

U.S. BANKRUPTCY COURT
District of South Carolina

Case Number: 07-00530

ADVERSARY PROCEEDING NO: 07-80137

ORDER ON DEFENDANT'S MOTION TO DISMISS ADVERSARY PROCEEDING

The relief set forth on the following pages, for a total of 8 pages including this page,
is hereby ORDERED.

FILED BY THE COURT
05/09/2008



A handwritten signature in black ink, appearing to read "S. R. O.", written over a horizontal line.

US Bankruptcy Court Judge
District of South Carolina

ENTERED

MAY 12 2008

D.L.L.

**UNITED STATES BANKRUPTCY COURT
DISTRICT OF SOUTH CAROLINA**

In re,

Christopher Evan Reese and Darla Randolph
Reese,

Debtor(s).

Christopher Evan Reese, Darla Randolph
Reese,

Plaintiff(s),

v.

INTERNAL REVENUE SERVICE, The
United States of America,

Defendant(s).

C/A No. 07-00530-DD

Adv. Pro. No. 07-80137-DD

Chapter 7

**ORDER ON DEFENDANT'S
MOTION TO DISMISS
ADVERSARY PROCEEDING**

THIS MATTER came before the Court for hearing on March 24, 2008 on the United States of America's Motion to Dismiss Plaintiffs' Amended Complaint. Appearing in person for the United States was Benjamin L. Tompkins and appearing telephonically for Plaintiffs Christopher and Darla Reese was Richard R. Gleissner. The Court having reviewed the record of this case, including the motion, Plaintiffs' response and the United States' reply (Docs. 16, 19 & 20) and after hearing the parties' oral arguments, the Court finds that the United States' motion to dismiss is granted in part and denied in part. Specifically, as set forth in the United States' motion to dismiss and its reply (Docs. 16 and 20), the Court finds as follows:

A. Count I – To Determine the Extent, Validity, and Priority of the IRS Claim

Count I of Plaintiff's complaint requests this Court to "determine the extent, validity, and priority" of the Internal Revenue Service's ("IRS") claim which is based on 26 U.S.C § 6672 and the nonpayment of withholding taxes and penalties. Based on the Federal

Courts' liberal "notice pleading" requirements of Fed. R. Civ. P. 8, the Court views Plaintiff's Count I as requesting relief under 11 U.S.C. §§ 502(b) and 505. See 2-8 *Moore's Federal Practice - Civil* § 8.04 ("A claimant does not have to set out in detail the facts on which the claim for relief is based, but must provide a statement sufficient to put the opposing party on notice of the claim.... The intent of the liberal notice pleading system is to ensure that claims are determined on their merits rather than through missteps in pleading); See also *Chao v. Rivendell Woods, Inc.*, 415 F.3d 342 (4th Cir. N.C. 2005).

Defendant concedes that IRS (i.e., United States) has waived sovereign immunity with respect to the claim filed and pursuant to 11 U.S.C. § 502(b) Plaintiffs are entitled to challenge the validity and amount of the IRS's claim. See *Georgia Dep't of Revenue v. Burke (In re Burke)*, 146 F.3d 1313, 1319 (11th Cir. Ga. 1998)("[B]y filing a proof of claim in the debtors' respective bankruptcy proceedings, the State waived its sovereign immunity for purposes of the adjudication of those claims").

Furthermore, under 11 U.S.C. § 505 the Court has the authority to determine "any unpaid [tax] liability of the debtor that has not been contested before or adjudicated by a judicial or administrative tribunal of competent jurisdiction prior to the commencement of the case under title 11." 4-505 *Collier on Bankruptcy-15th Edition Rev. P 505.01*.

Sovereign immunity is waived as to 11 U.S.C. §§ 502(b) and 505 pursuant to 11 U.S.C. 106(a)(1).

In the alternative Plaintiffs' Count I asserts a compulsory counterclaim against the IRS for alleged negligence. This counterclaim must be dismissed for two reasons: First, Sovereign immunity has not been waived as to common law negligence under these

circumstances. Plaintiff argues that 11 U.S.C. § 106(b) waives sovereign immunity as to compulsory counterclaims. 11 U.S.C. § 106(b) states,

A governmental unit that has filed a proof of claim in the case is deemed to have waived sovereign immunity with respect to a claim against such governmental unit that is property of the estate and that arose out of the same transaction or occurrence out of which the claim of such governmental unit arose.

11 U.S.C. § 106(b). It is true Section 106(b) waives sovereign immunity for certain counterclaims, but such waiver requires that the permissive or compulsory counterclaim be “property of the estate.” In the present case the Debtors are not the taxpayer. Rather, a corporation in which Debtors are shareholders is the taxpayer and any cause of action for negligence, if one exists, belongs to the corporation, not Debtors.

Second, supposing 11 U.S.C. § 106 did waive sovereign immunity as to the counterclaim and Debtors could assert a claim, it would nonetheless be barred by the Federal Tort Claims Act (“FTCA”). *28 U.S.C. § 2671 et seq.* While 11 U.S.C. § 106 waives sovereign immunity for certain counterclaims, it does not itself create a cause of action. *See 11 U.S.C. § 106(a)(5)*. *See also In re Supreme Beef Processors, Inc.*, 468 F.3d 248 (5th Cir. Tex. 2006). Thus, Plaintiff must rely on nonbankruptcy law in maintaining this cause of action against the United States. The FTCA waives sovereign immunity as to certain tort claims stating, “[t]he United States shall be liable, respecting the provisions of this title relating to tort claims, in the same manner and to the same extent as a private individual under like circumstances, but shall not be liable for interest prior to judgment or for punitive damages.” *28 U.S.C. § 2671*. However, the FTCA also contains numerous exceptions to this waiver including for “[a]ny claim arising in respect of the assessment or collection of

any tax....” 28 U.S.C. § 2680. Plaintiff’s counterclaim falls under this exception, and as such, must be dismissed.

B. Count II – Determination that Debt of IRS is Discharged

Count II of Plaintiffs’ amended complaint fails to state a claim upon which relief may be granted because 11 U.S.C. § 523(a)(1)(A) provides that the trust fund recovery penalties assessed against the Plaintiffs under 26 U.S.C. § 6672 are excepted from discharge. Despite Plaintiffs’ reliance upon 11 U.S.C. § 105, this section does not provide authority for the Court to discharge the tax liabilities assessed against Plaintiffs when such an action would contradict the specific provisions of the Bankruptcy Code. *See O’Neal v. Educ. Res. Inst. (TERI) (In re O’Neal)*, ___ B.R. ___, 2008 Bankr. LEXIS 893, 2008 WL 915973 (Bankr. D.S.C. Mar. 31, 2008)(quoting *Official Committee of Equity Sec. Holders v. Mabey*, 832 F.2d 299 (4th Cir. Va. 1987))(“The equitable powers of § 105(a) are not ‘a license for a court to disregard the clear language and meaning of the bankruptcy statute and rules.’ Where a remedy is supplied by statute, § 105 has no place in expanding the available relief”). This dismissal is without prejudice to an amendment asserting a statutory and factual basis for the Court to discharge this liability.

C. Count III – Equitable Subrogation

Count III survives in part and is dismissed in part. Sovereign immunity for relief under 11 U.S.C. § 510 is waived pursuant 11 U.S.C. 106(a)(1). Plaintiff’s complaint requests equitable subrogation pursuant to 11 U.S.C. § 510 stating, “the conduct of the IRS justifies the equitable subordination of [the IRS] claim to both discharge that claim and to allow payments to unsecured creditors prior to any payments to the IRS based upon its

priority status.” Debtors’ cause of action requesting subordination of the IRS’s claim to unsecured creditors survives Defendant’s motion to dismiss.

However, Plaintiffs’ request that the claim be equitably subordinated to “discharge” misses the mark. Plaintiffs’ request appears to be an attempt to expand 11 U.S.C. § 510 to include “equitable discharge.” Section 510 does not provide such relief. Count III is dismissed to the extent it attempts to equitably subrogate the IRS claim to discharge. Plaintiffs are given leave, however, to file an amended complaint for equitable subordination.

D. Count IV – Breach of Fiduciary Duty

Count IV should be dismissed for the same reasons the Court dismisses Plaintiffs’ counterclaim in Count I. First, the breach of fiduciary duty concerns the alleged failure of the IRS to collect certain accounts receivable. The accounts receivable are property of Debtors’ corporation and are not owned by Debtors. Thus, 11 U.S.C § 106(b) does not waive sovereign immunity. Additionally, breach of fiduciary duty is a common law cause of action and § 106(a)(5) does not create a “substantive claim for relief or cause of action not otherwise existing under this title, the Federal Rules of Bankruptcy Procedure, or nonbankruptcy law.” *11 U.S.C. § 106(a)(5) and Supreme Beef, Supra*. The cause of action is barred by the FTCA because the claim arises “in respect of the assessment or collection of any tax.” *28 U.S.C. § 2680(c)*. Because the FTCA bars tort claims resulting from the assessment and collection of taxes, Count IV is dismissed.

E. Count V – Violation of the Automatic Stay

Count V of the amended complaint survives. 11 U.S.C. § 106(a)(1) specifically waives sovereign immunity for causes of action with respect to 11 U.S.C. § 362 including

violations of the stay under § 362(k)(1). However, recovery is limited by 11 U.S.C.

§ 106(a)(3). *Fla. Dep't of Rev. v. Omine (In re Omine)* states,

Section 106(a)(3) clearly states that "[t]he court may issue against a governmental unit an order . . . under such sections." The phrase "such sections" in § 106(a)(3) unambiguously refers to the list of sections in § 106(a)(1), which includes an order pursuant to § 362, the section that addresses the automatic stay, and § 105, the section that addresses the power of the court to issue orders necessary to carry out the provisions of the Bankruptcy Code. A plain reading of § 106(a)(3) requires that "such order or judgment for costs or fees under this title" shall be consistent with the provisions and limitations of 28 U.S.C. § 2412(d)(2)(A) and may not include an award of punitive damages.

Fla. Dep't of Rev. v. Omine (In re Omine), 485 F.3d 1305, 1317 (11th Cir. Fla. 2007).

Furthermore, to the extent Plaintiffs seek an award of attorneys' fees; they must first establish that they have complied with the requirement to exhaust administrative remedies.

See 26 U.S.C. § 7433(e)(2)(B)(i); 26 U.S.C. § 7430; and 26 C.F.R. § 301.7433-2 (h).

For the reasons provided above, accordingly, it is ORDERED AND DECREED that

1. Plaintiffs' claim for negligence in Count I is dismissed;
2. Count II is dismissed with leave to amend;
3. Count III is dismissed in part with leave to amend their Complaint and assert a basis for discharge of the tax liability;
4. Count IV is dismissed;
5. The United States' motion to dismiss Count V of the amended complaint is denied, however, Plaintiffs must show that they exhausted their administrative remedies as required by 26 U.S.C. § 7433(e) and (d) in order to recovery attorneys' fees and Plaintiffs are not entitled to recover punitive damages as stated in 11 U.S.C.

§ 106(a)(3); and

6. Plaintiffs shall have ten days from the entry of this Order to file a Second Amended Complaint that is consistent with this Order. This resolution is without prejudice to the United States filing a motion to dismiss, or other responsive pleading, in response to the Second Amended Complaint.

AND IT IS SO ORDERED.

Columbia, South Carolina

May 9, 2008