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11 U.S.C. § 505: Does it Allow the Bankruptcy Court to Determine a Third Party's Tax Liability?

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11 U.S.C. § 505: Does it Allow the Bankruptcy Court to Determine a Third Party’s Tax Liability?

[The court may determine the amount or legality of any tax, any fine or penalty relating to a tax.]*

**INTRODUCTION**

The scope of the bankruptcy court’s jurisdiction has been a controversial issue among the courts.¹ The plain language of 11 U.S.C. section 505(a)(1)² allows the bankruptcy court to determine “the amount or legality of any tax, any fine or penalty relating to a tax, or any addition to tax.”³ It is this language that has given rise to judicial interpretations ranging from a broad grant of jurisdiction over any tax, including that of a third party,⁴ to the narrow conclusion that section 505(a)(1) only applies to the debtor or the debtor’s estate.⁵

The controversy arising from the language of section 505 is whether the bankruptcy court’s jurisdiction is broad enough to

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² 11 U.S.C. § 505(a)(1) (1982 & Supp. IV 1986). Section 505(a)(1) provides: 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.

³ Id.

⁴ Jon Co., Inc. v. United States, 30 B.R. 831 (Bankr. D. Colo. 1983) (the bankruptcy court has § 505(a)(1) jurisdiction to determine the legality of a 100% penalty against corporate officers, even if it would not be assessed against the debtor).

⁵ United States v. Huckabee Auto Co., 46 B.R. 741 (Bankr. M.D. Ga. 1985) (the jurisdiction of the bankruptcy court does not extend to the separate liabilities of taxpayers who are not debtors), aff’d, 783 F.2d 1546 (11th Cir. 1986).
encompass the obligations of third parties. The issue of the bankruptcy court’s jurisdiction over third parties was first considered in *In re Major Dynamics, Inc.*, which raised the question in the context of third-party unsecured creditors. The court found that the “jurisdictional grant of § 505 is not, by its terms, limited to a determination of [the] tax liability of the debtor”

Therefore, the court held that the bankruptcy court had jurisdiction to determine disputes between third-party creditors and the Internal Revenue Service (IRS). It is on the basis of this ruling that the courts have differed as to the proper interpretation of section 505(a)(1).

Although the issue of the bankruptcy court’s jurisdiction over third parties has arisen in a variety of contexts, it has most frequently been considered in the context of a 26 U.S.C. section 6672 tax penalty. The section 6672 penalty arises when a corporate officer or other responsible party fails to see that the corporate debtor’s taxes are paid. Section 6672 allows the IRS to assess a penalty against the corporate officer or respon-

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6 In this Comment, “third party” or “third party nondebtor” refers to corporate officers unless otherwise indicated. The courts have used “third party” and “third party nondebtor” to refer to a creditor’s committee, a spouse of a Chapter 13 debtor, a financer of employee payrolls, as well as corporate officers. See *In re Brandt-Airflex Corp.*, 843 F.2d 90 (2d Cir. 1988) (financer of employee payroll); *Pressimore v. IRS*, 39 B.R. 240 (Bankr. N.D.N.Y. 1984) (spouse); *In re H & R Ice Co., Inc.*, 24 B.R. 28 (Bankr. W.D. Mo. 1982) (corporate officer); *In re Major Dynamics, Inc.*, 14 B.R. 969 (Bankr. S.D. Cal. 1981) (creditor’s committee).

7 14 B.R. 969 (Bankr. S.D. Cal. 1981) (The Official Creditors’ Committee, comprised of investors in the debtor company, filed a motion for a temporary stay of IRS audits of the creditors based on the argument that the audits threatened to hopelessly fractionalize the unsecured creditors.).

8 *Id.* at 971.

9 *Id.* at 972. (Although the court found that it had jurisdiction, it did not grant the temporary injunction because there was no proof that an audit of the unsecured creditors would adversely affect the debtor’s reorganization efforts.).

10 See, e.g., *Pressimore*, 39 B.R. 240 (the third party is the spouse in a Chapter 13 proceeding); *H & R Ice Co., Inc.*, 24 B.R. 28 (the third party is a corporate officer); *Major Dynamics, Inc.*, 14 B.R. 969 (the third party is an Official Creditors’ Committee).

11 26 U.S.C. § 6672(a) (1982 & Supp. IV 1986). Section 6672(a) provides in part: Any person required to collect, truthfully account for, and pay over any tax imposed by this title who willfully fails to collect such tax, or truthfully account for and pay over such tax, shall, be liable to a penalty equal to the total amount of the tax evaded or not collected, or not accounted for and paid over.

12 *Id.*
sible party for the full amount of the corporate debtor’s unpaid taxes.\textsuperscript{13} Therefore, in a section 6672 case, the jurisdiction question that may arise is whether the bankruptcy court has subject matter jurisdiction to determine the legality and collection of a corporate officer’s 100\% tax penalty within the corporate debtor’s Chapter 11 proceeding.

This Comment presents an analysis of the bankruptcy court’s jurisdiction over third parties in the context of a section 6672 tax penalty against corporate officers. Part I gives the legislative history of the bankruptcy court’s jurisdiction prior to the enactment of 11 U.S.C. section 505(a)(1).\textsuperscript{14} Part II presents an objective overview of the arguments for and against jurisdiction over third parties.\textsuperscript{15} The arguments include: consideration of legislative intent,\textsuperscript{16} the scope of the jurisdictional grant in 28 U.S.C. section 1471,\textsuperscript{17} the impact of a section 6672 penalty on corporate reorganization,\textsuperscript{18} and the effect of the anti-injunction act\textsuperscript{19} on the bankruptcy court’s ability to enjoin the IRS.\textsuperscript{20} Part III presents possible solutions to the jurisdictional problem presented in this Comment.\textsuperscript{21} Finally, this Comment concludes that jurisdiction over third parties should be permitted in cases where corporate reorganization is affected.\textsuperscript{22}

\begin{itemize}
\item \textsuperscript{13} Id.
\item \textsuperscript{14} See infra notes 23-31 and accompanying text.
\item \textsuperscript{15} See infra notes 32-96 and accompanying text.
\item \textsuperscript{16} See infra notes 32-42 and accompanying text.
\item \textsuperscript{17} See infra notes 43-64 and accompanying text.
\item \textsuperscript{18} See infra notes 65-80 and accompanying text.
\item \textsuperscript{19} See infra notes 81-96 and accompanying text.
\item \textsuperscript{20} In addition, the courts have also considered the issues of standing and sovereign immunity. However, an in-depth analysis of these issues is beyond the scope of this Comment. The sovereign immunity argument is based on the question of whether the United States has waived its sovereign immunity based on 11 U.S.C. § 106. Section 106 states: “A governmental unit is deemed to have waived sovereign immunity with respect to any claim against such governmental unit that is property of the estate and that arose out of the same transaction or occurrence out of which such governmental unit’s claim arose.”

The question of standing arises because the debtor corporation is seeking to litigate the liability of its corporate officers. The test for standing is “whether the plaintiff has ‘alleged such a personal stake in the outcome of the controversy’ as to warrant his invocation of federal-court jurisdiction and to justify exercise of the court’s remedial powers on his behalf.” Simon v. Eastern Ky. Welfare Rights Org., 426 U.S. 26, 38 (1976) (quoting Warth v. Seldin, 422 U.S. 490, 498-99 (1975)) (emphasis in original).
\item \textsuperscript{21} See infra notes 97-118 and accompanying text.
\item \textsuperscript{22} See infra notes 119-27 and accompanying text.
\end{itemize}
I. LEGISLATIVE HISTORY OF THE BANKRUPTCY COURT'S JURISDICTION

The first grant of power to the bankruptcy court to determine a tax question was contained in section 64a of the Bankruptcy Act of 1898. Section 64a stated that, "in case any question arises as to the amount or legality of any such tax, the same shall be heard and determined by the court." The purpose of this provision was to provide a forum for the ready determination of the legality or amount of tax claims, which if left to other proceedings might delay administration of the bankruptcy estate.

In 1966, subsection (2A) was added to the 1898 Act which empowered the bankruptcy court to "[h]ear and determine, or cause to be heard and determined, any question arising as to the amount or legality of any unpaid tax." This section was enacted "to clarify the power of the bankruptcy court in the area of tax evaluation."

Section 505 of Title 11, enacted in 1978, was derived from the former Bankruptcy Act. Section 505 authorized the court to determine, "the amount or legality of any tax, any fine or penalty relating to a tax, or any addition to tax." This broad language of section 505, which allows the bankruptcy court to determine the legality of any tax, has created the controversy concerning the bankruptcy court's jurisdiction over disputes between third party nondebtors and the IRS.

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24 Id.
25 3 COLLIER ON BANKRUPTCY ¶ 505.01[2-3] (L. King 15th ed. 1988) [hereinafter COLLIER].
27 Id.
28 3 COLLIER, supra note 25, at ¶ 505.01[7].
30 See 3 COLLIER, supra note 25, at ¶ 505.04[22-23].
II. JURISDICTION OVER THIRD PARTIES

A. Legislative Intent: 11 U.S.C. § 505(a)(1)

The courts have consistently referred to the legislative intent of 11 U.S.C. section 505 for guidance as to the proper interpretation of this section in relation to third parties. The Senate and House comments to section 505 authorized the bankruptcy court to rule on the tax claims of "the debtor or the estate." However, the court in In re Major Dynamics, Inc. pointed out that there is no indication that Congress ever considered applying section 505 to third parties. Therefore, Major Dynamics concluded that the language of the statute itself should be consulted. Relying on Tennessee Valley Authority v. Hill, the bankruptcy court found that because the language is plain and unambiguous on its face, it is not necessary to look to the legislative history as a guide. Therefore, the court concluded that it may determine the amount of any tax, including an IRS assessment against a third party.

Conversely, the court in In re Interstate Motor Freight System found that, "taken at face value, without recourse to the legislative history, § 505 makes the Bankruptcy Courts a

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Footnotes:
1 124 Cong. Rec. S17,427 (daily ed. Oct. 6, 1978); 124 Cong. Rec. H11,110-11 (daily ed. Sept. 28, 1978). The relevant language of the House and Senate debate states that "[t]he House amendment authorizes the bankruptcy court to rule on the merits of any tax claim involving an unpaid tax, fine, or penalty relating to a tax, or any addition to a tax, of the debtor or the estate." App. 3 Collier, supra note 25, at X-54 to X-55.
3 Id. at 971.
4 Id. at 972 (the court concluded that they should look to the plain meaning of the words, but noted that there were instances when this would defeat a regulatory scheme).
5 437 U.S. 153 (1978). The Court stated that "[w]hen confronted with a statute which is plain and unambiguous on its face, we ordinarily do not look to legislative history as a guide to its meaning." Id. at 184 n.29 (quoting Ex parte Collett, 337 U.S. 55, 61 (1949)). But see Tram v. Colorado Pub. Interest Research Group, Inc., 426 U.S. 1, 23-24 (1976) (The court must look at the legislative history if reliance on the plain language of a statute would result in "a significant alteration of the pervasive regulatory scheme.").
second tax court system, empowering the Bankruptcy Court to consider 'any' tax whatsoever, on whomsoever imposed.\textsuperscript{39} The court concluded that Congress did not intend this result and that reliance on the language alone "would result in a significant alteration of the pervasive regulatory scheme of which the statute is a part."\textsuperscript{40} Thus, the court held that there must be implicit limits as evidenced in the legislative history\textsuperscript{41} of section 505.\textsuperscript{42}

The legislative comments do not indicate that Congress even considered applying section 505 to third parties. As a result, one cannot conclude whether Congress would or would not allow the bankruptcy court to determine third party tax liability. Therefore, disputes among the courts have resulted, and the split is unlikely to be resolved.


As additional support for broad interpretation of section 505, the courts have consulted the statutory definitions of the scope of the bankruptcy court's jurisdiction. Prior to 1984, the courts consulted 28 U.S.C. section 1471, which provided for original jurisdiction "of all civil proceedings arising under title 11 or arising in or related to cases under title 11."\textsuperscript{43} Relying on the language of former section 1471, the court in \textit{In re H & R Ice Co., Inc.}\textsuperscript{44} reasoned that because the corporate officer's liability under 26 U.S.C. section 6672\textsuperscript{45} arises from failure to pay the taxes of the debtor, his tax liability is related to a case arising under Title 11.\textsuperscript{46} Therefore, as defined by section 1471, the court found that it had general jurisdiction.\textsuperscript{47}

\textsuperscript{39} \textit{Id.} at 809.
\textsuperscript{40} \textit{Id.} (quoting \textit{Major Dynamics}, 14 B.R. at 972); see \textit{supra} note 35.
\textsuperscript{41} See \textit{supra} note 32 and accompanying text.
\textsuperscript{42} See \textit{Interstate}, 62 B.R. at 809.
\textsuperscript{44} 24 B.R. 28 (Bankr. W.D. Mo. 1982).
\textsuperscript{46} \textit{H & R Ice Co., Inc.}, 24 B.R. at 30.
\textsuperscript{47} \textit{Id.} (More specifically, Judge Pelofsky found that the bankruptcy court had § 505(a)(1) jurisdiction to determine the legality of the assessment.)
The Supreme Court held in *Northern Pipeline Construction Co. v Marathon Pipe Line, Co.*\(^4\) that section 1471 was unconstitutional. Congress responded by enacting the Bankruptcy Amendments and Federal Judgeship Act of 1984.\(^4\) The 1984 Amendments created 28 U.S.C. section 1334\(^5\) and 28 U.S.C. section 157\(^6\) as the new jurisdictional statutes for the bankruptcy court.

Although section 1334 uses the identical "arising under" language of former section 1471, sections 157(b)(1)\(^7\) and


\(^4\) The Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, 98 Stat. 333 (1984). The 1984 Amendments were the legislative response to the Supreme Court's decision in *Northern Pipeline Construction Co.*, 458 U.S. 50 that the grant of jurisdiction to the bankruptcy court in § 1471 was unconstitutional and that the jurisdiction given to the bankruptcy court was too broad for a non-Article III court. *King, Jurisdiction and Procedure Under the Bankruptcy Amendments of 1984*, 38 VAND. L. REV. 675, 676 (1985).

\(^5\) 28 U.S.C. § 1334 (1982 & Supp. IV 1986). The relevant language of § 1334(b) states that "the district courts shall have original but not exclusive jurisdiction of all civil proceedings arising under title 11, or arising in or related to cases under title 11." Bankruptcy judges constitute a "unit of the district court" in each judicial district. 28 U.S.C. § 151 (Supp. IV 1986).

\(^6\) 28 U.S.C. § 157. Section 157(a) provides: "Each district court may provide that any or all proceedings under title 11 or arising in or related to a case under title 11 shall be referred to the bankruptcy judges for the district." For additional language of § 157, see *infra* notes 52-53.

\(^7\) Section 157(b)(1) provides in part that "[b]ankruptcy judges may hear and determine all cases under title 11 and all core proceedings arising under title 11, or arising in a case under title 11." Section 157(b)(2)(A)-(O) provides that:

- (A) matters concerning the administration of the estate;
- (B) allowance or disallowance of claims against the estate or exemptions from property of the estate, and estimation of claims or interests for the purposes of confirming a plan under chapter 11, 12, or 13 of title 11 but not the liquidation or estimation of contingent or unliquidated personal injury tort or wrongful death claims against the estate for purposes of distribution in a case under title 11;
- (C) counterclaims by the estate against persons filing claims against the estate;
- (D) orders in respect to obtaining credit;
- (E) orders to turn over property of the estate;
- (F) proceedings to determine, avoid, or recover preferences;
- (G) motions to terminate, annul, or modify the automatic stay;
- (H) proceedings to determine, avoid, or recover fraudulent conveyances;
- (I) determinations as to the dischargeability of particular debts;
- (J) objections to discharges;
(c)(1) introduce a dichotomy of core and noncore proceedings. This distinction is significant in defining the ultimate power and jurisdiction of the bankruptcy court. Section 157(b)(1) authorizes the bankruptcy judges to enter final orders in core proceedings. In noncore proceedings, 157(c)(1) requires that the bankruptcy judge "submit proposed findings of fact and conclusions of law to the district court." Thus, in a noncore proceeding, the bankruptcy judge may not enter a final order but must submit his findings to the district court, which then enters the final order.

In *Campbell Enterprises, Inc. v United States*, the court considered the bankruptcy court's jurisdiction over a corporate officer's section 6672 tax penalty based on section 1334 and section 157. Pursuant to the "arising under" language of section 1334, the court found that it retained jurisdiction over a proceeding involving a corporate officer's section 6672 tax liability. Additionally, under the broad definition of "core pro-

(K) determinations of the validity, extent, or priority of liens;
(L) confirmations of plans;
(M) orders approving the use or lease of property, including the use of cash collateral;
(N) orders approving the sale of property other than property resulting from claims brought by the estate against persons who have not filed claims against the estate; and
(O) other proceedings affecting the liquidation of the assets of the estate or the adjustment of the debtor-creditor or the equity security holder relationship, except personal injury tort or wrongful death claims.


Section 157(c)(1) states in relevant part that "[a] bankruptcy judge may hear a proceeding that is not a core proceeding but that is otherwise related to a case under title 11. In such proceeding, the bankruptcy judge shall submit proposed findings of fact and conclusions of law to the district court." 28 U.S.C. § 157(c)(1) (Supp. IV 1986).

See King, supra note 49, at 679.

Id.

See supra note 52 and accompanying text.

See supra note 53 and accompanying text.


Id. at 203.

See supra note 50 for text of statute.

Campbell, 66 B.R. at 203. The court held, "[p]ursuant to 28 U.S.C. § 1334 and § 157, this court clearly retains subject matter jurisdiction over the instant proceeding." Id.
ceedings" in 157(b)(2)(A) and (O), the court concluded that the proceeding could be heard by the bankruptcy judge, and a final judgment could be entered.

This ruling indicates that courts may interpret the jurisdictional provisions of sections 1334 and 157 as broadly as they had previously interpreted section 1471. The impact of this interpretation is that almost anything may qualify as a core proceeding, even a proceeding involving a third party.

C. Effect on Reorganization: 26 U.S.C. § 6672

The court in In re the Original Wild West Foods, Inc. found that the "dispute over the collection of taxes assessed as a penalty against [a corporate officer] is of primary importance to this Court as it affects [sic] both the debtor corporation and this Court's ability to administer effectively the reorganization of the debtor corporation." Therefore, the court concluded that it had jurisdiction over the corporate officer's tax penalty. As with most issues concerning the bankruptcy court's jurisdiction over third parties, the courts are split over the significance of a 26 U.S.C. section 6672 penalty in corporate reorganization.

The individual corporate officer's liability under section 6672 is "distinct from and in addition to the employer's liability for..."
these taxes."\(^{69}\) The debtors argue that despite the "distinct" nature of section 6672, the court has jurisdiction to determine the corporate officer's tax liability because it affects the debtor corporation's reorganization efforts\(^{70}\) by depleting its key people of both the time and the money needed for implementation of the reorganization plan.\(^{71}\) Because of this adverse effect, the debtors argue that the corporate officer's section 6672 liability is related to a case under Title 11.\(^{72}\)

In response to the above argument, the court in \textit{Booth Tow Services, Inc. v Spector}\(^{73}\) stated that, "whether the penalty if assessed will in fact injure the debtor is irrelevant."\(^{74}\) The court concluded that because the officer's section 6672 penalty is distinct from the debtor's liability, the section 6672 penalty should be determined in a separate proceeding.\(^{75}\) The \textit{Booth} court reasoned that it is contradictory to call the corporate officer's section 6672 liability distinct from the corporation's liability if an adverse impact on the debtor's reorganization is enough to sustain subject matter jurisdiction over the proceeding.\(^{76}\) The court went on to say, "[t]he Government's alternative remedies for recovering revenues that it is owed would then not be independent of each other but would rather be essentially linked."\(^{77}\)

Contrary to the \textit{Booth} opinion, the court in \textit{In re Major Dynamics, Inc.}\(^{78}\) found that the effect of the third party corporate officer's tax dispute on the reorganization of the debtor corporation was significant. The court held that it could exercise jurisdiction over third parties, "\textit{provided however}, that the IRS activity to be enjoined directly affected the debtor or the estate, and that the exercise of such jurisdiction was necessary to the

\(^{69}\) Booth Tow Services, Inc. v. Spector, 53 B.R. 1014, 1017 (Bankr. W.D. Mo. 1985) (quoting Howard v. United States, 711 F.2d 729, 733 (5th Cir. 1983)).

\(^{70}\) See Campbell, 66 B.R. at 204.


\(^{72}\) See supra notes 43, 50 and accompanying text.


\(^{74}\) Id. at 1018 (quoting United States v. Huckabee Auto Co., 46 B.R. 741, 744 (Bankr. W.D. Ga. 1985)).

\(^{75}\) Id.

\(^{76}\) Id.

\(^{77}\) Id.

\(^{78}\) 14 B.R. 969.
rehabilitation of the debtor or the orderly and efficient administration of the debtor's estate.'"79

Thus, the significance the court gives to the adverse effects of a section 6672 penalty on corporate reorganization becomes a substantial factor in determining whether the court will exercise jurisdiction. If a court determines that the corporate officer's section 6672 tax liability is absolutely separate and distinct from the debtor corporation's Chapter 11 proceeding, then each must be adjudicated separately. Conversely, if a court acknowledges the distinct nature of the penalty but adds that the penalty adversely affects the debtor's reorganization, the bankruptcy court may exercise jurisdiction over the penalty. The effect of the section 6672 penalty on the debtor's reorganization is also an important factor in the analysis of the anti-injunction statute.80

D Effects of the Anti-Injunction Statute on Jurisdiction: 26 U.S.C. § 7421

Because the majority of cases that involve a section 6672 penalty against a corporate officer are seeking injunctive relief, the anti-injunction statute's81 effect on the bankruptcy court's jurisdiction is significant. Section 7421 of Title 26 provides that, "no suit for the purpose of restraining the assessment or collection of any tax shall be maintained in any court by any person, whether or not such person is the person against whom such tax was assessed."82 The purpose of this statute is "the protection of the Government's need to assess and collect taxes as expeditiously as possible with a minimum of pre-enforcement judicial interference."83

The issue, however, is the jurisdictional standard, not the test for whether an injunction should be issued based on a

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79 Id. at 972 (emphasis in original).
80 See infra notes 81-96 and accompanying text.
81 In this Comment, the term "anti-injunction" statute refers to 26 U.S.C. § 7421(a).
82 Id.
83 Bob Jones University v. Simon, 416 U.S. 725, 736 (1974). (The petitioners sought injunctive relief from an IRS decision to deny tax-exempt status to the petitioners' religious school. The court held that the terms of § 7421 could only be avoided if there is irreparable injury and certainty of success on the merits.).
particular fact situation. Thus, the question before the courts is whether the bankruptcy court has the power to issue an injunction to restrain the IRS from collecting a section 6672 tax penalty against a corporate officer despite section 7421. Section 105(a) of Title 11 permits the bankruptcy judge to "issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title." Thus, section 105 gives the bankruptcy court enforcement powers, which may include the ability to issue injunctions against the IRS. The conflict between section 105 and section 7421 requires the court to make a policy choice between the government's need to collect taxes and the orderly administration of the Bankruptcy Act. This conflict has created a split among the circuits.

In *Bostwick v United States*, the United States Court of Appeals for the Eighth Circuit held that the anti-injunction statute was not relevant because Congress showed an intent to enact a complete scheme governing bankruptcy that overrides the general policy of section 7421. The court concluded that since the overriding policy of the Bankruptcy Act is the rehabilitation of the debtor, the bankruptcy court must have the power to "enjoin the assessment and/or collection of taxes in order to protect its jurisdiction, administer the bankrupt's estate in an orderly and efficient manner and fulfill the ultimate policy of the Bankruptcy Act."

In contrast to *Bostwick*, the United States Court of Appeals for the Third Circuit held in *In re Becker's Motor Transporta-

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84 See Otero Mills, Inc. v. Security Bank & Trust, 25 B.R. 1018, 1021 (Bankr. D.N.M. 1982) (The court considered whether the bankruptcy court had jurisdiction to enjoin a bank from proceeding in state court against a debtor corporation's officer who was guarantor on a loan for the company. The court found that the bankruptcy court had jurisdiction and an injunction was appropriate based on the facts.).
86 Id.
87 Jon Co., Inc. v. United States, 30 B.R. 831, 834 (Bankr. D. Colo. 1983). (The court adopted the reasoning used in Bostwick v. United States, 521 F.2d 741 (8th Cir. 1975) that Congress intended to enact a complete scheme governing bankruptcy that overrides the general policy of section 7421.).
88 521 F.2d 741 (8th Cir. 1975). (*Bostwick* did not involve a third party issue. The issue before the court was whether the bankruptcy court could enjoin the IRS from collecting a tax until the court determined the dischargeability of the tax debt.).
89 Id. at 744.
90 Id.
tion, Inc.\(^91\) that no matter how persuasive the argument might be against application of section 7421 in bankruptcy proceedings, a judicial exemption for the bankruptcy court would contravene congressional intent.\(^92\) Additionally, the Becker court argued that had Congress intended to authorize the bankruptcy court to issue injunctions, it would have included a grant of such power in the 1966 Amendments to 26 U.S.C. section 7421(a).\(^93\)

The court concluded that these arguments should be addressed to Congress, not the judiciary.\(^94\)

Although the Becker court concluded that the controversy concerning the interpretation of 11 U.S.C. section 505 can only be resolved by Congress,\(^95\) other solutions may be possible.\(^96\)

III. Possible Solutions

A. Corporate Officers in Their Own Title 11 Proceeding

*In re O H. Lewis Co.*\(^97\) suggested that the availability of an alternate remedy at law would eliminate the need for a section 105 injunction,\(^98\) which frustrates the strong tax policies underlying the penalty tax.\(^99\) The court suggested that the corporate officers could file their own bankruptcy proceeding and thus receive the protection of the bankruptcy laws.\(^100\) This alternative would accommodate the policies of both section 105 and section 6672, without trampling the important concerns of either.\(^101\) However, this remedy fails to take into consideration the repercussions to the corporate officer's credit standing resulting from

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\(^91\) *In re Becker's Motor Transp., Inc.*, 632 F.2d 242 (3rd Cir. 1980), *cert. denied*, 450 U.S. 916 (1981). (The court in Becker considered generally whether the bankruptcy court could enjoin the IRS from collecting a tax debt or penalty.).

\(^92\) *Id.* at 246.

\(^93\) *Id.*

\(^94\) *Id.*

\(^95\) *See supra* notes 93-94 and accompanying text.

\(^96\) *See infra* notes 97-118 and accompanying text.


\(^99\) *O. H. Lewis Co.*, 40 B.R. at 533.

\(^100\) *Id.*

\(^101\) *Id.*
bankruptcy. Moreover, this solution would have an adverse impact on the debtor's reorganization by diverting the corporate officer's attention to his own bankruptcy proceeding.\(^{102}\)

B. Ancillary and Pendent Jurisdiction

The policies that form the foundation of ancillary and pendent jurisdiction may justify application of these grants of expanded jurisdiction to third party nondebtors in bankruptcy proceedings. The exercise of ancillary or pendent jurisdiction expands the limited subject matter jurisdiction of the federal courts in order to avoid piecemeal litigation of related disputes\(^{103}\) and facilitate judicial economy, convenience, and fairness to litigants.\(^{104}\) These judicial policies are related to the present controversy because the debtor corporation is seeking to have its own liability and its key officer's liability considered simultaneously in order to implement reorganization effectively.

Both ancillary and pendent jurisdiction allow a federal court to adjudicate a claim that is closely related to an action properly within the court's statutory jurisdiction, but that by itself does not satisfy the jurisdictional requirements.\(^{105}\) The test for determining whether a claim is closely related to an action before the court was set forth in *United Mine Workers of America v. Gibbs.*\(^{106}\) The Court held that to exercise pendent jurisdiction:

 ))) the state and federal claims must derive from a common nucleus of operative fact. But if, considered without regard to their federal or state character, a plaintiff's claims are such that he would ordinarily be expected to try them all in one judicial proceeding, then, assuming substantiality of the federal issues, there is power in federal courts to hear the whole.\(^{107}\)

Applying this standard to the bankruptcy cases, the corporate officer's tax liability and the liability of the debtor certainly arise

\(^{102}\) *See supra* note 71 and accompanying text.

\(^{103}\) J. Friedenthal, M. Kane & A. Miller, *Civil Procedure* 66 (1985) [hereinafter J. Friedenthal].


\(^{105}\) J. Friedenthal, *supra* note 103, at 67.


\(^{107}\) *Id.* at 725. Although *Gibbs* involves a pendent action, the same test applies to ancillary jurisdiction. *Owen Equip. & Erection Co. v. Kroger*, 437 U.S. 365 (1978).
from a "common nucleus of operative fact," because the corporate debtor's failure to pay the withholding taxes imposes liability on the corporate officer under section 6672.

Because bankruptcy cases involve many of the same policy concerns addressed by ancillary and pendent jurisdiction, the bankruptcy court's use of ancillary or pendent jurisdiction may be a viable means of conferring jurisdiction over third party proceedings.

C. Protective Jurisdiction

Protective jurisdiction is a way for federal courts to fashion a body of federal common law in areas in which Congress has already enacted a general regulatory scheme. Textile Workers Union of America v. Lincoln Mills of Alabama explored the concept of protective jurisdiction in the context of collective bargaining agreements and section 301 of the Labor Management Relations Act. Attempting to interpret section 301 of the Labor Management Relations Act of 1947, the Court found that Congress had developed a statutory scheme that demonstrated a strong federal interest in industrial peace and an intent to have collective bargaining agreements enforced in federal courts. The Court concluded that federal law, which courts must fashion from the policy of the national labor laws, should be applied to enforce collective bargaining agreements. This conclusion was found to have constitutional support in article III, section 2, which extends judicial power to cases arising under the laws of

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108 Gibbs, 383 U.S. at 725.
109 26 U.S.C. § 6672(a) (1982 & Supp. IV 1986). See supra note 11. See also Treas. Reg. § 301.6672-1 (1957): "The penalty imposed by Section 6672 applies only to the collection, accounting for, or payment over of taxes imposed on a person other than the [corporation] who is required to collect, account for, and pay over such taxes." Id.
110 See, e.g., Textile Workers Union of Am. v. Lincoln Mills of Ala., 353 U.S. 448 (1957) (The issue before the court concerned the collective bargaining agreements that Congress regulated under the Labor Relations Act.).
111 353 U.S. 448 (1957).
113 Id. at 454 (relying on S. REP. No. 105, 80th Cong., 1st Sess. 16 (1947)).
114 Id. at 456.
115 U.S. Const. art. III, § 2. (The judicial power extended to all cases "arising under the Laws of the United States.")
the United States. Thus, as held by the Court in *Lincoln Mills*, a case arising under the Labor Relations Act is within the judicial power of the federal courts.

As in the area of labor relations in the *Lincoln Mills* case, Congress has evidenced an intent to exercise broad powers in the area of bankruptcy and has enunciated a strong policy interest in the protection of the debtor. Therefore, in cases where the debtor corporation seeks protection of its key personnel from a section 6672 penalty, the concept of protective jurisdiction should allow the federal courts to determine the third party corporate officer's tax liability in accordance with the policy of the bankruptcy laws.

Although the courts have not dealt with protective jurisdiction with regard to a section 6672 penalty, Justice Frankfurter, dissenting in *Lincoln Mills*, pointed out that, "the bankruptcy decisions may be justified by the scope of the bankruptcy power, which may be deemed to sweep within its scope interests analytically outside the 'federal question' category, but sufficiently related to the main purpose of bankruptcy to call for comprehensive treatment." Therefore, there may be a strong argument for application of protective jurisdiction to bankruptcy cases, and a section 6672 penalty against a corporate officer may be sufficiently related to a Chapter 11 bankruptcy proceeding to call for comprehensive treatment through protective jurisdiction.

**CONCLUSION**

Application of section 505(a)(1) jurisdiction to third parties should not be so broadly construed as to create a "second tax

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116 *Lincoln Mills*, 353 U.S. at 457


118 *Lincoln Mills*, 353 U.S. at 483 (Frankfurter, J., dissenting). The bankruptcy cases that Justice Frankfurter is referring to do not involve the explicit issue of protective jurisdiction. In *Schumacher v. Baler*, 293 U.S. 367 (1934), the issue before the Court was whether the district court had jurisdiction over a suit brought by a trustee in bankruptcy to enjoin the sale of certain property. This consideration of the jurisdictional ability of the court to determine these bankruptcy-related matters brings it within Justice Frankfurter's protective jurisdiction analysis.

nor should it be so narrowly construed as to defeat the policy and purpose of the bankruptcy court. Pragmatically, there must be a middle ground.

Reading section 505(a)(1) in conjunction with the jurisdictional grants of 28 U.S.C. section 1334 and 28 U.S.C. section 157, Congress has consistently given broad grants of jurisdiction to the bankruptcy courts. Additionally, the consistent use of "arising under" and "related to" language suggests an intent to authorize a broad grant of jurisdiction. Therefore, it seems that the question should not be whether the bankruptcy court has jurisdiction, but more appropriately, whether jurisdiction should be exercised.

Because the overriding policy of the Bankruptcy Reform Act is the rehabilitation of the debtor, a denial of jurisdiction in the case of a section 6672 penalty, which could seriously affect the reorganization efforts of the debtor, would be unreasonable. The resources of a debtor corporation's key officers are essential in most instances for a successful reorganization effort. However, each fact situation should be evaluated to determine if there is, in fact, an adverse effect on reorganization. The court in In re Major Dynamics, Inc. stated the solution most effectively when it concluded that the bankruptcy court may extend its jurisdiction to tax disputes of third parties, "provided, however, that the exercise of such jurisdiction was necessary to the rehabilitation of the debtor or the orderly and efficient administration of the debtor's estate."

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121 See supra note 5 and accompanying text.
122 See supra notes 50-51 and accompanying text.
126 Major Dynamics, Inc., 14 B.R. 969.
127 Id. at 972 (emphasis in original).