



SO ORDERED.

SIGNED this 18 day of October, 2006.

Dale L. Somers

Dale L. Somers
UNITED STATES BANKRUPTCY JUDGE

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

In Re:

**STEVEN CUSTER SMITH and
SANDRA JOANNE SMITH,**

DEBTORS.

**CASE NO. 05-21483
CHAPTER 7**

**MEMORANDUM AND ORDER DISMISSING DEBTORS'
MOTION TO DETERMINE TAX LIABILITY PURSUANT TO 11 U.S.C. § 505(a)(1)**

Following oral argument, the Court took under advisement the objection to Debtors' Motion to Determine Tax Liability Pursuant to 11 U.S.C. § 505(a)(1) (hereafter "Motion").¹ The Debtors, Steven and Sandra Smith, appear by Carl R. Clark and Andrew D. Hennier, Lentz & Clark, P.A. The

¹ The Court finds that the Motion initiated a contested matter within the meaning of Fed. R. Bankr. P. 9014.

United States (hereafter “IRS”), which opposes the Debtors’ Motion, appears by Thomas W. Curteman, Jr., United States Department of Justice. There are no other appearances. The Court is now ready to rule. For the reasons stated below, the Court denies the Motion for lack of a case or controversy.

I. DEBTORS’ MOTION AND IRS RESPONSE.

The Debtors filed for relief under Chapter 7 on April 8, 2005. Subsequent to the filing of the case, Debtors filed amended tax returns² stating they were entitled to substantial refunds. Postpetition Debtors received refunds of \$23,001.98 from the United States, \$11,830 from the Kansas Department of Revenue, and \$609 from the Missouri Department of Revenue. The Trustee made demand upon Debtors for turnover of the refunds in the total amount of \$35,843.74.³

Debtors filed the Motion pursuant to 11 U.S.C. § 505(a)(1)⁴ asking the Court to determine the amount or legality of taxes⁵ before turnover. Section 505(a)(1) 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

² The Debtors state the returns were amended returns, but the IRS states it has records of original returns but not amended returns.

³ The demand must include some interest since it exceeds the sum of the foregoing refunds.

⁴ This case was filed before October 17, 2005, when most provisions of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 become effective. All statutory references to the Bankruptcy Code are to 11 U.S.C. §§ 101 - 1330 (2004), unless otherwise specified. All references to the Federal Rules of Bankruptcy Procedure are to Fed. R. Bankr. P. (2004), unless otherwise specified.

⁵ The IRS states the tax years in issue are 2002 through 2005. Debtors do not refute this position.

assessed, whether or not paid, and whether or not contested before and adjudicated by a judicial or administrative tribunal of competent jurisdiction.

The refunds are being held in trust by the Debtors' attorney pending the outcome of the Debtors' Motion for determination of tax liability.

Debtors in essence seek a declaratory judgment that they have no unpaid tax liabilities for the years in issue. The Motion states, "the Debtors in the instant case seek such determination [of tax liability] in an effort to avoid a future audit and redetermination of the amounts of the refunds." The IRS is the only party objecting to the Motion, even though Debtors are seeking determination of taxes owed to the states of Kansas and Missouri.

The IRS's objection is essentially a motion to dismiss. The IRS argues that in order for a Bankruptcy Court to have jurisdiction over tax liability pursuant to § 505, "the matter must be ripe for adjudication; a case or controversy must presently exist as to tax liability." The IRS argues in this case there is no case or controversy with respect to the refunds issued by the IRS to the Debtors or with respect to liability for taxes for tax years 2002 through 2005. None of the taxing authorities have filed proofs of claim, and neither the Debtors nor the Trustee have filed proofs of claim on their behalf. There is no evidence that any investigations or audits are being conducted.

In response, Debtors argue that since the Debtors had income for tax years 2002 through 2005, based on that income they have tax liabilities, and they may or may not have paid sufficient money to satisfy those liabilities. They assert the express purpose of the Motion is to reach a final and certain resolution of the amount of the liabilities. Debtors assert that the plain language of § 505 supports jurisdiction. In Debtors' view, because in this case the estate has assets to be distributed, the

determination of Debtors' tax liabilities is a ripe issue. They argue that in order for the Trustee to do his job and distribute the assets of the estate, the tax liabilities for the years subject to the motion must be determined now, rather than later.

II. ANALYSIS.

The Code, in addition to the general process for resolution of disputed claims, includes § 505, which is a unique vehicle for determination of tax claims. "Section 505(a) imposes only two significant limitations on the bankruptcy court's jurisdiction to determine federal tax liabilities. They are: (i) the prohibition against determining (or redetermining) a tax liability contested and adjudicated before a judicial or administrative tribunal of competent jurisdiction before the commencement of the case under title 11, and (ii) the requirement that there be an actual controversy based upon a filed tax return."⁶ The first requirement arises from subsection (a)(2) and is not relevant to this case because it is agreed that there has been no prior judicial or administrative determination of the Debtors' federal tax liabilities. The second requirement, that there be an actual controversy, arises from the Article 3, Section 2 of the Constitution which allows federal courts to act only in cases and controversies. Bankruptcy courts have been assigned by Congress the authority to resolve disputes which would otherwise be decided by the district courts.⁷ Because the district courts are constrained by the Constitution not to render advisory opinions but to decide only cases and controversies, it follows the bankruptcy courts are

⁶ 15 *Collier on Bankruptcy* ¶ TX5.04[2][a] (Alan N. Resnick and Henry J. Sommer, eds.-in-chief, 15th ed. rev. 2005).

⁷ 28 U.S.C. § 1334 and 157(a).

likewise constrained.⁸ In resolving the IRS objection to the Motion, the determinative jurisdictional issue is whether there is an actual controversy.

Much ink has been spilled over the definition of case or controversy. One statement is the following, basically, the question in each case is whether the facts alleged, under all the circumstances, “show there is a substantial controversy, between parties having adverse legal interests, of sufficient immediacy and reality to”⁹ establish jurisdiction. Whether particular facts are sufficiently immediate and real to make an actual controversy must be determined on a case-by-case basis.¹⁰

The primary case relied upon by the Debtors in support of the existence of a case or controversy is *In re Kilen*.¹¹ Debtor Kilen, an individual who filed under Chapter 11, was the owner, director or officer of corporations, each of which had also filed for bankruptcy relief. The court identified debtor’s potential liability for withholding taxes owed by the corporations as his most significant financial problem. Debtor’s Chapter 11 plan was confirmed. Even though pursuant to the plan \$640,000 was set aside to satisfy debts owed to various tax collectors, the IRS showed little interest in resolving the amount of liability. Debtor filed claims on behalf of the United States for any and all personal liability he might have for unpaid corporate withholding taxes. Debtor also filed an

⁸ *Kilen v. United States (In re Kilen)*, 129 B.R. 538, 543 (Bankr. N.D. Ill. 1991).

⁹ *Maryland Cas. Co. v. Pacific Coal & Oil Co.*, 312 U. S. 270, 273 (1941) (applying standard for purposes of the Declaratory Judgment Act). The word “controversy” in the Declaratory Judgment Act is the equivalent of the word “controversy” in Article III of the Constitution. *In re Kilen*, 129 B.R. at 544 n. 12.

¹⁰ 10B Charles Alan Wright, Arthur R. Miller & Mary Kay Kane, *Federal Practice and Procedure* § 2757 (3d ed. 1998).

¹¹ *In re Kilen*, 129 B.R. at 538.

adversary complaint objecting to those claims and seeking entry of declaratory judgment that the amount of his liability or declaring that he owed the government nothing. The government argued the claim should be denied since the IRS had not assessed or proposed to assess penalties for tax deficiencies against the debtor for these corporations so that there was no existing case or controversy for the court to resolve under § 505. The court defined the “basic element of the case or controversy requirement is that there be individual injury”¹² and noted that as a minimum the Constitution requires “actual or threatened injury as a result of the putatively illegal conduct of the defendant.”¹³ The court found a case or controversy based upon the existence of concrete injury of significant magnitude to overcome the problem of a contingency arising from the fact that the IRS had not acted to collect the tax.

In arguing that there is no case or controversy in this case, the IRS relies upon the following: The IRS has not challenged the amount or validity of the refund received by the Debtors; the IRS did not disallow the refund; there are no pending audits or assessments as to the tax returns filed by the Debtors for tax years 2002 to 2005; the IRS did not file a proof of claim and does not anticipate doing so; and neither the Debtors nor the Trustee has filed a proof of claim.

At oral argument the Debtors suggested no contrary facts from which the existence a case or controversy could be found. This case is clearly distinguishable from *In re Kilen*, the case relied upon by Debtors. In that case the debtor’s potential liability as a responsible person for the unpaid corporate withholding taxes was the debtor’s most significant financial issue. Debtor had filed a proof of claim to

¹² *Id.*, 129 B.R. at 544.

¹³ *Id.*

place the matter in controversy and set aside funds for payment of tax liabilities in his confirmed Chapter 11 plan. In this case, there is no proof of claim or other basis from which the Court can find an issue as to the Debtors' liability for unpaid taxes. No actual or threatened injury is identified. Debtors appear to be in the same situation as many Chapter 7 debtors where tax returns have been filed but not audited, taxes owed and paid, and assets will be distributed without a ruling under § 505 that Debtors owe no additional taxes. Debtors identify no circumstances indicating a case or controversy for purposes of § 505 jurisdiction.

Although the Motion addresses liability for taxes owed to the United States, Kansas, and Missouri, the objection and the response to the objection addresses only federal taxes. Debtors have not argued that their state tax liabilities are different from their federal liabilities for purposes of jurisdiction under § 505. The Court therefore finds there is no case or controversy as to the state as well as the federal taxes.

For the forgoing reason, the Court finds that it lacks jurisdiction to determine the Debtors' Motion to Determine Tax Liability Pursuant to 11 U.S.C. § 505(a)(1) and the Motion must be dismissed.

The foregoing constitute Findings of Fact and Conclusions of Law under Rule 7052 of the Federal Rules of Bankruptcy Procedure and Rule 52(a) of the Federal Rules of Civil Procedure. A judgment based upon this ruling will be entered on a separate document as required by Federal Rule of Bankruptcy Procedure 9021 and Federal Rule of Civil Procedure 58.

IT IS SO ORDERED.

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