. 1146(c) did not override the state taxes at issue, see 335 F.3d at 246, the Tax Injunction Act did not "bar"

the action because the relief *sought* was necessary to enforce "provisions of the Bankruptcy Code that affect the collection of state taxes," *id.* at 247 n.1.

Section 346's specific command also distinguishes this case from *In re American Bicycle Ass'n*, 895 F.2d 1277 (9th Cir. 1990). There, the only Code section that "might arguably" have supported a tax injunction (895 F.2d at 1279) was 11 U.S.C. 105(a), a *general* provision authorizing the issuance of "any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title." That non-tax-specific provision is wholly unlike Section 346's specific focus on "State or local law[s] imposing a tax." 11 U.S.C. 346(a). Section 346, involving the "statutorily defined tax effects of a bankruptcy plan" (*Antonelli*, 123 F.3d at 784), is linked inextricably to the "specific authorization" in the Code (*Am. Bicycle Ass'n*, 895 F.2d at 1279) that "affect[s] the collection of state taxes" (*Hechinger Investment*, 335 F.3d at 247 n.1).

California also cites *In re J.J. Re-Bar Corp., Inc.*, 644 F.3d 952 (9th Cir. 2011), see Cal. Br. 54, but that decision involved no tax-specific provision of the Bankruptcy Code (and indeed the opinion cites not a single section of Title 11 for any purpose). It involved an attempt "to have the bankruptcy plan" itself "trump the Anti-Injunction Act in an effort to avoid the assessment of an *otherwise uncontested* tax." 644 F.3d at 953 (emphasis added). A case governed by Section 346 is very different.

Because the Tax Injunction Act "did not abridge the power specifically granted to the bankruptcy court" to "enforce[]" the "provisions of the Bankruptcy Act" (*Ellett*, 254 F.3d at 1149), the State is wrong that the Act withdraws federal jurisdiction here.

CONCLUSION

The judgment of the Bankruptcy Appellate Panel should be reversed.

Respectfully submitted.

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CERTIFICATE OF SERVICE

I hereby certify that on July 6, 2012, an electronic copy of the foregoing Reply 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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