IN THE UNITED STATES BANKRUPTCY COURT
FOR THE SOUTHERN DISTRICT OF IOWA

IN THE MATTER OF:	:	
DIANE C. JEPSEN,	:	Case No. 98-03272-C J
Debtor.	:	Chapter 7
DIANE C. JEPSEN,	:	Adv. Pro. No. 98-98181
Plaintiff,	:	
v.	:	
STATE OF IOWA, through the Iowa Department of Revenue and Finance,	:	
Defendant.	:	

RULING ON MOTION TO DISMISS COMPLAINT

On July 27, 1998 Diane C. Jepsen (Debtor) filed a petition for relief under Chapter 7 of the United States Bankruptcy Code. On Schedule E (Creditors Holding Unsecured Priority Claims), the Debtor indicated she owed the Iowa Department of Revenue and Finance (Department) $471,000.00. The debt stemmed from a January 29, 1997 jeopardy drug stamp tax assessment. In Paragraph 4(b) of her Statement of Financial Affairs, the Debtor states the Department seized personal property from her homestead on July 15, 1997.

On September 4, 1998 the Debtor filed a "Complaint To Determine Dischargeability; And For Turnover Of Property [11 U.S.C. section 523; 11 U.S.C. section 542]" against the State of Iowa through the Department. As for the dischargeability action, the Debtor stated she was charged in state court with the delivery

of less than 5 grams of a controlled substance. The Department, however, assessed the tax based on 908 grams.[1] She asked this Court to hold any liability in excess of $1,250.00—the amount owed for 5 grams at $250.00 per gram—dischargeable pursuant to 11 U.S.C. section 523(a)(7).[2] As for the turnover cause of action, the Debtor stated the Department seized from her homestead personal property in which she had an undivided one-half interest and sold that property for $7,234.85.[3] She asked this Court to require the Department to turn over to her $2,000.00—the portion of $2,367.43 (the difference between a $1,250.00 assessment and her one-half interest in the sale proceeds) that is exempt as the monetary equivalent of household goods under 11 U.S.C. section 522.

On October 13, 1998 the Department filed a motion to dismiss the complaint pursuant to Federal Rule of Bankruptcy Procedure 7012 and Federal Rule of Civil

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[1] According to the Debtor, the Schedule E debt consists of $227,000.00 tax (908 grams at $250.00 per gram), $227,000.00 penalty, $3,632.00 interest, and $12.00 fees. The Debtor maintains the assessment is an excessive fine that violates the Eighth Amendment to the United States Constitution and Article I Section 17 of the Iowa Constitution. She also contends that the assessment's related seizure of her property and assets was without due process of law and, therefore, violated both her Fifth Amendment rights under the United States Constitution by operation of the Fourteenth Amendment and her similar rights under Article I, Section 9 of the Iowa Constitution. She also argues the Iowa statute providing for the assessment is unconstitutional.

[2] 11 U.S.C. section 523 provides in part:

> (a) A discharge under section 727. . .of this title does not discharge an individual debtor from any debt—
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> . . .
>
> (7) to the extent such debt is for a fine, penalty, or forfeiture payable to and for the benefit of a governmental unit, and is not compensation for actual pecuniary loss, other than a tax penalty—
>
> (A) relating to a tax of a kind not specified in paragraph (1) of this subsection; or
>
> (B) imposed with respect to a transaction or event that occurred before three years before the date of the filing of the petition;
>
> . . .

11 U.S.C. section 523.

[3] The Debtor contends the Department's actions amounted to an unlawful seizure under the Fourth Amendment to the United States Constitution and under Article I, Section 8 of the Iowa Constitution.

Procedure 12(b)(1) and (2).[4] Relying on Seminole Tribe of Florida v. Florida, 517 U.S. 44, 116 S. Ct. 1114, 134 L. Ed. 2d 252 (1996), In re Sacred Heart Hosp. of Norristown, 133 F.3d 237 (3rd Cir. 1998), Matter of Estate of Fernandez, 123 F.3d 241 (5th Cir. 1997), and In re Creative Goldsmiths of Washington, D.C., Inc., 119 F.3d 1140 (4th Cir. 1997), cert. denied 118 S. Ct. 1517 (1998), the Department argued that 11 U.S.C. section 106(a) was unconstitutional to the extent it purported to abrogate the United States Constitution's Eleventh Amendment prohibition against states and their agencies being sued, without their consent, in federal courts.[5] The Department pointed out it had neither filed a proof of claim nor otherwise appeared in the Chapter 7 case. Accordingly, the Department requested dismissal based on this Court's lack of jurisdiction.

On October 19, 1998 the Debtor filed her objection. Relying on a quote from Hoffman v. Connecticut Dept. of Income Maintenance, 492 U.S. 96, 109 S. Ct. 2818, 106

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[4] Federal Rule of Bankruptcy Procedure 7012 provides that Federal Rule of Civil Procedure 12(b), governing how defenses and objections are presented, applies in adversary proceedings. Federal Rule of Civil Procedure 12(b) provides in part:

> . . .Every defense, in law or fact, to a claim for relief in any pleading, whether a claim, counterclaim, cross-claim, or third-party claim, shall be asserted in the responsive pleading thereto if one is required, except that the following defenses may at the option of the pleader be made by motion: (1) lack of jurisdiction over the subject matter, (2) lack of jurisdiction over the person,. . . A motion making any of these defenses shall be made before pleading if a further pleading is permitted. . . .

[5] 11 U.S.C. section 106 provides in part:

> (a) Notwithstanding an assertion of sovereign immunity, sovereign immunity is abrogated as to a governmental unit to the extent set forth in this section with respect to the following:
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> (1) Sections 105, 106, 107, 108, 303, 346, 362, 363, 364, 365, 366, 502, 503, *505*, 506, 510, 522, *523*, 524, 525, *542*, 543, 544, 545, 546, 547, 548, 549, 550, 551, 552, 553, 722, 724, 726, 728, 744, 749, 764, 901, 922, 926, 928, 929, 944, 1107, 1141, 1142, 1143, 1146, 1201, 1203, 1205, 1206, 1227, 1231, 1301, 1303, 1305, and 1327 of this title.
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> . . .

11 U.S.C. section 106. (Emphasis added.)

The Eleventh Amendment provides that "[t]he Judicial power of the United States shall not be construed to extend to any suit in law or equity, commenced or prosecuted against one of the United States by Citizens of another State, or by Citizens or Subjects of any Foreign State." The Amendment applies to suits brought against a state by citizens of that state. Hans v. Louisiana, 134 U.S. 1, 10 S. Ct. 504, 33 L. Ed. 842 (1890).

L. Ed. 2d 76 (1989) that discussed former 11 U.S.C. section 106(c),[6] the Debtor implied the Department would be bound by the discharge of debts entered in the Chapter case regardless of any waiver issue.[7] Then, in seeming response to the Department's contention that the complaint was really just an attack on the constitutionality of Iowa Code Chapter 453B and a request for this Court to make a determination regarding Debtor's tax liability, the Debtor stated the adversary proceeding's main focus was on discharging the tax debt in issue. Nevertheless, the Debtor then cited 11 U.S.C. sections 106(c) and 505 in support of her contention the Court had express authority to determine dischargeability.[8]

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[6] The version of 11 U.S.C. section 106(c) under consideration in the Hoffman case read:

> (c) Except as provided in subsections (a) and (b) of this section and notwithstanding any assertion of sovereign immunity—;
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> (1) a provision of this title that contains "creditor", "entity", or "governmental unit" applies to governmental units; and
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> (2) a determination by the court of an issue arising under such a provision binds governmental units.

11 U.S.C. section 106(c)(1979).

[7] The Court granted the debtor a discharge on November 23, 1998. Debtor's other listed debts include $1.00 for an unsecured priority claim related to her 1994 income tax and $60,868.00 for unsecured nonpriority claims. The vast majority of the latter appear to be for consumer goods and services incurred in 1997.

[8] Current 11 U.S.C. section 106(c) reads:

> (c) Notwithstanding any assertion of sovereign immunity by a governmental unit, there shall be offset against a claim or interest of a governmental unit any claim against such governmental unit that is property of the estate.

11 U.S.C. section 106(c).

11 U.S.C. section 505 provides in part:

> (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.
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> (2) The court may not so determine—
>
> (A) the amount or legality of a tax, fine, penalty, or addition to 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; or
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> . . .

11 U.S.C. section 505.

On December 8, 1999 the Court conducted a telephonic hearing on the contested motion to dismiss. At that time, Debtor's attorney conceded the Seminole decision did prohibit the Court from entering a monetary judgment against the Department and, accordingly, agreed to a dismissal of the turnover cause of action. After listening to the arguments of counsel on the remaining cause of action, the Court directed the parties to file a stipulation of facts and their respective briefs and arguments by January 19, 1999. The Court entered a minute order to that effect the following day.

The parties timely complied with the December 9, 1999 Order. However, the Department filed a supplement to its brief and a "Notification of Constitutional Challenge" on April 7, 1999. In the supplement, the Department reported that In re Doiel, 228 B.R. 439 (D. S.D. 1998), a decision supporting its position, was pending before the Eighth Circuit Court of Appeals as No. 99-1187.[9] As for the Notification, the Department explained the document was filed pursuant to Federal Rule of Bankruptcy Procedure 7024, Federal Rule of Civil Procedure 24(c), and Local District Court Rule 24.1.[10] Since the motion to dismiss challenges the constitutionality of 11 U.S.C. section 106(a), the Department concluded the Court must notify the Attorney General in accordance with 28 U.S.C. section 2403(a).[11]

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[9] As of this date, the Eighth Circuit Court of Appeals web site indicates the Court has not set a final deadline for briefs and has not set a date for argument.

[10] Federal Rule of Bankruptcy Procedure 7024 provides that Federal Rule of Civil Procedure 24, governing intervention, applies in adversary proceedings. With respect to the procedure for intervention, the latter rule provides in part:

> (c) . . .When the constitutionality of an act of Congress affecting the public interest is drawn in question in any action in which the United States or an officer, agency, or employee thereof is not a party, the court shall notify the Attorney General of the United States as provided in Title 28, U.S.C. § 2403. . . .

Fed. R. Civ. P. 24.

[11] 28 U.S.C. section 2403(a) provides:

DISCUSSION

At this point in time, the vast majority of courts from the trial level to the circuit level have held that Congress did intend to abrogate the States' sovereign immunity when it enacted the current form of section 106 in 1994. The vast majority, however, have also held that Congress lacked the power to do so. The Doiel decision is no exception.

Given the above, the Court could put this matter on hold until the Eighth Circuit Court of Appeals ruling on the issue is final. In the alternative, the Court could notice the Attorney General, consider her arguments, and then add yet another decision to the sovereign immunity debate. The Court will do neither. That is, even if the Eighth Circuit Court of Appeals were to find that Congress did have the power to enact legislation giving federal courts jurisdiction over the States in the various matters enumerated in section 106(a), this Court would not be inclined to permit the pending cause of action to proceed in this forum for the following reasons:

(1) The pending cause of action sounds in section 505, not in section 523(a)(7).[12] That is, the Debtor acknowledges the debt is nondischargeable to the extent it is related to 5 grams of a controlled substance. She is simply challenging the validity and amount of the debt to the extent it is related to more than 5 grams.

> (a) In any action, suit or proceeding in a court of the United States to which the United States or any agency, officer or employee thereof is not a party, wherein the constitutionality of any Act of Congress affecting the public interest is drawn in question, the court shall certify such fact to the Attorney General, and shall permit the United States to intervene for presentation of evidence, if evidence is otherwise admissible in the case, and for argument on the question of constitutionality. The United States shall, subject to the applicable provisions of law, have all the rights of a party and be subject to all liabilities of a party as to court costs to the extent necessary for a proper presentation of the facts and law relating to the question of constitutionality.
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> . . .

[12] Since 11 U.S.C. section 523(c) provides that federal courts have exclusive jurisdiction only over dischargeability actions under paragraphs (2), (4), (6), and (15) of 11 U.S.C. section 523(a), this ruling

(2) The language of section 505(a)(1) is clear—federal court review of a tax controversy in a bankruptcy setting is discretionary. Section 505(a)(2)(A) prohibits a federal court from determining the amount or legality of a tax if such matters were heard and decided by a judicial or administrative tribunal of competent jurisdiction before the bankruptcy case commenced.

(3) The Debtor and the Department have not stipulated that the pending controversy falls under section 505(a)(2)(A). However, they do state the following in paragraph 1 of their January 19, 1999 stipulation of facts:

> The Department mailed a Notice of Assessment to the Debtor on July 16, 1997, for unpaid Iowa Drug Tax pursuant to Iowa Code Chapter 453B in the amount of $277,000.00, penalty in the amount of $277,000.00 and interest in the amount of $3632.00. The Notice stated that the assessment related to the tax period January 29, 1997. The Notice also stated that the assessment would be final unless the Debtor filed an appeal within 60 days. The Debtor did not file an appeal.[13]

(4) On page 5 of its brief in support of the motion to dismiss, the Department indicates it does not challenge the bankruptcy discharge per se. On page 9, the Department adds it does not contend it is immune from the discharge injunction per se.

(5) To the extent Debtor has not waived any of her arguments regarding the validity and the amount of the tax assessment (over and above what she has conceded is nondischargeable), she may raise those arguments in defending against any enforcement action the Department might bring in state court.

(6) The Chapter 7 bankruptcy estate has no stake in the outcome of the controversy between the Debtor and the Department.

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would have been the same had the controversy required consideration of facts and law relevant and material to paragraph (7) of section 523(a).

Since this ruling amounts to a decision to abstain from considering the liability and amount of the tax assessment in issue pursuant to 11 U.S.C. section 305,[14] the Court must provide an opportunity for the parties to be heard on the matter.

THEREFORE, IT IS ORDERED that this adversary proceeding shall be dismissed on August 17, 1999 unless the Chapter 7 Debtor or the State of Iowa, through the Iowa Department of Revenue and Finance, requests a hearing on abstention on or before August 12, 1999. See Fed. R. Bank. P. 9006(a) and (f).

Dated this 3rd day of August, 1999.

LEE M. JACKWIG
U.S. BANKRUPTCY JUDGE

Parties Served: Debtor, C. Lucas, J. Waters, Trustee, U.S. Trustee

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[13] In its brief in support of the motion to dismiss, the Department contends the Debtor could have challenged the constitutionality of the Iowa drug tax statute or the computation of the amount of her liability as part of a protest challenging the tax assessment.

[14] 11 U.S.C. section 305 provides in part:

> (a) The court, after notice and a hearing, may dismiss a case under this title, or may suspend all proceedings in a case under this title, at any time if—
>
> (1) the interests of creditors and the debtor would be better served by such dismissal or suspension; or
>
> . . .

11 U.S.C. section 305. See generally In re Titan Energy, Inc., 837 F.2d 325 (8th Cir. 1988) (discussing various policy considerations supporting abstention under section 305).