

**IN THE UNITED STATES BANKRUPTCY COURT  
FOR THE DISTRICT OF KANSAS**

<b>IN RE:</b>	)	
	)	
<b>CHANCE RIDES, INC.,</b>	)	<b>Case No. 01-12000</b>
	)	<b>Chapter 11</b>
	)	
<b>Debtor.</b>	)	
_____	)	
	)	
<b>CHANCE RIDES, INC.,</b>	)	
	)	
<b>Plaintiff,</b>	)	
	)	
<b>v.</b>	)	<b>Adversary No. 01-5123</b>
	)	
<b>DIRECTOR, DIVISION OF TAXATION,</b>	)	
<b>DEPARTMENT OF THE TREASURY,</b>	)	
<b>STATE OF NEW JERSEY,</b>	)	
	)	
<b>Defendant.</b>	)	
_____	)	

**ORDER DENYING THE DIRECTOR, NEW JERSEY DIVISION OF TAXATION’S  
MOTION TO DISMISS FOR LACK OF JURISDICTION PURSUANT TO 28 U.S.C.  
§1341 OR TO ABSTAIN PURSUANT TO 28 U.S.C. §1334 AND 11 U.S.C. §505.**

This matter is before the Court on the Director, New Jersey Division of Taxation’s motion to dismiss this adversary proceeding for lack of jurisdiction or abstain and remand the matter back to the New Jersey Tax Court for determination of Chance Rides, Inc.’s sales tax and corporate business tax liability. Chance Rides, Inc, debtor, seeks to have this Court determine the degree and extent of its sales and corporate business tax liability to New Jersey under 11 U.S.C. §505(a) of the Bankruptcy Code, which allows this Court to make such a determination. The New Jersey Division of Taxation has previously determined in an administrative proceeding that Chance Rides

had sufficient nexus to New Jersey to render it liable for both Sales and Corporate Business taxes from 1996 forward, and has filed a proof of claim for \$186,500.00, an amount substantially in excess of the amount which will be available to creditors based upon the debtor's liquidation analysis. The New Jersey Division of Taxation asserts that this Court must dismiss Chance Rides, Inc.'s 11 U.S.C. §505 action because the Tax Injunction Act, 28 U.S.C. §1341, bars this Court from exercising jurisdiction.<sup>1</sup> In the alternative, the Division argues that under 28 U.S.C. §1334, this Court must abstain from deciding the tax liability issue because the tax liability issue is not a core proceeding, or if the Court finds that the matter is a core proceeding, that it should discretionarily abstain since its exercise of jurisdiction under §505 is permissive.

Based on the plain language of 11 U.S.C. §505 and City Vending of Muskogee, Inc., v. Oklahoma Tax Com'n, 898 F.2d 122 (10<sup>th</sup> Cir. 1990), the controlling authority on point in this Circuit, the Court finds that the Tax Injunction Act does not preempt its subject matter jurisdiction to determine Chance Rides' tax liability under 11 U.S.C. §505(a). The Court further holds that it need not exercise mandatory abstention under 28 U.S.C. §1334(c)(2), and that it should decline to exercise discretionary abstention under 28 U.S.C. §1334(c)(1).

#### FACTS

The relevant facts are essentially undisputed. From September 30, 1995 through September 30, 2000, Chance Rides, Inc. ("Chance Rides") made 33 sales of large amusement rides to New Jersey customers.<sup>2</sup> These sales were usually made after the customer visited Chance

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<sup>1</sup>In contrast to its position in the briefs, the Division admitted in its answer to Chance's Rides complaint that this Court has jurisdiction and that the matter was a core proceeding under 28 U.S.C. § 157.

<sup>2</sup>Division's Motion, Attachment 2A.

Rides' place of business in Kansas, or made contact at a trade show outside of New Jersey. The rides were generally shipped to New Jersey by common carrier. The customer was responsible for installation of the rides, although employees of Chance Rides's sister corporation, Chance Engineering, Inc., occasionally observed the installation to insure safety.

At some time prior to September 7, 2000, the New Jersey Division of Taxation ("the Division") audited Chances Rides to determine whether it had sufficient contact with New Jersey to be liable for New Jersey sales tax and corporate business taxes. On September 2, 1998, it appears that Chance Rides requested a conference to discuss the tax matters.<sup>3</sup> On September 7, 2000, the Division issued a "Final Determination" in regards to that request, finding that Chance Rides had a "nexus" with New Jersey and was liable for sales tax and corporate business taxes starting January 1, 1995.<sup>4</sup> In addition, the Division also determined that Chance Rides was doing business in New Jersey and was required to file sales tax and corporate business tax returns from January 1, 1995 forward.<sup>5</sup>

On December 1, 2000, and in accordance with New Jersey law, Chance Rides filed a complaint with the New Jersey Tax Court contesting the "Final Determination."<sup>6</sup> Chance Rides then filed an amended complaint on March 30, 2001. The only difference between the allegations in the initial complaint and the amendment is Chance Ride's allegation that New Jersey's assertion of a tax nexus constitutes an impermissible burden on interstate commerce and violates the

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<sup>3</sup>Division's Motion, Attachment 1.

<sup>4</sup>Id.

<sup>5</sup>Id.

<sup>6</sup>Division's Motion, Attachment 2.

Commerce Clause. U.S. Const. art. 1, §8, cl. 3. The Division filed Answers to the Complaint and Amended Complaint, denying Chance Rides' allegations in each.<sup>7</sup> On April 17, 2001, Chance Rides filed its bankruptcy case and in May, 2001, requested that the proceedings in the tax case be suspended.<sup>8</sup> By this time, the tax case had only entered the discovery phase. The Tax Court proceeding is therefore incomplete.

On June 12, 2001, Chance Rides filed this adversary complaint in under 11 U.S.C. §505 to determine the validity and amount, if any, of Chance Rides' New Jersey tax liability. On July 16, 2001, the Division filed a proof of claim in the bankruptcy case for \$186,500.00 for estimated sales tax and actually reported corporation business tax.

Chance Rides and its companion debtors filed their joint first amended chapter 11 plan and disclosure statement on November 21, 2001. This Court has set the hearing on the adequacy of the disclosure statement under 11 U.S.C. §1125 for January 10, 2002. Acceptances of the plan will be solicited thereafter and a hearing on the confirmation of the debtors' plan may occur in the next several months. Debtors' plan provides, inter alia, that priority tax claimants will receive payment in full of their claims via the liquidation of assets and avoidance causes of action. The unsecured creditors in this case, whose scheduled claims total in excess of \$2,600,000.00, will recover nothing until the priority claims are paid in full. The allowance of the claims of the New Jersey Tax Division will have substantial impact on the dividend which may or may not be paid to the unsecured creditors.

THE COURT HAS SUBJECT MATTER JURISDICTION UNDER  
11 U.S.C. §505(a) TO DECIDE THIS MATTER.

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<sup>7</sup>Division's Motion, Attachment 3A.

<sup>8</sup>Division's Motion, Attachment 4.

11 U.S.C. §505(a) provides:

(a)(1) Except as provided in paragraph (2) of this subsection, the court may determine the amount or legality of any tax, any fine or penalty relating to a tax, or any addition to tax, whether or not previously assessed, whether or not paid, and whether or not contested before and adjudicated by a judicial or administrative tribunal of competent jurisdiction.

(2) The Court may not so determine—

(A) the amount or legality of a tax, ... if such amount or legality was contested before and adjudicated by a judicial or administrative tribunal of competent jurisdiction before the commencement of the case under this title; ...

The Tax Injunction Act, 28 U.S.C. §1341, provides:

“The district courts shall not enjoin, suspend, or restrain the assessment, levy or collection of any tax under state law where a plain, speedy and efficient remedy may be had in the courts of such state.”

Contrary to the Division’s argument that the Tax Injunction Act “deprives this Court of jurisdiction to consider the merits of the present complaint,”<sup>9</sup> 28 U.S.C. §1341 does not “preclude the determination of state tax liability where federal courts have jurisdiction under the Bankruptcy Code, 11 U.S.C. §505.” City Vending of Muskogee, Inc., v. Oklahoma Tax Com’n, 898 F.2d 122, 123 (10<sup>th</sup> Cir. 1990)(citing supporting cases). “Section 505 gives federal courts authority to determine, in bankruptcy proceedings, the amount and legality of any tax, 11 U.S.C. §505(a)(1), except where the amount and legality of the tax has been ‘contested before and adjudicated by a judicial or administrative tribunal of competent jurisdiction’ prior to the commencement of bankruptcy proceedings., 11 U.S.C. §505(a)(2)(A).” 898 F.2d at 124. See also City of Perth Amboy v. Custom Distr. Serv., Inc. (In re Custom Distr. Serv., Inc.), 224 F.3d 235, 239-40 (3<sup>rd</sup>

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<sup>9</sup>Division’s Motion, p. 6.

Cir. 2000); In re Stoecker, 179 F.3d 546, 549 (7<sup>th</sup> Cir. 1999), aff'd on other grounds, sub nom Raleigh v. Illinois Dept. of Rev., 530 U.S. 15 (2000)(“The Bankruptcy Code expressly authorizes bankruptcy courts to decide tax issues, 11 U.S.C. §505(a)(1), and although *state* taxes are not specified, the courts have interpreted the statute to cover them.”)(emphasis in original); In re Hechinger Invest. Co. of Delaware, 254 B.R. 306, 315 (Bankr. D. Del. 2000)(“Section 505(a) carves out an exception to the Tax Injunction Act and confers jurisdiction on the bankruptcy court to determine a debtor’s tax liability.”)

In this case, there has neither been an assessment of any tax amount, nor any contest or adjudication of tax liability against Chance Rides in New Jersey. The Division has filed a priority proof of claim only for *estimated* Sales and Corporation Business taxes from January 1, 1995 forward.<sup>10</sup> The New Jersey Department of the Treasury has only determined that Chance Rides had a sufficient “nexus” to New Jersey making it liable for the collection and payment of Sales and Corporate Business taxes and subject to the filing of these tax returns. The determination has been challenged in the state’s Tax Court, but that proceeding had not concluded prior to the commencement of this bankruptcy case. Thus, there has been no “adjudication” as §505(2)(A) would contemplate and this Court clearly can exercise jurisdiction of this issue under 11 U.S.C. §505(a).

The Court believes that it can and should provide a speedy resolution of this tax issue in the context of allowing the Division’s claim under the Bankruptcy Code. “Section 505 allows the prompt resolution of a debtor’s tax liability, where that liability has not yet been determined prior to the bankruptcy proceeding, in the same forum addressing the debtor’s overall financial

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<sup>10</sup>Division’s Motion, p. 3.

condition.” City Vending, 898 F.2d at 124-25 (citing City of New York v. Fashion Wear Realty Co. (In re Fashion Wear Realty Co.), 14 B.R. 287, 290 (D.C. N.Y. 1981); In re Diez, 45 B.R. 137, 139 (Bankr. S.D. Fla. 1984). “If federal courts could not determine the debtor’s liability for state taxes – if they had to abstain pending a determination of that liability in state court – bankruptcy proceedings would be even more protracted than they are.” Stoecker, 179 F.3d at 549. In deciding whether to exercise its discretion to hear the tax matter, the Court must consider whether a bankruptcy purpose would be served and if an alternative forum for the dispute exists. See In re Gossman, 206 B.R. 264, 267 (Bankr. N.D. Ga. 1997).

From the attachments and exhibits submitted with the Division’s motion, it appears that a resolution of the matter can be held in a more timely fashion in this Court. The Court bases its opinion on the fact that Chance Rides initially appealed the Division’s decision that it had a nexus with New Jersey on September 2, 1998, however a “final determination” was not made until September 7, 2000, some two years later. A further lengthy delay in determining the amount of taxes owed to New Jersey would seriously harm the administration of Chance Rides’ and any chance it has of a successful Chapter 11 reorganization. Clearly, this Court has jurisdiction to determine the amount and legality of any state taxes owed to New Jersey, and making this determination promptly is critical to the timely consideration of Chance Rides’ chapter 11 plan.

THE COURT IS NOT REQUIRED TO ABSTAIN FROM ADJUDICATING  
CHANCE RIDES’ TAX LIABILITY UNDER 28 U.S.C. §1334 OR 11 U.S.C. §505(a).

The Division alternatively argues that this Court should abstain, either mandatorily or discretionarily, from deciding this adversary proceeding because Chance Rides’ tax liability issues are currently pending in the New Jersey Tax Court, which is “deemed to be an expert on

deciding tax issues,”<sup>11</sup> and the factors for abstention are present. See 28 U.S.C. §1334(c)(1),(2).

Section 1334(c)(2) governs mandatory abstention. In order for mandatory abstention to apply, five (5) factors must be met. They are: (1) the party seeking abstention must timely file a motion; (2) the adversary proceeding must be based on a state law claim or cause of action; (3) the adversary proceeding is “related to” a case under Title 11, but does not “arise under” Title 11 or “arise in” a case under Title 11; (4) the action could not have been commenced in federal court absent bankruptcy jurisdiction; and (5) the action can be timely adjudicated in a state forum of appropriate jurisdiction. In re Clayter, 174 B.R. 134, 141-42 (Bankr. D. Kan. 1994). Core proceedings are those proceeding that “arise in” or “arise under” the Bankruptcy Code. 28 U.S.C. §157(b)(1). If the Court’s authority to determine Chance Rides’ tax liability under 11 U.S.C. §505(a) “arises in” or “arises under” Title 11, then the Court is not required to abstain.

Because §505(a) specifically provides bankruptcy courts with jurisdiction to hear tax liability matters, most courts have held that a §505(a) proceeding “arises under” the Bankruptcy Code and is a “core proceeding.” “A proceeding ‘arises under’ the Bankruptcy Code if it asserts a cause of action created by the Code, such as exemption claims under 11 U.S.C. §522, avoidance actions under 11 U.S.C. §§544, 547, 548 or 549, or claims of discrimination under 11 U.S.C. §525. (citation omitted).” In re Midgard Corp., 204 B.R. 764, 771 (10<sup>th</sup> Cir. B.A.P. 1997). Additionally, proceedings affecting liquidation of the estate’s assets or adjustment of the debtor-creditor relationship are included in the Bankruptcy Code’s non-exhaustive list of core proceedings. See 28 U.S.C. §157(b)(2)(O); In re Kreidle, 143 B.R. 941, 945 (D. Colo. 1992). “Assessment and collection of a tax liability that relates to a pre-petition or pre-confirmation tax

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<sup>11</sup>Division’s motion, p. 8.

year will affect the validity of the plan's confirmation and therefore the issue is core. Kreidle, 143 B.R. at 945 (citing In re Brooks Fashion Stores, Inc., 124 B.R. 436, 441 (Bankr. S.D. N.Y. 1991)). See also In re Service Merch. Co., Inc., 262 B.R. 738, 743 (Bankr. M.D. Tenn. 2001)(listing cases); United States v. In re Gordon Sel-Way, Inc. (In re Gordon Sel-Way, Inc.), 239 B.R. 741, 747 (E.D. Mich. 1999). Since Chance Rides' §505(a) adversary proceeding is a "core proceeding," and, as stated above, the Court is not convinced that the tax liability issues can be timely adjudicated in the New Jersey tax courts, the Court is not required to mandatorily abstain from hearing the tax issues.

The Court also concludes that the interests of comity do not require it to exercise discretionary abstention over the tax liability issues presented in this case. 28 U.S.C. §1334(c)(1). Section 1334(c)(1) states: "Nothing in this section prevents a district court in the interest of justice, or in the interest of comity with State courts or respect for State law, from abstaining from hearing a particular proceeding arising under title 11 or arising in a related to a case under title 11." Under this statute, Congress has given this Court the right to use discretionary abstention, which can be invoked when the Court sees fit to do so. In re Mills, 163 B.R. 198, 202 (Bankr. D. Kan. 1994)(citing In re Wicecarver, 110 B.R. 957, 959 (Bankr. D. Kan. 1990)). Courts have found various factors relevant in deciding whether to abstain under §1334(c)(1). Some of the factors relevant here include the effect or lack thereof on the efficient administration of the estate if a Court recommends abstention, the degree of relatedness or remoteness of the proceeding to the main bankruptcy case, and the burden on the bankruptcy court's docket. Mills, 163 B.R. at 202-03.<sup>12</sup> Additionally, relief under §505(a) is discretionary. ("[T]he court *may* determine the amount

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<sup>12</sup>An exhaustive list of the factors Courts' consider in whether to exercise discretionary abstention can be found in In re Mills, 163 B.R. 198, 202-03 (Bankr. D. Kan. 1994).

or legality of any tax ...”) In deciding whether to exercise authority under §505(a), courts have analyzed, (1) the complexity of the tax issue; (2) the need to administer the bankruptcy case in an expeditious fashion; (3) the burden on the bankruptcy court’s docket; (4) the length of time necessary to conduct the hearing and to render a decision thereafter; (5) the asset and liability structure of the debtor; and (6) the potential prejudice to the debtor, the taxing authority, and creditors. See In re New Haven Prod., L.L.C., 225 F.3d 283, 289 (2<sup>nd</sup> Cir. 2000), cert denied 531 U.S. 1150 (2001).

A prompt determination of Chance Rides’ tax liability is essential to continuing and completing the administration of this bankruptcy case. The allowance of the Division’s \$186,500.00 priority claim will have a significant affect on the rights of unsecured creditors under Chance Rides’ reorganization plan, and therefore, is closely related to the administration of this case. There is also the need for a timely resolution of the tax liability matters which can be adjudicated more quickly by this Court, whose docket will not be overburdened by this adversary proceeding. While it will be somewhat prejudicial to the Division to litigate this matter in Kansas, it would be even more prejudicial to Chance Rides, who is impecunious at best, to litigate this matter, which implicates a Commerce Clause issue, in the New Jersey courts without access to any federal judicial intervention until such time as a final decision of the highest appellate court of New Jersey could be appealed to the United States Supreme Court. While this Court is always solicitous of issues of comity and holds deep respect for the state court, the prompt overall resolution of this bankruptcy case requires that this controversy be resolved here, rather than in New Jersey.

For these reasons, the Division’s motion for abstention is also DENIED. Counsel are reminded that the Scheduling Order entered in this adversary proceeding on September 6, 2001 set

a discovery termination date of November 30, 2001 and a pretrial order deadline of November 30, 2001. The Court will take up the status of this adversary proceeding at the hearing on the adequacy of Chance Rides' disclosure statement which is set for January 10, 2002 at 10:30 a.m.. New Jersey counsel for the Division may participate in that hearing by telephone.

IT IS SO ORDERED.

Dated this 5<sup>th</sup> day of December, 2001.

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ROBERT E. NUGENT, BANKRUPTCY JUDGE  
UNITED STATES BANKRUPTCY COURT  
DISTRICT OF KANSAS

#### CERTIFICATE OF SERVICE

The undersigned certifies that a copy of the **Order Denying The Director, New Jersey Division Of Taxation's Motion To Dismiss For Lack Of Jurisdiction Pursuant To 28 U.S.C. §1341 Or To Abstain Pursuant To 28 U.S.C. §1334 And 11 U.S.C. §505** was deposited in the United States mail, postage prepaid on this 5<sup>th</sup> day of December, 2001, to the following:

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