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## U.S. Supreme Court Holds That Section 1146(a) Stamp Tax Exemption Does Not Apply to Preconfirmation Transfers

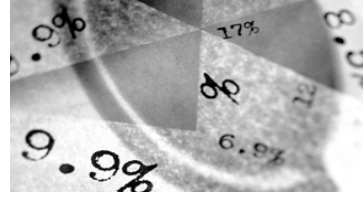
On June 16, 2008, the United States Supreme Court resolved a split of authority among the Circuit Courts of Appeal, issuing a decision clearly defining the meaning of the phrase “under a plan” for purposes of the stamp tax exemption pursuant to section 1146(a) of the United States Bankruptcy Code, 11 U.S.C. §§ 101-1532 (the “Bankruptcy Code”). In *Florida Department of Revenue v. Piccadilly Cafeterias, Inc. (In re Piccadilly Cafeterias, Inc.)*, 2008 WL 2404077, the Supreme Court held that the tax exemption set forth in section 1146(a) of the Bankruptcy Code “does not apply to transfers made before a plan is confirmed under Chapter 11.”

### Facts of the Case and Procedural Background

On October 29, 2003, cafeteria chain Piccadilly Cafeterias, Inc. (“Piccadilly”) filed a petition for relief under Chapter 11 of the Bankruptcy Code. Piccadilly sought Bankruptcy Court approval to sell substantially all of its assets pursuant to section 363(b)(1) of the Bankruptcy Code, and in connection therewith, sought an exemption pursuant to section 1146(a) of the Bankruptcy Code from any stamp taxes which could be imposed on the sale. The United States Bankruptcy Court for the Southern District of Florida approved the sale and ruled that the transfer of assets was exempt from stamp taxes. Piccadilly subsequently filed and sought confirmation of its Chapter 11 plan.

The Florida Department of Revenue (the “Department”) objected to confirmation of Piccadilly’s plan, arguing that \$39,200.00 in stamp taxes it had assessed on certain of Piccadilly’s transferred assets fell outside section 1146(a)’s exemption because the transfer had not occurred “under a plan confirmed” under Chapter 11. The Bankruptcy Court overruled the objection and held that the transfer of substantially all of Piccadilly’s assets was under a confirmed plan because the sale was necessary to consummate the plan. On appeal, the District Court affirmed, holding that section 1146(a) can afford a stamp tax exemption even when a transfer occurs prior to confirmation. *In re Piccadilly Cafeterias, Inc.*, 379 B.R. 215, 226 (S.D. Fla. 2006).

The Eleventh Circuit Court of Appeals affirmed the District Court, holding that section 1146(a)’s tax exemption “may apply to those pre-confirmation transfers that are necessary to the consummation of a confirmed plan of reorganization,



which, at the very least, requires that there be some nexus between the pre-confirmation transfer and the confirmed plan." *In re Piccadilly Cafeterias, Inc.*, 484 F.3d 1299, 1304 (11th Cir. 2007).

The Supreme Court granted certiorari to resolve a conflict among the Circuit Courts of Appeal as to whether section 1146(a) can apply to preconfirmation transfers. For example, in contrast to the Eleventh Circuit's ruling in *Piccadilly*, the Third Circuit Court of Appeals held in *In re Hechinger Inv. Co. of Delaware, Inc.*, 335 F.3d 243 (3d Cir. 2003) that section 1146(a) "appl[ies] only to transfers under the Plan occurring after the date of confirmation." 335 F.3d at 246. Similarly, the Fourth Circuit Court of Appeals has held that section 1146(a) "does not apply to ... transactions that occur prior to the confirmation of a plan." *In re NVR, LP*, 189 F.3d 442, 458 (4th Cir. 1999).

### The Supreme Court's Decision

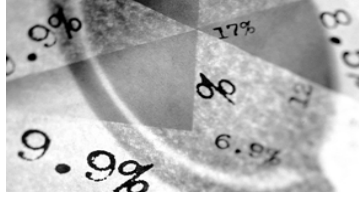
In *Piccadilly*, the Department and Piccadilly advanced competing interpretations of section 1146(a), centering on: (i) whether the section applies to preconfirmation transfers so long as such transfers are made in accordance with a plan that is eventually confirmed, or (ii) whether the section applies solely to postconfirmation transfers. Section 1146(a) of the Bankruptcy Code provides:

(a) 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 this title, may not be taxed under any law imposing a stamp tax or similar tax.

11 U.S.C. § 1146(a) (emphasis added). Stamp taxes are creations of state or local law designed for revenue purposes to tax transfers of personal property or real estate.

While recognizing that Congress could have been more precise in its drafting of section 1146(a), for example by including an express temporal limitation, the Supreme Court found that the more natural reading of 1146(a) is that the exemption only applies to postconfirmation transfers. The Supreme Court analyzed the proper interpretation of the terms leading to the parties' competing interpretations, namely "under" and "confirmed." With respect to the term "under," the Court agreed with the Department's interpretation that a preconfirmation transfer, by definition, cannot be subject to, or under the authority of, something that did not exist at the time of the transfer, i.e. a confirmed plan. The Court further rejected an interpretation of "under" coterminous with the phrase "in accordance with" and concluded that the sale cannot be said to have been consummated "in accordance with" any confirmed plan because, as of the closing date of Piccadilly's asset sale, Piccadilly had not even submitted its plan to the Bankruptcy Court. With respect to the phrase "confirmed plan," the Court noted that in section 1146(a), the word "confirmed," which modifies the word "plan," indicates past or completed action.

The Supreme Court went on to caution that courts should "proceed carefully when asked to recognize an exemption from state taxation that Congress has not clearly expressed," rejecting Piccadilly's argument that section 1146(a), as part of the Bankruptcy Code, a remedial statute, should be liberally construed. Piccadilly's argument in favor of a liberal construction of section 1146(a), the Court reasoned, would in effect recognize an exemption that Congress has not clearly expressed. Finally, the Court stated, without ruling expressly on whether section 1146(a) is ambiguous or unambiguous on its face, that while there may be certain ambiguities in section 1146(a), none of these ambiguities warrant the conclusion that section 1146(a) permits application of the tax exemption to preconfirmation transfers.



### Implications of the Supreme Court's Decision

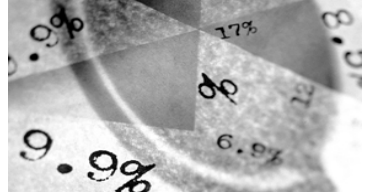
A section of the Bankruptcy Code which was once the subject of great debate by courts and practitioners alike has been reduced by the Supreme Court to, in its words, a "straightforward exemption." Any preconfirmation sale or transfer of property, regardless of its ultimate impact upon the consummation of a plan, cannot be subject to the exemption provided in section 1146(a) of the Bankruptcy Code. Instead, as the *Piccadilly* decision makes clear, the exemption applies only to transfers made pursuant to a Chapter 11 plan that has been confirmed.

The allocation of various types of taxes is generally a significant issue between purchasers and sellers in a bankruptcy acquisition transaction, particularly where there is significant amount of real estate involved in the sale. By applying section 1146(a) to a preconfirmation sale under section 363 of the Bankruptcy Code, bankruptcy courts had effectively eliminated the issue of which party is responsible for transfer taxes in such a sale. Although, where applicable, it was customary for the seller to pay any transfer taxes, as a result of the decision in *Piccadilly*, the allocation of such transfer taxes will now be a point of negotiation between the purchaser and seller, and could reduce the proceeds available to the estate. Further, any requirement in a bid procedures order that the buyer pay applicable transfer taxes will undoubtedly have a chilling effect on bidding.

The parties to such transactions may also want to consider sales pursuant to a bankruptcy plan, and weigh the benefit of the tax exemption against the potential costs and delays involved with the plan process. There are a number of factors involved in evaluating these strategies, and parties are advised to seek the assistance of qualified counsel in making these decisions.

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This *GT Alert* was prepared by Greenberg Traurig's Business Reorganization & Bankruptcy Group. Questions about this information can be directed to any member of the [Business Reorganization & Bankruptcy team](#).



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