IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF MARYLAND
(GREENBELT DIVISION)

In re:	*	Chapter 11
CREATIVE HAIRDRESSERS, INC., *et al.*,	*	Case Nos. 20-14583, 20-14584-TJC
	*	(Jointly Administered)
Debtors.[1]	*	

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POST-HEARING STATEMENT IN SUPPORT OF OBJECTION TO (I) PRIORITY STATUS OF IRS PROOF OF CLAIM AND (II) DUPLICATIVE IRS PROOF OF CLAIM

Creative Hairdressers Inc. and Ratner Companies, L.C., debtors and debtors in possession (the "Debtors"), by and through their undersigned counsel, file this Post-Hearing Statement in Support of Objection to (I) Priority Status of IRS Proof of Claim and (II) Duplicate IRS Proof of Claim (the "IRS Claims Objection")[2] [Dkt. No. 788, December 16, 2020].

ARGUMENT

On November 2, 2021, the Court conducted a hearing on the IRS Claims Objection and the United States' Response to Debtors' Objection to Proof of Claim [Dkt. No. 881, March 3, 2021]. At the conclusion of argument, the Court invited the Parties to submit supplemental argument regarding the impact of the Fourth Circuit's opinion in *Liberty University, Inc. v. Lew*, 733 F.3d 72 (4th Cir. 2013) on the issues before the Court in the IRS Claims Objection. On November 16, 2021, the United States filed its Supplemental Response to Debtors' Objection to Proof of Claim

[1] The Debtors in these chapter 11 cases are: (i) Creative Hairdressers, Inc. ("CHI") and (ii) Ratner Companies, L.C ("RC").

[2] Capitalized terms not defined herein shall have the meaning ascribed in the IRS Claims Objection.

[Dkt. No. 1011]. In turn, the Debtors hereby file their supplemental statement. As hereinafter discussed, *Liberty University* does not alter the legal underpinnings of the IRS Claims Objection.

In *Liberty University*, the Fourth Circuit upheld the constitutionality of the ESRP pursuant to Congress' taxing authority under U.S. Const. art. I, § 8, cl 1. 733 F.3d at 95-98. The Fourth Circuit relied exclusively on the analysis of the Supreme Court in *National Federation of Independent Business v. Sebelius*, 567 U.S. 519 (2012), which upheld the constitutionality of the interrelated ISRP also pursuant to Congress' taxing authority.[3] In essence, *Liberty University* is simply a repeat of the *Sebelius* constitutional analysis. *Id.* at 95 ("[A]lthough *NFIB* did not present the Supreme Court with an opportunity to address the constitutionality of the employer mandate, we are convinced that the *NFIB* taxing power analysis inevitably leads to the conclusion that the employer mandate exaction, too, is a constitutional tax."). To reach its result, the Fourth Circuit cited the same factors set forth in *Sebelius* (*i.e.*, generation of revenue, enforcement by IRS, absence of scienter, burden, lack of consequences beyond liability). *Id.* at 96-98.

Importantly, in both *Sebelius* and *Liberty University*, the respective courts were charged with determining whether the individual mandate and employer mandate should be invalidated as an unconstitutional exercise of Congressional authority. In that context, a federal court is to make every reasonable construction to save a statute from unconstitutionality. *See, e.g.*, *Sebelius*, 567 U.S. at 537-538, 563, 574 (stating that the Supreme Court's reading of Congress' authority "is explained in part by a general reticence to invalidate the acts of the Nation's elected leaders" and that "every reasonable construction must be resorted to, in order to save a save a statute from unconstitutionality"; concluding based on these principles that the ISRP "may reasonably be characterized as a tax" for constitutional purposes). These cases demonstrate that scrutinizing a

[3] *Liberty University* also held that the ESRP, like the ISRP, does not constitute a tax for purposes of the Anti-Injunction Act, focusing on the related nature of the exactions and finding no reason that the two mandates should be treated differently. 733 F.3d at 88-89.

statute for constitutional muster is a much broader and theoretical exercise than determining whether a specific claim in bankruptcy is entitled to be treated as a tax or general unsecured penalty.[4] Thus, while *Sebelius* and *Liberty University* are binding on the constitutionality of the IRSP and ESRP, respectively, the Court should conduct an independent, functional examination of the exaction at issue to determine whether it is a tax for bankruptcy purposes.

As discussed at the hearing, the Supreme Court set forth the relevant test for whether an exaction is a tax or penalty under the Bankruptcy Code in *U.S. v. Reorganized CF & I Fabricators of Utah, Inc.*, 518 U.S. 213, 220-225 (1996).[5] A tax is "a pecuniary burden, laid upon individuals or property, for the purpose of supporting the Government", while a penalty is an exaction imposed by statute as "punishment for an unlawful act or omission." *Id.* at 224. In the bankruptcy context, the functional examination of the provision should be geared to determining its character based upon its operation. *Id.* at 220, 224-225. In *Reorganized CF & I*, the Supreme Court had little difficulty holding that a ten percent "tax" (in the amount of $1.2 million) on a pension plan funding deficiency "must be treated as imposing a penalty, not authorizing a tax" for "bankruptcy purposes", without requiring scienter and notwithstanding that the remedy was only monetary. *Id.* ("punishment for an unlawful omission is what this exaction is"). Ultimately, the Supreme Court looked behind the "tax" label and saw that the exaction was intended to operate in a coercive and punitive manner.

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[4] Even in the constitutional setting, the Supreme Court noted that there comes a point when an exaction becomes so punitive that it loses its character as a tax and becomes a mere penalty with the characteristics of regulation and punishment. *Sebelius*, 567 U.S. at 572-573 ("we need not decide here the precise point at which an exaction becomes so punitive that the taxing power does not authorize it").

[5] *Reorganized CF&I* was cited in the opinion of the court by Chief Justice Roberts in *Sebelius* as setting forth a relevant definition of "penalty." *Sebelius*, 567 U.S. at 567. Thus, it remains good law.

Applying *Reorganized CF & I*, the Court can likewise characterize the $2.1 million ESRP in this case as a penalty for bankruptcy purposes: the ACA sets forth a regulatory mandate for an employer to provide sufficient coverage; the mandate is enforced by a punitive payment for employers who disobey and is intended to act as a deterrent; the aggregate burden in this case is substantial and disproportionate to other claims – the $2.1 million ESRP is the second largest filed claim that asserts priority[6]; and the ESRP should not be construed as primarily providing for support of the government since it is premised upon disobedience.

Finally, for the reasons stated at the hearing, should the Court determine that the ESRP is a tax and not a penalty for bankruptcy purposes, the ESRP is not entitled to priority treatment because it does not satisfy the statutory definition of an "excise tax on- … a transaction occurring during the three years immediately preceding the date of the filing of the petition." 11 U.S.C. § 507(a)(8)(E)(ii).

Respectfully submitted,

Dated: November 30, 2021

/s/ *Joel I. Sher*

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[6] A purported priority class action claim has been filed in the amount of $4 million. *See* Olsen Proof of Claim 460-1 [August 11, 2020]. The Debtors have objected to that claim for numerous reasons [Dkt. No. 858, February 9, 2021].

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that on the 30th day of November, 2021, I reviewed the Court's CM/ECF system and it reports that an electronic copy of the foregoing will be served electronically by the Court's CM/ECF system on the following:

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