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U.S. Supreme Court Limits Stamp-Tax Exemption to Asset Transfers Under Confirmed Chapter 11 Plans

Resolving a split among various circuits, the United States Supreme Court has ruled that the exemption from state stamp taxes under section 1146(a) of the Bankruptcy Code does not apply to asset sales under section 363 of the Bankruptcy Code that took place before confirmation of a debtor's chapter 11 plan—an event that may take months or years to accomplish.¹

Piccadilly concerned a Florida stamp tax of \$39,200 which resulted from a section 363 sale for \$80 million of substantially all of *Piccadilly's* assets. The closing took place before the filing (much less the confirmation) of *Piccadilly's* chapter 11 plan. More specifically, *Piccadilly* sought bankruptcy court approval to sell its assets upon the filing of its chapter 11 petition in October 2003. It closed the sale in March 2004, filed a chapter 11 plan ten days later, and ultimately confirmed a plan in October 2004. In connection with plan confirmation, the Florida Department of Revenue sought a bankruptcy court declaration imposing the stamp taxes. It maintained that the asset transfer had not occurred “under a plan confirmed,” and thus, the section 1146(a) exemption did not apply. The bankruptcy court confirmed *Piccadilly's* chapter 11 plan and ruled against Florida on the stamp tax issue. On appeal, both the District Court and the Court of Appeals for the Eleventh Circuit affirmed the bankruptcy court's decision and held that section 1146(a) applied to pre-confirmation asset transfers provided a nexus existed between the transfer and the eventually confirmed chapter 11 plan.²

In a 7-2 decision authored by Justice Thomas, the Supreme Court reversed the Eleventh Circuit's decision and concluded that section 1146(a)'s exemption only applies to transfers “made pursuant to a Chapter 11 plan that has been confirmed.” Because *Piccadilly's* chapter 11 plan had not even been submitted to the bankruptcy court at the time its assets were sold, the Supreme Court concluded that the stamp tax exemption was not available.

In reaching its decision, the Supreme Court first considered whether the statutory text contained any ambiguity subject to interpretation. Although it noted that both sides had presented

¹ *Florida Dept. of Rev. v. Piccadilly Cafeterias, Inc.*, 554 U.S. ___, No. 07-312, 2008 WL 2404077, (June 16, 2008). Section 1146(a) provides that “the issuance, transfer, or exchange of a security, or the making or delivery of an instrument of transfer under a plan confirmed under section 1129 of [the Bankruptcy Code], may not be taxed under any law imposing a stamp or similar tax.” 11 U.S.C. § 1146(a). A “stamp-tax” is a tax imposed in connection with recording certain legal documents such as deeds, certificates, and other similar transfer documents.

² *In re Piccadilly Cafeterias, Inc.*, 379 B.R. 215, 226 (S.D. Fla. 2006); *In re Piccadilly Cafeterias, Inc.*, 484 F.3d 1299, 1304 (11th Cir. 2007).

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“credible interpretations” of section 1146(a), it preferred Florida’s interpretation as the “most natural” reading of section 1146(a). It rejected Piccadilly’s argument that “under a plan confirmed” could be read to mean “in accordance with a plan confirmed;” that reading placed “greater strain on the statutory text” than Florida’s more simple construction that “plan confirmed” means an already confirmed plan. The Supreme Court observed further that Piccadilly’s “curious interpretation” would have the exemption turn on the consistency of the debtor’s actions with a “legal instrument that does not exist—and indeed may not even be conceived of—at the time of sale.”

Justice Thomas also seized upon the cannon of statutory construction that federal courts “should proceed carefully when asked to recognize an exemption from state taxation that Congress had not clearly expressed.”³ He concluded that the Supreme Court was obligated to construe section 1146(a) narrowly. By resting its case on the perceived ambiguity of section 1146(a), Justice Thomas held that Piccadilly sought an exemption not “clearly expressed” in the statute, an approach that violated a “decisive” canon of statutory construction. He rejected Piccadilly’s argument that, as a remedial statute, the Bankruptcy Code deserved a liberal construction in favor of the sanctity of the states’ interests in regulating property transfers.

In a dissent in which Justice Stevens joined, Justice Breyer expressed his view that “under a plan” means under a plan that “either *already has been* or *subsequently* is” confirmed. He suggested that if Congress had thought that the time of confirmation mattered, it would have said so, as it has done elsewhere in the Bankruptcy Code. Justice Stevens went on to observe that imposing a temporal limit on the availability of the section 1146(a) exemption lacked “no reasonable congressional purpose” because “it makes no difference whether a transfer takes place before or after the plan is confirmed. In both instances the exemption puts in the hands of the creditors the estate money that would otherwise go to the State in the form of a stamp tax.” Focusing on practical concerns, the dissent noted the frequent need for pre-confirmation sales to maximize value for the estate and that delaying such sales could result in significant creditor harm. In conclusion, Justice Breyer accused the majority of failing to construe section 1146(a) in light of the Bankruptcy Code’s basic purposes.

Whatever the better view of section 1146(a)’s imprecise language, the Supreme Court in *Piccadilly* has eliminated an important advantage of section 363 sales previously available in several jurisdictions. A debtor must have recourse to the section 363 sale alternative; in many cases sales of some or substantially all of the estate’s property cannot await the often lengthy process of negotiating and obtaining creditor and court approval of a chapter 11 plan. While debtors will continue to sell their property under section 363, they will need to scrutinize more closely the attendant state stamp tax liability and then pay for the privilege of monetizing their assets before confirmation of a chapter 11 plan.

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This memorandum is not intended to provide legal advice with respect to any particular situation and no legal or business decision should be based solely on its content. Questions concerning issues addressed in this memorandum should be directed to any of the following:

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³ *California State Bd. of Equalization v. Sierra Summit, Inc.*, 490 U.S. 844, 851-852 (1989).