



BANKRUPTCY PRACTICE

BY JOHN J. RAPISARDI

Stamp Tax Relief to Post-Approval Asset Transfers Limited

In a 7-2 decision, the U.S. Supreme Court recently held in *Florida Department of Revenue v. Piccadilly Cafeterias Inc.*¹ that only those asset transfers made after the confirmation of a chapter 11 plan are eligible for the exemption from state stamp tax provided by Bankruptcy Code §1146(a).

The Court based its conclusion on the most natural reading of the statutory text and its reluctance to interpret §1146(a) in a manner that would provide a broad tax exemption not clearly expressed by Congress. The Court adopts a clear, bright-line rule that will not allow debtors to enjoy a state tax exemption with respect to asset transfers made before the confirmation of a chapter 11 plan.

From a bankruptcy practice perspective, this decision is disappointing because it will increase inefficiencies in chapter 11 by delaying, or causing the loss of, important asset sales, thereby decreasing creditor recoveries.

The Stamp Tax Exemption

Section 1146(a) of the Bankruptcy Code provides that “[t]he 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 this title, may not be taxed under any law imposing a stamp tax or similar tax.”² This provision sets forth an exemption from state taxes imposed on instruments of transfer, which include, for example, mortgage recording tax.

The stamp tax exemption serves to facilitate reorganizations by motivating parties to craft and submit for court approval a confirmable plan of reorganization, which plan serves to resolve creditors’ claims and provide for a debtor’s emergence from chapter 11. In practice, the proceeds of an asset transfer may be subject to a stamp tax. Such transfers occur most frequently before plan confirmation and the proceeds



derived from such sales may be critical to the funding of a confirmed plan.

The Circuit Split

The Supreme Court granted certiorari to review the U.S. Court of Appeals for the Eleventh Circuit’s decision in the bankruptcy case of *Piccadilly Cafeterias Inc. (Piccadilly)*,³ which decision conflicted with existing opinions by the Third and Fourth circuits.⁴ The Third and Fourth circuits held that the words “under a confirmed plan” in Bankruptcy Code §1146(a) are not ambiguous and that the provision’s stamp tax exemption applies only to those transfers that occur after the confirmation of a plan and not to transfers that occur preconfirmation.

Particularly persuasive to the Third and Fourth circuits was the canon of statutory construction that provides that “a court must proceed carefully when asked to recognize an exemption from state taxation that Congress has not clearly expressed.”⁵ In contrast, the Eleventh Circuit held that §1146(a)’s exemption also applies to preconfirmation transfers that are necessary to the consummation of a prospectively confirmed plan.

Prior Proceedings

Piccadilly had been one of the nation’s largest cafeteria chains, with 145 cafeterias located in the Southeast. Upon filing for bankruptcy in October 2003, Piccadilly sought to sell certain real estate in Florida. Piccadilly’s sale motion sought an

exemption from Florida stamp tax pursuant to Bankruptcy Code §1146(a). To facilitate a competitive sale process, the bankruptcy court ordered an auction be held for the properties. The auction resulted in a winning bid of \$80 million. Soon after the sale, Piccadilly sought confirmation of a chapter 11 plan.

The Florida Department of Revenue (Florida) objected to the sale and to the confirmation of Piccadilly’s plan, contending that the sale proceeds were not entitled to an exemption from stamp tax. The bankruptcy court approved the sale, including the tax exemption, and confirmed the plan, but permitted Florida to pursue its claim without prejudice. Florida subsequently commenced an adversary proceeding against Piccadilly, seeking approximately \$39,200 in stamp taxes.

The bankruptcy court, district court, and the Eleventh Circuit each rejected Florida’s argument that §1146(a)’s exemption should not apply to preconfirmation asset transfers. The decisions focused on a reading of the statutory text that accounted for the practicalities of chapter 11 in which a preconfirmation transfer often represents a significant step toward a successful plan.

The Eleventh Circuit held that §1146(a) was ambiguous because the words “under a confirmed plan” could plausibly mean either “in accordance with” or “authorized by” a confirmed plan. According to these constructs, a transfer made “in accordance with” a confirmed plan could conceivably occur before or after the confirmation of the plan, while a transfer “authorized by” could only be made after it was accounted for in a confirmed plan.

Having held the text of §1146(a) ambiguous, the Eleventh Circuit concluded that §1146(a) was not drafted in a manner requiring the strict temporal limitation imposed by the Third and Fourth circuits. The court relied on the canon of construction that provides that, when Congress has sought to impose temporal restrictions in the Bankruptcy Code, it has done so expressly. In support of this canon, the court cited a number of instances in the Bankruptcy Code of words such as “before confirmation” or “after confirmation,” which would have clarified the temporal scope of §1146(a). The court also disagreed with the strict

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statutory interpretation of the Third and Fourth circuits because it ignored the practical reality of chapter 11 practice in which a debtor often must close the sale of an asset for going-concern value as a condition precedent to creditors' willingness to support a plan. Accordingly, the court held that preconfirmation transfers are eligible for §1146(a)'s stamp tax exemption so long as the transfer proves necessary to the consummation of a plan.

The Supreme Court Decision

Justice Clarence Thomas delivered the Supreme Court's decision on behalf of a seven-justice majority. The majority opinion focused on the text of Bankruptcy Code §1146(a), interpretative inferences from other Bankruptcy Code provisions, and canons of statutory construction.

Relying on numerous instances of the word "under" in the Bankruptcy Code, *Piccadilly* argued that the Court should interpret "under a confirmed plan" to mean "in accordance with a confirmed plan," not the more stringent "authorized by a confirmed plan." As its most pertinent example, *Piccadilly* cited Bankruptcy Code §365(g)(1), which utilizes the words "under a confirmed plan" to refer to the assumption or rejection of a contract that may be set forth in a plan but cannot occur after plan confirmation. *Piccadilly* also argued that the Bankruptcy Code is a remedial statute requiring a liberal construction and that allowing Florida to collect its stamp tax would inequitably dilute creditor recoveries.

The Court rejected *Piccadilly's* arguments, grounding its decision on Florida's invocation of the federalism canons that courts should not (i) expand a state tax exemption not clearly expressed by Congress or (ii) interfere with the administration of a state taxation scheme. The Court also found that *Piccadilly's* reading of §1146(a) unduly strained the statutory text because an asset transfer cannot be said to occur "in accordance" with a plan that does not yet exist. Reluctant to expand the scope of §1146(a) to reflect current bankruptcy practice in which preconfirmation transfers far outnumber post-confirmation transfers, the Court deferred to Congress to decide whether the provision should be revised.

In his dissent, Justice Stephen Breyer posited a reading of Bankruptcy Code §1146(a) that inquired into, and squared with, the underlying purpose of the provision, which is to facilitate reorganizations by providing tax relief to debtors that obtain confirmation of their chapter 11 plans. Justice Breyer gave an opinion that a temporal restriction on the stamp tax exemption serves no legislative purpose because such a restriction does not facilitate reorganizations or benefit creditors.

Analysis

The root of the conundrum faced by the

Supreme Court in *Piccadilly* was the proper interpretation to be ascribed to the word "under." Courts often resolve such interpretative dilemmas by reviewing other instances of the relevant word or phrase in the same statute. In *Piccadilly*, such a pursuit would have been futile because the word "under" is used no less than 200 times in the Bankruptcy Code, reflecting a variety of meanings, including "authorized by" and "in accordance with," the two opposing interpretations advocated by the parties.

Piccadilly and the Third and Fourth circuits favored the "authorized by" construction. In contrast, a number of lower court decisions and dissenting opinions preceding *Piccadilly* rejected this approach because an asset transfer, whether occurring before or after a confirmed plan, could be said to be "authorized" only by Bankruptcy Code §363, not a confirmed plan. Further complicating the "authorized by" interpretation is the Bankruptcy Code's use of the words "authorized" or "authorized under" in at least 20 instances, which illustrates that Congress could have opted for clearer language had it intended such a meaning for "under" in §1146(a).

At the crux of the interpretive issue in *Piccadilly* is whether Congress intended to impose a temporal restriction upon §1146(a)'s stamp tax exemption. Minor adjustments to the statutory text would have clearly communicated an intention to impose a temporal restriction on the exemption. As noted above, the Bankruptcy Code is replete with phrases such as "before confirmation" or "after confirmation" that would have evidenced such a legislative intent.

The Court could have resolved the interpretative quandary presented by §1146(a) by crafting a holding that would have given weight to bankruptcy policy and the provision's purpose. Instead, the majority favored a narrow bright-line rule, casting any broader interpretation as an expansion that must be authorized, if at all, by Congress.

Piccadilly may have resulted, in part, from the erosion of legislative history as a persuasive tool among the justices. Although the majority did not discuss the legislative history of §1146(a), the earliest appearance of the stamp tax exemption in the Bankruptcy Act of 1898 stated that it applied to any transfer that serves "to make any plan effective," which is a common construction in the Internal Revenue Code. Over time those words evolved into "under a plan," with no other substantive alteration to the exemption. In this light, it seems that the legislative history gives credence to the view that the exemption applies to both pre- and post-confirmation transfers so long as the transfers facilitate plan consummation.

The reality of bankruptcy practice also supports the notion that, if Bankruptcy Code §1146(a)'s stamp tax exemption is designed to facilitate reorganizations, it should apply to a transfer that leads to a confirmed plan, regardless of when the transfer occurs. Critical bankruptcy events, such as asset sales, are often marked

by unpredictable timing. During a bankruptcy case, debtors have a duty to respond to the market and maximize the value of their assets. *Piccadilly* limits the availability of §1146(a)'s exemption to only those less-common scenarios in which asset transfers occur after plan confirmation. Viewing the exemption in the context of bankruptcy practice, one must query whether Congress intended such a narrow exemption in light of the provision's overarching purpose of facilitating reorganizations.

In this author's view, Justice Breyer's dissent is more persuasive, logical, and reflective of bankruptcy practice than the majority opinion. Instead of advancing the objectives of chapter 11, the Court invited Congress to speak on the issue. Given the obstacles and inefficiencies that *Piccadilly* will cause—forcing debtors to delay or lose asset sales in contravention of chapter 11's rehabilitative purpose and eliminating an attractive incentive for potential asset purchasers—Congress should consider amending §1146(a) to make it clear that the stamp tax exemption should apply to asset transfers that have a nexus to a confirmed chapter 11 plan.

Conclusion

The Supreme Court in *Piccadilly* was faced with the task of interpreting a statutory provision that certainly could have benefited from clearer prose. As is often the case in bankruptcy jurisprudence, *Piccadilly* reached the high court because appellate courts reached diverging conclusions when faced with competing policy choices. The Supreme Court resolved this conflict by preferring a statutory interpretation that limits federal encroachment upon state taxation, an outcome consistent with the Court's recent federalism jurisprudence. As such, *Piccadilly* ignores the practical reality of chapter 11 and focuses on a strict construction of Bankruptcy Code §1146(a)'s tax exemption, leaving it to Congress to clarify the statutory text in a manner consistent with bankruptcy policy. Congress should consider amending §1146(a) to eliminate any temporal limitation on the exemption, which would remedy the inefficiencies that *Piccadilly* will impose on the chapter 11 process.



1. No. 07-312, 2008 WL 2404077 (U.S.) (June 16, 2008).
2. 11 U.S.C. §1146(a).
3. *Fla. Dept. of Rev. v. Piccadilly Cafeterias Inc.* (In re *Piccadilly Cafeterias Inc.*), 484 F.3d 1299 (11th Cir. 2007).
4. See *Baltimore County v. Hechinger Liquidation Trust* (In re *Hechinger Inv. Co. of Del.*), 335 F.3d 243 (3d Cir. 2003); *NVR Homes Inc. v. Cir. Cts. for Anne Arundel County* (In re *NVR, LP*), 189 F.3d 442 (4th Cir. 1999).
5. *Cal. St. Bd. of Equalization v. Sierra Summit Inc.*, 490 U.S. 844, 851-52 (1989).

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