Nothing Natural About It: Still Searching for a Solution to the Chapter 11 Stamp Tax Exemption

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I. Introduction

The recent financial crisis has wreaked havoc on the U.S. economy. It has contributed to the failure of businesses, a decline in consumer wealth, and a substantial downturn in economic activity. Many companies, small and large, have contemplated or will be forced to contemplate bankruptcy. In fact, during the federal judiciary's fiscal year ending September 2008, corporate bankruptcies were up 49% from the previous fiscal year.[1]

Bankruptcy reorganization under Chapter 11, the Chapter most prominently used by corporations, seeks to aid financially troubled entities by capturing and preserving any value remaining in the company.[2] Under reorganization, as opposed to liquidation, the company continues to operate and can do so with a little breathing room. The company no longer fears harassment from creditors or potential litigation, but is able to formulate a plan for rehabilitation with the hope of eventually returning to a viable state.[3] When the company reorganizes, all parties involved benefit; with the company in a more stable financial position, more claims are paid to creditors, jobs are saved, and returns can still be produced for stockholders.[4]

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1. Press Release, U.S. Courts, Bankruptcy Filings Over One Million for Fiscal Year 2008 (Dec. 15, 2008) (on file with author), *available at* http://www.uscourts.gov/Press_Releases/2008/BankruptcyFilingsDec2008.cfm.

2. 9C AM. JUR. 2D *Bankruptcy* § 2797 (2010).

3. 10 WILLIAM L. NORTON, JR., NORTON BANKR. L. & PRAC. 11 U.S.C. Ch. 11 Note (3d ed. 2010) [hereinafter NORTON BANKR. L. & PRAC.].

4. *See id.*

In a typical Chapter 11 proceeding, the debtor drafts a reorganization plan.[5] This plan details how much, and in what form, each creditor will be paid; the amount of interest, if any, stockholders will retain; and how the business will operate in the future.[6] In addition, the plan may also include the terms of any proposed sales of the debtor's assets.[7] The Bankruptcy Code then requires that, after the creditors have divided up into classes of substantially similar claims, they vote.[8] If all of the creditors approve the reorganization plan, it is then submitted to the bankruptcy court for confirmation—official approval.[9] Conversely, through their vote, creditors can veto a sale if their claims are "impaired"—e.g., those that preclude receiving payment in full. By vetoing the reorganization plan, creditors can prevent the entire plan's confirmation.[10] If no creditors object and the court approves the reorganization plan, the plan is confirmed and the debtor emerges as a reorganized company.[11]

To generate the funds needed for a Chapter 11 reorganization, assets may be sold at any time under § 363 of the Bankruptcy Code.[12] The Chapter 11 reorganization process costs money,[13] and more often than not, a financially strapped company will find it "impossible or imprudent" to wait to sell off its assets until confirmation of a plan at the end of a Chapter 11 case.[14] Section 363 allows a trustee or debtor in possession (DIP),[15] with the court's approval, to "use, sell, or lease, other than

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5. *See* 11 U.S.C. § 1121 (2009).

6. *Id.* § 1123.

7. Paul D. Leake & Mark G. Douglas, *Testing the Limits of the Chapter 11 Transfer Tax Exemption: In Search of the Meaning of "Under a Plan Confirmed,"* 1 N.Y.U. J.L. & BUS. 839, 842 (2005).

8. 11 U.S.C. § 1126 (2009).

9. *Id.* §§ 1128–1129.

10. Leake & Douglas, *supra* note 7. However, if enough creditors vote in favor of the plan, the court has the option to "cram down" the plan on those creditors that do not vote in favor of the plan. 11 U.S.C. § 1129(b).

11. NORTON BANKR. L. & PRAC., *supra* note 3. If the debtor fails to obtain approval within the prescribed time limits, the Chapter 11 reorganization proceeding will be converted into a Chapter 7 liquidation proceeding. 11 U.S.C. § 1112(b)(1) (2009).

12. 11 U.S.C. § 363 (2009).

13. *See* Arturo Bris, Ivo Welch & Ning Zhu, *The Costs of Bankruptcy: Chapter 7 Liquidation Versus Chapter 11 Reorganization Bankruptcy*, 61 J. FIN. 1253 (2006). Reorganizations are expensive because they impose upon the debtor both direct and indirect costs. *Id.* Direct bankruptcy costs are the out-of-pocket expenditures associated with the bankruptcy proceeding itself, which include filing fees, lawyer fees, accountant fees, expert witness fees, trustee fees, and other out-of-pocket administrative costs. *Id.* at 1278. In addition, bankruptcy also imposes certain indirect costs, such as lost opportunities, time spent in bankruptcy, and lost sales or profits. *Id.* at 1270.

14. Steven A. Meyerowitz, *Supreme Court "Bright Line" Ruling on Scope of Chapter 11 Transfer Tax Exemption is Bad News for Pre-Confirmation Asset Sales in Bankruptcy*, J. BANKR. L. 2008.09-1 (2008).

15. Once the debtor files his petition for relief under Chapter 11, the debtor automatically assumes an additional identity as DIP. 11 U.S.C. § 1101 (2009). A DIP typically refers to the deb-

in the ordinary course of business, property of the estate."[16] These sales provide the distressed companies with many benefits, including greater leverage with creditors, less oversight and review than under a Chapter 11 confirmation, and fewer disclosure requirements.[17] Moreover, as an additional benefit to debtors and purchasers, sales under § 363, under certain circumstances,[18] cleanse the assets of any prior liens and most claims and liabilities.[19] Finally, a debtor company further benefits from this provision because a sale can be made at any time after the filing for bankruptcy and is usually relatively quick, which allows the company to maximize the value of the asset.[20]

While these sales were initially used only when there was a compelling need, the recent trend has been to use pre-confirmation plan sales much more frequently.[21] Companies have realized that these sales often provide a "cheaper and quicker exit from bankruptcy."[22] In terms of overall numbers, thirty-two pre-confirmation plan sales worth $1.6 billion were announced in the first quarter of 2008 as compared with twenty-one such sales worth $888 million in the first quarter of 2007.[23] These numbers are only expected to increase given the jump in overall Chapter 11 filings.[24] Indeed, companies as large as Lehman Brothers have taken this route. The global financial-service firm sold its capital markets and investment banking businesses under a pre-plan sale for $1.7 billion.[25]

Unfortunately, due to a recent Supreme Court decision, a portion of these sales suffered a setback. In June of 2008, in *Florida Department of Revenue v. Piccadilly Cafeterias, Inc.*,[26] the Supreme Court settled a circuit split and issued a bright line rule stating that asset transfers made

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tor's original management that continues to maintain possession and control of the business during the reorganization process. J. Seth Moore & Vincent P. Slusher, *Bankruptcy Code Section 363 Sales: Trends and Opportunities*, 9 WILLIAM L. NORTON, JR., NORTON BANKR. L. ADVISER 2 (2007).

16. 11 U.S.C. § 363(b) (2009).

17. Moore & Vincent, *supra* note 15.

18. 11 U.S.C. § 363(f).

19. *Id.*

20. Moore & Vincent, *supra* note 15. By contrast, a sale pursuant to a plan involves a prolonged notice period and a two-step approval process: (1) a disclosure statement and (2) confirmation of the plan. NORTON BANKR. L. & PRAC., *supra* note 3.

21. *See* Moore & Vincent, *supra* note 15.

22. Moore & Vincent, *supra* note 15; Brief for Professors Richard Aaron et al. as Amici Curae Supporting Respondent at 19, Fla. Dep't of Rev. v. Piccadilly Cafeterias, Inc. (*Piccadilly III*), 128 S. Ct. 2326 (2008) (No. 07-312), 2008 WL 494942.

23. Avital Louria Hahn, *An Epilogue to Chapter 11*, CFO MAG., May 1, 2008, *available at* http://www.cfo.com/article.cfm/11079995?f=related.

24. *Id.*

25. Press Release, Orrick Client Alert, Lehman Brothers Holdings Inc. Asset Sale Summary (Oct. 31, 2008) (on file with author).

26. *Piccadilly III*, 128 S. Ct. 2326 (2006).

prior to the confirmation of a Chapter 11 plan of reorganization no longer benefit from certain tax exemptions.[27] As a result, the cost of selling assets in a bankruptcy case outside of a plan will increase.

The provision at issue in the case, which exempts asset transfers and sales from certain state taxes, contains language ambiguous enough that four federal circuit courts have contemplated which types of asset sales qualify for the tax benefit.[28] Although the Supreme Court set a bright line rule that brings clarity and simplicity to the provision, the Court ignored the intent behind the provision, and the Court's decision may ultimately result in the exemption's obsolescence. As a result, Congress should adopt a revised provision that nullifies the Supreme Court's *Piccadilly* decision in order to stay true to the purpose behind the Code.

This Comment analyzes the *Piccadilly* opinion and its practical effects. Part II discusses the history and purpose of the stamp tax exemption within the Bankruptcy Code. Part III discusses the circuit split resolved by *Piccadilly* and addresses the problems each side presents. Part IV first presents the background and procedural history of *Piccadilly* and then summarizes the Supreme Court's creation of the bright line rule and decision to limit the tax exemption to post confirmation transfers. Part V critiques the Court's decision and suggests that Congress reject the Supreme Court's bright line rule and revise the statute to remove the temporal limitation and add a notice provision. In addition, Part V addresses the suggested revision's application and its potential pitfalls. Finally, Part VI concludes and briefly comments on the future impacts of the decision.

II. TAX EXEMPT TRANSFERS UNDER THE BANKRUPTCY CODE

The Bankruptcy Code contains several "special tax provisions" relating to Chapter 11 business reorganization.[29] This Part and Part III discuss one such provision, § 1146(a). Section 1146(a) exempts any stamp or similar tax imposed by state or local authorities on "the issuance, transfer or exchange of a security, or the making or delivery of an instrument of transfer under a plan confirmed" under Chapter 11 of the Bankruptcy Code.[30]

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27. *Id.* at 2339.

28. *Compare* City of New York v. Jacoby-Bender, Inc. (*In re* Jacoby-Bender, Inc.), 758 F.2d 840, 841 (2d Cir. 1985), *and* Fla. Dep't of Rev. v. T.H. Orlando Ltd., et al. (*In re* T.H. Orlando Ltd.), 391 F.3d 1287 (11th Cir. 2004), *with* NVR Homes, Inc. v. Clerks of the Circuit Courts (*In re* NVR, L.P.), 189 F.3d 442 (4th Cir. 1999), *and* Baltimore County v. Hechinger Liquidation Trust (*In re* Hechinger Inv. Co. of Del., Inc.), 335 F.3d 243 (3d Cir. 2003).

29. 11 U.S.C. § 1146 (2009).

30. *Id.* § 1146(a). Before October 17, 2005, 11 U.S.C. § 1146(a) was previously designated as § 1146(c). However, under the Bankruptcy Abuse Prevention and Consumer Protection Act

The purpose and origins of the stamp tax exemption aid in understanding its scope. The primary purpose of the special tax provisions is to balance the objectives of state and local tax codes with those of the Bankruptcy Code and therefore limit any negative effects these tax policies may have on the bankruptcy process.[31] Thus, Congress enacted the stamp tax exemption in order to provide relief from taxes that might be imposed on the transfer of assets to a restructuring business.[32] Congress's objective in enacting the stamp tax exemption was simple: By exempting the stamp tax, a larger amount of the profits generated by the sale are available to creditors, and the likelihood the debtor will successfully emerge from reorganization increases.[33]

The stamp tax exemption originated under § 77B(f) of the Bankruptcy Act of 1898. The Act exempted from federal transfer taxes "the issuance, transfers, or exchanges of securities or making or delivery of conveyances to make effective any plan of reorganization confirmed under the provisions of this section."[34] Section 77B(f) was replaced with § 267 of the Bankruptcy Act of 1938, which expanded the stamp tax exemption to both state and federal taxes, and the language evolved from transfers that serve "to make effective any plan" to those that arise "under any plan confirmed."[35, 36] The litigation surrounding the tax exemp-

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(BAPCPA) of 2005, both §§ 1146(a) and 1146(b) were deleted. Pub. L. No. 109-8, § 719(b)(3), 119 Stat. 23, 133. The substance of the new subsection (a) is identical to that of the old subsection (c). For simplicity, the provision will be referred to as the "stamp tax exemption."

31. Robert A. Morse, Annotation, *Exemption, Under 11 U.S.C. § 1146(c), From Payment of Tax Under Any Law Imposing Stamp Tax or Similar Tax*, 108 A.L.R. FED. 701 (1992).

32. John C. Murray, *Transfer-Tax Considerations in Real Estate Bankruptcy Proceedings*, 38 REAL PROP. PROB. & TR. J. 377, 379 (2003).

33. *Id.* Murray states the following:

> Congress enacted [the stamp tax exemption] to facilitate reorganization by giving debtors tax relief from stamp or similar tax, such as transfer taxes, for transfers of property pursuant to an instrument of transfer under a confirmed plan. By exempting the transaction from tax, [the stamp tax exemption] reduces the obligations encumbering the property, thereby making a greater portion of the sale proceeds available to creditors and affords debtor a quick and efficient means of distributing and discharging its obligations under the plan.

Id. (citing *In re* Kerner Printing Co. 188 B.R. 121, 124 (Bankr. S.D.N.Y. 1995)).

34. Act of Jun. 7, 1934, Pub. L. No. 73-296, 48 Stat. 911, 919 (1934).

35. Act of Jun. 22, 1938, Pub. L. No. 75-696, 52 Stat. 840, 903–904 (1938). *See generally* 6A COLLIER ON BANKRUPTCY § 15.08 at 836–837 (14th ed. 1977). H.R. REP. No. 95-595, at 281 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6238. The leading contemporary bankruptcy treatise asserts that the provision was not extended to exempt any taxes on transfers "*which occur prior to confirmation of the plan and which are merely prepatory steps*." 6A COLLIER ON BANKRUPTCY § 15.08, at 840. No reason was provided for why the language was changed. *See* 52 Stat. at 903–904.

36. Congress used virtually the same language in the subsequent BAPCPA revisions, including the phrase "under a plan confirmed." 11 U.S.C. § 1146(a) (2009). With the BAPCPA revisions of 2005, Congress made several significant changes to the Bankruptcy Code while attempting to,

tion provision has focused on two areas of debate: (1) the type of transfer the exemption applies and (2) the proper timing of the transfer as dictated by the language of the statute. This Part will address the first of these issues, and Part III will discuss the timing issue as it relates to asset sales under § 1146(a).

The provision's application to various types of state taxes was the first area of dispute. The stamp tax exemption specifically exempts a "stamp tax or similar tax,"[37] but the scope of the provision is unclear due to the noticeable lack of a definition of stamp or similar tax within the code. Black's Law Dictionary defines a stamp tax as "a tax imposed by requiring the purchase of a revenue stamp that must be affixed to a legal document (such as a deed or note) before the document can be recorded."[38] Many courts have addressed this issue. The Second Circuit has asserted that all stamp or similar taxes share the following elements:

> (1) they are imposed only at the time of transfer or sale of the item at issue; (2) the amount due is determined by the consideration for, par value of, or value of the time being transferred; (3) the tax rate is a relatively small percentage of the consideration, par value or value of the property; (4) the tax is imposed irrespective of whether the transferor enjoyed a gain or suffered a loss on the underlying sale or transfer; and (5) in the case of state documentary transfer taxes, the tax must be paid as a prerequisite to recording.[39, 40]

Thirty-seven states impose a tax that is covered by the statute at either the state, county, or municipal level.[41] These taxes, most commonly used on the recording of deeds, mortgages, or leases, are generally a very small percentage of the overall transaction (typically 1% or less).[42] Despite their seemingly nominal value, the classification of these taxes, as well as when they may be tax exempt, generates significant controversy.

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among other things, make it more difficult for some consumers to file bankruptcy under Chapter 7. *Id.*

37. *Id.* § 1146(a).

38. BLACK'S LAW DICTIONARY 1597 (9th ed. 2009).

39. 995 Fifth Ave. Assocs., L.P. v. N.Y. St. Dep't of Taxation and Fin. (*In re* 995 Fifth Ave. Assocs. L.P.), 963 F.2d 503, 512 (2d Cir. 1992).

40. In contrast, courts have also ruled that sales and capital gains taxes are not considered stamp taxes because they are too high and, unlike stamp taxes, are imposed solely for gain or profit. Murray, *supra* note 32, at 385.

41. Brief for the States of Illinois et al. as Amici Curiae Supporting Petitioner at 1, Fla. Dep't of Rev. v. Piccadilly Cafeterias, Inc., 128 S. Ct. 2326 (2008) (No. 07-312), 2008 WL 345045.

42. National Association of Realtors, *Summary of Real Estate Transfer Taxes by State* (Aug. 15, 2005) (on file with author), *available at* http://www.realtor.org/library/library/fg717.

III. THE CIRCUIT SPLIT

The second area of debate surrounding the stamp tax exemption spurred a split among the federal circuit courts. This split hinged largely on whether the stamp tax exemption includes a timing element in order for a transfer to qualify for the tax exemption. Specifically, the dispute related to the interpretation of the requirement that the transfer be made "under a plan confirmed." There were two schools of thought.[43] The Court of Appeals for the Second and Eleventh Circuits broadly followed the "'necessity' interpretation," requiring only that the transfer be necessary to the confirmation of a plan for the exemption to be valid. In contrast, the Court of Appeals for the Third and Fourth Circuits followed a "'temporal limitation' interpretation" of the stamp tax exemption, requiring that a transfer occur post-conformation for the exemption to be valid.

The circuit split developed in 1999 when the Fourth Circuit rejected the Second Circuit's more expansive necessity approach adopted in *City of New York v. Jacoby-Bender, Inc.*, and instead interpreted "under a plan confirmed" as including a temporal limitation.[44] This split has led to an uncertainty regarding the scope of the tax exemption. After the split developed, debtors in jurisdictions that had yet to rule on the issue were left in a state of uncertainty as to whether their pre-confirmation asset transfers would receive the same tax benefits as any post-confirmation transfers. The following discussion tracks the origins and development of the circuit split. Specifically, section A discusses the necessity interpretation, and then, section B discusses the temporal limitation interpretation. Both sections also discuss the problems that each interpretation presents.

A. Necessary to the Confirmation of the Plan

The Second Circuit, as the first federal circuit court to address the issue of whether the stamp tax exemption[45] includes a temporal limitation, developed the necessity interpretation,[46] which was eventually embraced by the majority of bankruptcy courts.[47] The court developed the necessity interpretation in *City of New York v. Jacoby-Bender*.[48] In *Ja-*

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43. Throughout this Comment, the two predominant views will be referred to as the "'necessity' interpretation" and the "'temporal limitation' interpretation."

44. NVR Homes, Inc. v. Clerks of the Circuit Courts (*In re* NVR, L.P.), 189 F.3d 442, 456 (4th Cir. 1999); City of New York v. Jacoby-Bender, Inc. (*In re* Jacoby-Bender, Inc.), 758 F.2d 840, 841 (2d Cir. 1985).

45. 11 U.S.C. § 1146(a) (2009).

46. *Jacoby-Bender*, 758 F.2d at 840–41.

47. Leake & Douglas, *supra* note 7, at 855.

48. *Jacoby-Bender*, 758 F.2d at 840–41 (holding that the New York City Property Transfer Tax is a "similar tax" under 11 U.S.C. § 1146(c)).

coby-Bender, the court affirmed a bankruptcy decision, which held that the delivery of a deed transferring a building to The Hearst Corporation occurred under a confirmed reorganization plan and was thus exempt from all stamp or similar taxes.[49] While not a pre-confirmation transfer, the sale at issue was a post-confirmation transfer that was not specifically authorized by the reorganization plan but was necessary to the plan's consummation—the eventual emergence from bankruptcy.[50]

The City of New York argued that because the plan did not mention the transfer nor provide authority to make the sale, delivery could not have been made under the plan as required by the code.[51] In rejecting this argument, the court found that the statute does not require a specific reorganization plan.[52] It was sufficient that "the plan's consummation depended almost entirely upon the sale of the building."[53] Thus, the Second Circuit's decision stating that the transfer did not have to be included within the confirmed plan as long as the transfer was necessary for the plan's consummation created the necessity interpretation.

Bankruptcy courts and other federal circuit courts extended this already expansive view of the stamp tax exemption to sanction not only those sales "necessary to the consummation of a plan, but [also] those necessary to the confirmation of a plan."[54] Thus, under a plan confirmed also applied to those transfers that took place before a plan was confirmed, so long as it was "necessary" or "essential" to the confirmation of a plan.

Similarly, once the split developed,[55] the Eleventh Circuit weighed in on the issue and further expanded the scope of under a plan confirmed.[56] In *State of Florida, Department of Revenue v. T.H. Orlando Ltd.*, the debtor, a hotel owner, filed an action against the Florida Department of Revenue seeking declaratory relief and requesting a refund of $161,425 for stamp taxes paid in connection with a $29,350,000 mortgage refinancing.[57] The issue the court considered was whether a trans-

49. *Id.*

50. *Id.*

51. *Id.* at 840.

52. *Id.*

53. *Id.*

54. NVR Homes, Inc. v. Clerks of the Circuit Courts (*In re* NVR, L.P.), 189 F.3d 442, 456 (4th Cir. 1999) (citing *In re* Smoss Enterprises Corp., 54 B.R. 950, 951 (E.D.N.Y. 1985) (finding that a sale was under a plan because "the transfer of property was essential to the confirmation of the plan")).

55. *See infra* Part III.B.

56. Fla. Dep't of Rev. v. T.H. Orlando Ltd. et al. (*In re* T.H. Orlando Ltd.), 391 F.3d 1287 (11th Cir. 2004).

57. *Id.* at 1289–90.

action between two non-debtors was exempt from the stamp taxes when the transaction was specifically considered in the confirmed plan.[58]

The parties involved in the dispute did not include the debtor, but rather an adjacent landowner and the new lender.[59] Nonetheless, the court found that without these two parties, the plan would never have been consummated because the first lender would have foreclosed on the mortgage, leaving the unsecured creditors with nothing.[60] The court distinguished *T.H. Orlando Ltd.* from those cases where the transaction could have been completed by other means, including an outright purchase.[61] Here, the transfer was not irrelevant but essential because the plan would have failed without it.[62] Ultimately, the court held that under a plan confirmed refers to a transfer that is necessary to the consummation of a confirmed Chapter 11 plan.[63, 64]

Originating over twenty years ago in *Jacoby-Bender*, the necessity interpretation has been embraced by numerous courts and applied to transfers both pre- and post-confirmation. However, despite these endorsements, this interpretation is flawed. With little regulation, the use of the tax provision has increased along with scope of the interpretation.[65] Critics argue that the necessity interpretation sets a vague standard and creates a windfall for debtors at the expense of state taxing authorities.[66] Recently, the trend has been to include a boilerplate provision in the standard pre-confirmation asset sale motion, which usually seeks to "avoid any taxes 'under any law imposing a stamp or similar tax.'"[67] However, this broad language, which is simply tacked on to the asset sale motion, does not generally contain the amount of the tax or even the listing of the property being transferred.[68] As a result, the state tax authorities argue they have no notice as to whether or not they will be affected by the transfer.[69] This practice then allows the debtor to take advantage

58. *Id.* at 1290.
59. *Id.*
60. *Id.* at 1294.
61. *Id.*
62. *Id.* at 1295.
63. *Id.*
64. Although the court did not address the precise issue of whether the stamp tax exemption applies to pre-confirmation transfers, the court's decision was a precursor to the Eleventh Circuit's decision in *Piccadilly*. *See supra* Part IV.A.
65. *See* Karen Cordy, *The Incredible Expanding § 1146(c)*, AM. BANKR. INST. J., Jan. 21, 2003, at 10.
66. *Id.*
67. *Id.*
68. *Id.*
69. *Id.*

of the exemption, while little is documented with either the court or the city.[70]

This flaw spurs additional problems when the debtor utilizes the tax exemption and then subsequently fails to confirm a plan. Only about 25% of Chapter 11 plans are confirmed; the vast majority of cases that begin under Chapter 11 are dismissed or converted to Chapter 7 proceedings.[71] Clearly, this was never Congress's intent. Further, the taxing authority argues that attempts to collect the tax from the debtor after the fact are highly impractical because the state will face high administrative costs in doing so.[72]

B. Temporal Limitation

The necessity interpretation of the stamp tax exemption dominated the jurisdictions and was the only view endorsed by a circuit court until the Fourth Circuit reversed the bankruptcy and lower courts' use of this interpretation in *NVR Homes, Inc. v. Clerks of the Circuit Courts* in 1999.[73] In *NVR*, the Fourth Circuit rejected the necessity interpretation and, instead, held that the stamp tax exemption includes a temporal limitation.[74] NVR, a leading homebuilder, acquired Ryan Homes in an effort to expand its business.[75] NVR financed this deal, incurring over $450 billion in debt.[76] Unable to meet its financial obligations, NVR filed for bankruptcy under Chapter 11.[77] During the five-month period after filing and before emerging from bankruptcy, NVR made 5,671 real property transfers and incurred $8,439,103 in transfer and recordation taxes, the majority of which were paid to the taxing authorities in Pennsylvania and Maryland.[78] Ultimately, the court concluded, "transfers taking place prior to the date of the reorganization plan's confirmation are not covered by [the stamp tax exemption]."[79]

In reaching this conclusion, the Fourth Circuit cited the holding in *California State Board of Equalization v. Sierra Summit, Inc.*, in which the court stated that, "[a]lthough Congress can confer an immunity from state taxation, . . . a court must proceed carefully when asked to recog-

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70. *See id.*

71. Transcript of Oral Argument, Fla. Dep't of Rev. v. Piccadilly Cafeterias, Inc., 128 S. Ct. 2326 (No. 07-312), 2008 WL 791974 at *3–*4.

72. *Id.* at *18–*19.

73. NVR Homes, Inc. v. Clerks of the Circuit Courts (*In re* NVR, L.P.), 189 F.3d 442 (4th Cir. 1999).

74. *See id.*

75. *Id.* at 447.

76. *Id.*

77. *Id.* at 447.

78. *Id.* at 448.

79. *Id.* at 456.

nize an exemption from state taxation that Congress has not clearly expressed."[80] The court asserted that this passage dictates that courts must narrowly construe tax provisions in favor of the state.[81] Thus, using the Black's Law Dictionary definition of the word "under,"[82] which means inferior or subordinate, the Fourth Circuit could not hold that a pre-confirmation transfer could be subordinate to or authorized by something that did not exist at the time of the transfer.[83]

In 2003, the Third Circuit entered the fray with *Baltimore County v. Hechinger Liquidation Trust*[84] and sided with the Fourth Circuit, agreeing that courts should take a restrictive approach when dealing with the stamp tax exemption.[85] Hechinger, a retailer of home and garden care products, filed a voluntary Chapter 11 petition in June of 1999.[86] In October, Hechinger requested permission to make certain real estate sales prior to confirmation of the plan.[87] Hechinger's motion also requested that the court find the sales exempt from taxes under the stamp tax exemption provision.[88]

Despite objections by the taxing authorities that the proposed sales were not being made under a confirmed plan, the bankruptcy court approved the sales and declared them exempt from transfer and recording taxes.[89] The Third Circuit, in an opinion authored by then Third Circuit Judge Alito, reversed, holding that under a plan confirmed means "'made pursuant to the authority conferred by such a plan,' and since an unconfirmed plan cannot confer such authority, this interpretation means that a transfer made prior to plan confirmation cannot qualify for tax exemption."[90]

In adopting this temporal limitation interpretation of under a plan confirmed, the Third and Fourth Circuits asserted that transfers occurring before a plan is confirmed, regardless of their importance to the plan, do not qualify for the tax benefit. This assertion is based on a narrow and strict textualist interpretation of under a plan confirmed. However, the temporal limitation interpretation is not without its own fair share of crit-

80. *Id.* at 457 (citing Cal. State Bd. of Equalization v. Sierra Summit, Inc., 490 U.S. 844 (1989)).

81. *Id.*

82 *Id*. (citing BLACK'S LAW DICTIONARY 1525 (6th ed. 1990)).

83. *Id.*

84. Baltimore County v. Hechinger Liquidation Trust (*In re* Hechinger Inv. Co. of Del., Inc.), 335 F.3d 243 (3d Cir. 2003).

85. *Id.*

86. *Id.* at 246.

87. *Id.*

88. *Id.*

89. *Id.* at 246–47.

90. *Id.* at 254.

ics.[91] Critics of this interpretation argue that the temporal limitation (1) draws an arbitrary line and, as a result, is under inclusive and (2) does not comport with the practical realities of Chapter 11 reorganization.[92]

First, critics argue that in limiting the scope of the provision, the temporal limitation interpretation draws a strict line between transfers that qualify for the transfer tax exemption and those that do not.[93] A transfer that is essential to the plan but occurs one day before plan confirmation is barred, while a transfer that occurs one day after will qualify regardless of whether it is necessary or essential to the plan. One of the goals of the stamp tax exemption is to provide tax relief to distressed companies while encouraging asset sales to preserve any remaining value and increase the debtor's chance of a successful reorganization.[94] The line created by the temporal limitation arbitrarily limits the extension of the tax provision to those debtors who can afford to wait for plan confirmation and rejects those debtors who need to sell assets earlier in order to fund their reorganization.[95]

Second, critics argue that the temporal limitation fails to comport with the practical realities of Chapter 11 reorganization.[96] Because of their numerous benefits, the increased use of pre-confirmation asset sales will likely continue despite an inability to take advantage of the exemption, and less money will be available for creditors and reorganization. The reality is that these transfer taxes are far too small to drive the timing of an asset sale.[97] The benefit to those who take the time and effort to hold off on the deal until the plan has been confirmed will be nominal. Furthermore, the numerous benefits associated with a pre-confirmation asset sale—such as simplicity, speed, and the lack of liens and encum-

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91. *See, e.g.*, David Stratton, *Real Property Transfers and Bankruptcy Tax Exemptions: In re Hechinger and 11 U.S.C. § 1146(c)*, AM. BANKR. INST. J., Sept. 22, 2003, at 32; Lorenzo Marinuzzi & Jordan Wishew, *Piccadilly Cafeterias: Congress Should Revisit Supreme Court Bright Line Test*, AM. BANKR. INST. J., Aug. 27, 2008, at 1.

92. Marinuzzi & Wishew, *supra* note 91.

93. *See, e.g.*, Stratton, *supra* note 91.

94. *See supra* notes 32–34.

95. *See* Stratton, *supra* note 91.

96. Marinuzzi & Wishew, *supra* note 91.

97. Brief for the States of Illinois et al. as Amici Curiae Supporting Petitioner, *supra* note 41, at 14. The brief stated the following:

> In fact we know of no reported cases finding that but for the availability of the exemption, an assets sale would not have gone forward. Nor are there any reported cases finding that a debtor was unable to confirm a plan because it had to pay the transfer tax on a pre-confirmation sale.

Id. Moreover, companies continue with these transfers despite having to pay sales or capital gains tax, which can range up to the high teens. *Id.*

brances—serve as powerful incentives to "engage in these pre-plan transactions, even without [the] minor added tax advantage."[98]

In addition, even if the tax benefit is an attractive incentive, given the recent trouble in the credit markets, companies will face additional difficulties in obtaining the financing needed to fund the reorganization. As a result, many debtors will be unable to postpone a sale until plan confirmation solely to preserve the tax exemption. With the increase in pre-confirmation asset sales, this use of the tax exemption provision will also likely decline. Because the taxes will still need to be paid, either the burden will be placed on the purchaser, hurting the bidding process, or on the debtor, resulting in less proceeds from the sale. Either way, creditors will end up with less money.

IV. *FLORIDA DEPARTMENT OF REVENUE V. PICCADILLY CAFETERIAS, INC.*

Less than twenty years after the circuit split developed, the Supreme Court, in a 7–2 decision, settled the debate in *Florida Department of Revenue v. Piccadilly Cafeterias, Inc*.[99] By issuing a "simple, bright line rule" that the stamp tax exemption does not apply to an asset sale made before the debtor's plan is confirmed under Chapter 11, the majority of the Court squared largely with the temporal limitation interpretation previously used by the Third and Fourth Circuits.[100] This Part begins by examining the background and procedural history of *Piccadilly*. Then, this Part discusses the Court's ruling in more detail, examining the arguments presented in the majority opinion and dissent.

A. Course of Bankruptcy Proceedings

In operation for over sixty years, Piccadilly Cafeterias, Inc. (Piccadilly) was once one of the most successful and largest cafeteria chains in the Southeast.[101] However, due to financial difficulties, on October 29, 2003, Piccadilly declared bankruptcy under Chapter 11 of the Bankruptcy Code.[102] Piccadilly entered bankruptcy with the belief that an asset sale would be the best way to maximize its enterprise value.[103] The day before filing, Piccadilly executed an asset purchase agreement with Piccadilly Acquisition Corporation (PAC), an affiliate of TruFoods Corpo-

98. *Id.* at 12.

99. Fla. Dep't of Rev. v. Piccadilly Cafeterias, Inc. (*Piccadilly III*), 128 S. Ct. 2326, 2329 (2006).

100. *Id.*

101. *Id.* at 2230.

102. *Id.*

103. Fla. Dep't of Rev. v. Piccadilly Cafeterias, Inc. (*In re* Piccadilly Cafeterias, Inc.) (*Piccadilly I*), 379 B.R. 215, 217 (S.D. Fla. 2006), *aff'd*, 484 F.3d 1299, 1301 (11th Cir. 2007), *rev'd*, 128 S. Ct. 2326 (2006).

ration, for the sale of all of Piccadilly's assets for $54 million.[104] With the commencement of the bankruptcy proceeding, Piccadilly also filed a motion requesting leave to sell substantially all of its assets free and clear of all liens, claims, encumbrances, and interests.[105]

Although Piccadilly had already entered into the purchase agreement, it requested the bankruptcy court's permission to conduct an auction, which would entitle the highest bidder to purchase the assets.[106] In addition, Piccadilly requested that the sale be exempt from any stamp taxes.[107] Just over a month later, the Court approved the bidding process, using PAC's $54 million offer as the opening minimum bid.[108] Ultimately, Piccadilly Investments, LLC had the winning bid of $80 million.[109]

Next, Piccadilly entered into a global settlement agreement ("Global Settlement"), which resolved the priority of distribution among Piccadilly's creditors; Piccadilly contended that the Global Settlement was "analogous to a confirmation of a plan."[110] In response, the bankruptcy court conducted a sale hearing approving the asset sale to Piccadilly Investments, the Global Settlement, and the tax exemption on the sale under the stamp tax exemption provision.[111]

Four parcels of land were among the assets sold, and Florida asserted that each sale was subject to stamp taxes.[112] Accordingly, the Florida Department of Revenue filed a motion to reconsider the sale order.[113] However, the bankruptcy court entered an amended sale order over Florida's objections, ultimately approving the sale.[114] Shortly thereafter, Piccadilly filed its initial Chapter 11 plan and disclosure statement; it later filed an amended plan, to which Florida again objected, still maintaining that it was entitled to collect the taxes.[115] In addition, Flori-

104. *Id.*

105. *Id.*

106. *Id.* at 218.

107. *Id.* at 217.

108. "As the initial bidder, Piccadilly Acquisition Corporation served as a so-called 'stalking horse' whose initial research, due diligence, and subsequent bid may encourage later bidders. . . . For its role, Piccadilly Acquisition Corporation was entitled to receive a breakup fee." *Id.* at 218, n.6.

109. *Id.* at 218.

110. Fla. Dep't of Rev. v. Piccadilly Cafeterias, Inc. (*In re* Piccadilly Cafeterias, Inc.) (*Piccadilly II*), 484 F.3d 1299, 1301 (11th Cir. 2007), *rev'd*, 128 S. Ct. 2326 (2006).

111. *Id.*

112. *Piccadilly I*, 379 B.R. 215, 218 (S.D.Fla. 2006), *aff'd*, 484 F.3d 1299, 1301 (11th Cir. 2007), *rev'd*, 128 S. Ct. 2326 (2006).

113. *Piccadilly II*, 484 F.3d at 1301.

114. The sale order was amended in order to alter the manner in which secured noteholders could accept payment. *Piccadilly I*, 379 B.R. at 218 n.9. The asset sale closed the next day. *Piccadilly II*, 484 F.3d at 1301.

115. *Piccadilly II*, 484 F.3d at 1301.

da initiated an adversary proceeding requesting a declaration that the asset sale was not exempt from stamp taxes.[116]

Almost seven months later, the bankruptcy court confirmed Piccadilly's amended plan over the Department of Revenue's objections.[117] The court ruled that the tax exemption applied on the grounds that the sale was necessary for the eventual consummation of the Chapter 11 reorganization plan.[118]

The district court and the Eleventh Circuit both affirmed. The Eleventh Circuit rejected the temporal limitations followed by the Third and Fourth Circuits and instead held that "[transfer] tax exemptions 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."[119] It is under these circumstances that *Piccadilly* was before the Supreme Court.

B. The Supreme Court Opinion

After years of confusion regarding the stamp tax exemption,[120] the Supreme Court finally granted certiorari. In resolving the circuit split, the Supreme Court took a textualist approach to the stamp tax exemption[121] and issued a bright line rule that the tax exemption only applies to post-confirmation asset transfers.[122]

1. Majority Opinion

On June 16, 2008, in an opinion authored by Justice Thomas, the Supreme Court reversed the Eleventh Circuit's decision.[123] The Court's analysis of the statute was broken into three parts: (1) the ambiguity of the statute; (2) Piccadilly's argument that even if not facially ambiguous, the provision is ambiguous when compared to other provisions of the Bankruptcy Code; and (3) the canons of statutory construction asserted by each party.[124] This sub-section will address each of these issues in the same order as the Court addressed them.

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116. *Id.*
117. *Id.*
118. *Id.*
119. *Id.* at 1304.
120. 11 U.S.C. § 1146 (2009).
121. *Id.* § 1146(a).
122. Fla. Dep't of Rev. v. Piccadilly Cafeterias, Inc. (*Piccadilly III*), 128 S. Ct. 2326, 2339 (2006).
123. *Id.*
124. *See id.* at 2331–39.

The Court first addressed the ambiguity of the stamp tax exemption language.[125] Florida argued that the meaning of "under a plan confirmed" in the statute is not ambiguous. It asserted that the word "confirmed" is a past participle, modifying the word "plan."[126] As a past participle, "confirmed" indicates a completed action, meaning that a plan confirmed denotes a confirmed plan or, in other words, a plan that has been confirmed in the past.[127]

Moreover, Florida urged the Court to define the word "under" as "with the authorization of" or "inferior or subordinate to" the confirmed plan.[128] In doing so, Florida referred to the two other uses of "under" within the provision where "under" is clearly used as "subject to."[129] Evoking a similar argument to the one used in *In re NVR, LP*, Florida asserted that to be eligible for the exemption, a transfer must be subject to a confirmed plan, and likewise, a pre-confirmation transfer cannot be made subject to a plan that does not exist at the time the transfer is made.[130]

In contrast, Piccadilly argued that the stamp tax exemption does not include a temporal requirement. Piccadilly asserted that "plan confirmed" and "confirmed plan" are not the same, and if Congress had indeed intended the latter, it would have used that language.[131] In fact, in a related provision, § 1142(b), Congress did use "confirmed plan."[132] Piccadilly also rejected Florida's proposed definition of "under," arguing that one could just as easily read the term as "in accordance with" and pointing out that the numerous dictionary definitions demand the meaning be drawn from the context surrounding the term.[133] If nothing else,

125. *Id.* at 2331–33; *see also* 11 U.S.C. § 1146(a) ("The issuance, transfer, or exchange of a security, or the making or delivery of an instrument of transfer under a plan confirmed . . . , may not be taxed under any law imposing a stamp tax or similar tax.").

126. "[I].e., '[a] verb form indicating past or completed action or time that is used as a verbal adjective in phrases such as *baked beans* and *finished work*.'" *Piccadilly III*, 128 S. Ct. at 2331 (citing AMERICAN HERITAGE DICTIONARY 1287 (4th ed. 2000)).

127. *Id.* at 2331–32.

128. *Id.* at 2332.

129. *Id.*; *see also* 11 U.S.C. § 1146(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.") (emphasis added).

130. *Piccadilly III*, 128 S. Ct. at 2232; *see* discussion *supra* Part III.B.

131. *Id.*

132. 11 U.S.C. § 1142(b) (2009) ("The court may direct the debtor and any other necessary party to execute or deliver or to join in the execution or delivery of any instrument required to effect a transfer of property dealt with by a *confirmed plan*, and to perform any other act, including the satisfaction of any lien, that is necessary for the consummation of the plan.") (emphasis added).

133. *Piccadilly III*, 128 S. Ct. at 2332. The court summarized Piccadilly's argument as follows:

> [Piccadilly] observes that the variability of the term "under" is well-documented, noting that the American Heritage Dictionary 1395 (1976) provides 15 definitions, including

Piccadilly argued, the language of the stamp tax exemption could have at least more than one interpretation.

Conceding that both sides proffered credible interpretations, the Court concluded that Florida's interpretation of "under a plan confirmed" is the better one.[134] While admitting that Congress could have been clearer, the Court viewed Florida's interpretation as a simpler construction and the more natural reading of the statute, noting that Piccadilly's version places a "greater strain on the statutory text."[135]

The Court next addressed Piccadilly's argument that even if not facially ambiguous, the provision is ambiguous when compared to other provisions of the Bankruptcy Code.[136] Piccadilly again asserted that Congress would have included a temporal limitation, as it did in other code provisions, if it had intended for there to be one. Because the stamp tax exemption lacks an explicit temporal provision, Piccadilly argued that the Court must presume that Congress acted intentionally when excluding the language.[137]

Piccadilly also proffered several examples of code provisions where using Florida's definition of "under" as "authorized by" would not comport with the meaning of the provision. For example, the term "under" in § 303(a), which reads "[a]n involuntary case may be commenced only under chapter 7 or 11 of this title," cannot mean "authorized by" because § 303(a) itself authorizes involuntary cases and the provisions of Chapters 7 and 11 do not.[138] Thus, Piccadilly contended that "under" is ambiguous.[139]

Florida rejected Piccadilly's argument on the grounds that it would be redundant for Congress to include any further temporal limitation.[140] Florida argued that the stamp tax exception must apply to post-confirmation transfers because of its location within the code.[141] The subchapter within which the stamp tax exemption is located is entitled

> "[i]n view of," "because of," "by virtue of," as well as "[s]ubject to the restraint . . . of." *See also Ardestani* (citation omitted) (recognizing that "[t]he word 'under' has many dictionary definitions and must draw its meaning from its context"). Although "under" appears several times in [the stamp tax exemption], Piccadilly maintains there is no reason why a term of such common usage and variable meaning must have the same meaning each time it is used, even in the same sentence.

Id.

134. *Id.*
135. *Id.* at 2333.
136. *Id.*
137. *Id.*
138. *Id.* at 2333–34.
139. *Id.* at 2334.
140. *Id.*
141. *Id.*

"POSTCONFIRMATION MATTERS."[142] Basing its argument on the textual canon of statutory interpretation that suggests a court should interpret a code in its context and consistent with the chapter within which it appears, Florida claimed the tax exemption should apply only to post-confirmation transfers as dictated by the heading.[143]

Siding again with Florida, the Court rejected Piccadilly's argument that the statute is ambiguous when compared to other provisions of the code.[144] If anything, the Court found Piccadilly's arguments to support the opposite conclusion—that the statutory context suggests that the stamp tax exemption is inapplicable to pre-confirmation transfers.[145]

The Court finally focused on the four substantive canons of statutory construction asserted within the parties' arguments. Florida's arguments included two canons: (1) "Congress is presumed to be aware of an administrative or judicial interpretation of a statute and to adopt that interpretation when it reenacts a statute without change;"[146] and (2) courts should "proceed carefully when asked to recognize an exemption from state taxation that Congress has not clearly expressed."[147]

Florida contended that the language within the tax exemption provision has remained the same since 1978, despite several revisions to the Bankruptcy Code, including the most recent 2005 BAPCPA revision that occurred before the Eleventh Circuit's decision below.[148] Because Congress re-adopted the stamp tax provision as § 1146 (a) with the exact same language, Florida asserted that Congress ratified the longstanding temporal limitation as interpreted by the Fourth Circuit in *NVR* and the Third Circuit in *Hechinger*.[149]

Florida also contended that the federalism principle articulated in *Sierra Summit*—that courts should proceed carefully when asked to recognize an exemption from state taxation that Congress has not clearly expressed—demands that the provision be strictly construed in favor of

142. *Id.*

143. *Id.* at 2234–35 (quoting Davis v. Mich. Dep't of Treasury, 489 U.S. 803, 809 (1989) ("It's a fundamental canon of statutory construction that the words of a statute must be read in their context and with a view to their place in the overall statutory scheme.")).

144. *Id.* at 2335.

145. *Id.*

146. *Id.* at 2336 (quoting Lorillard v. Pons, 434 U.S. 575, 580–81 (1978)). The BAPCPA amendments occurred in 2005, before the Eleventh Circuit's *Piccadilly* decision, but after the Fourth Circuit decided *NVR* and the Third Circuit decided *Hechinger*, both of which held that pre-confirmation transfers were not tax exempt.

147. *Piccadilly III*, 128 S. Ct. at 2336–37 (quoting Cal. State Bd. of Equalization v. Sierra Summit, Inc. 490 U.S. 844, 851–52 (1989)).

148. *Id.*

149. *Id.*

the states to prevent "unwarranted displacement of their tax laws."[150] Furthermore, Florida argued that this canon also discouraged the extension of the exemption to pre-confirmation transfers because it is a direct interference with the administration of a state's taxation scheme, which, in this case, is imposed "prior to recordation" of the transfer instrument.[151] In response, Piccadilly asserted that when the exemption from state taxation is clearly expressed, the canon is inapplicable.[152] Thus, because here Congress clearly intended to exempt a category of state taxation, the federalism canon argument must fail.[153]

Piccadilly continued by offering two additional substantive canons to support its arguments: (1) "provisions allowing preferences must be tightly construed,"[154] and (2) "a remedial statute such as the Bankruptcy Code should be liberally construed."[155] First, Piccadilly maintained that Florida's stamp tax is the equivalent of a preference in favor of a particular claimant. Arguing that Florida's stamp tax is nothing more than a post-petition claim or administrative expense that is paid ahead of most creditors' pre-petition claims, Piccadilly asserted that a narrow interpretation of the stamp tax exemption "is not only inconsistent with the policy of equality distribution" but also "dilutes the value of the priority for those creditors Congress intended to prefer."[156]

Second, Piccadilly reasoned that the Court should construe the Bankruptcy Code liberally because the tax exemption provision is a remedial statute.[157] Piccadilly asserted that the tax exemption's main purpose is to facilitate the Chapter 11 process by providing tax relief.[158] As a result, the courts should interpret any ambiguities in the text in a manner that furthers the policy goals of maximizing asset value and, thus, the property available for creditors.[159]

The Court, finding Florida's federalism canon argument to be decisive, declined to interpret the statute liberally.[160] Justice Thomas wrote that interpreting the statute liberally would be "recognizing an exemption

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150. *Id.* at 2337.

151. *Id.* (quoting FLA. STAT. §§ 201.01, 201.02(1) (2006)).

152. *Piccadilly III*, 128 S. Ct. at 2337.

153. *Id.*

154. *Id.* (quoting Howard Delivery Serv., Inc. v. Zurich Am. Ins. Co., 547 U.S. 651, 667 (2006)).

155. *Piccadilly III*, 128 S. Ct. at 2337.

156. *Id.*

157. *Id.* at 2337–38.

158. *Id.*

159. *Id.*

160. *See id.* at 2338.

from state taxation that *Congress has not clearly expressed*."[161] Moreover, the Court found that Piccadilly's argument proves this point; because Piccadilly rested its case on the assertion that the language of the stamp tax exemption is ambiguous as opposed to express, it follows that Congress could not have intended the exemption to apply to pre-confirmation transfers.[162]

The Court also rejected both of Piccadilly's substantive canons, finding both inapplicable. First, although preferences must be tightly construed, the Court found that the stamp tax exemption is not a preference granting provision and makes no mention of preferences within the text.[163] Second, the Court declined to interpret the statute liberally in order to serve its remedial purpose because interpreting the provision in this way would "stretch the disallowance wall beyond what the statutory text can naturally bear."[164] While the Court acknowledged the practical realities of Chapter 11 reorganizations and the various policy goals behind the Bankruptcy Code, it left the ultimate decision to revise the provision to the legislature rather than the judiciary.[165]

In summation, the Court adopted the bright line rule that "section 1146 affords a stamp-tax exemption only to transfers made pursuant to a Chapter 11 plan that has been confirmed."[166]

2. The Dissenting Justices Rejection of the Temporal Interpretation

The dissenting opinion, authored by Justice Breyer[167] and joined by Justice Souter, rejected the majority opinion, characterized the language of the stamp tax exemption as ambiguous, and argued the necessity interpretation is more appropriate.[168] Justice Breyer disagreed with the majority's textualist approach and asserted that in the "absence of a clear answer in text or canons," he would prefer looking towards the exemption's purpose—to encourage and facilitate bankruptcy asset sales.[169]

The dissenters acknowledged that the pre-confirmation bankruptcy process is time consuming and that there are circumstances where the debtor must sell assets quickly, rather than wait for confirmation, in or-

161. *Id.* at 2338 (quoting Cal. State Bd. of Equalization v. Sierra Summit, Inc., 490 U.S. 844, 851–52 (1989)).
162. *Piccadilly III*, 128 S. Ct. at 2338.
163. *Id.*
164. *Id.*
165. *Id.* at 2339.
166. *Id.*
167. *Id.* at 2339–42 (Breyer, J., dissenting). Justice Breyer, unsurprisingly, was also the most hostile during oral arguments. *See* Transcript of Oral Argument, *Piccadilly III*, 128 S. Ct. 2326 (No. 07-312), 2008 WL 791974.
168. *See Piccadilly III*, 128 S. Ct. at 2339–42.
169. *Id.* at 2341–42.

der to preserve the maximum value of the asset.[170] Recognizing first that a pre-confirmation asset sale is a valuable tool for generating more revenue for creditors and second that stamp taxes accomplish the inverse by reducing the funds available, Justice Breyer made clear that the majority's opinion failed to accomplish Congress's primary objectives in enacting the stamp tax exemption.[171] By limiting the statute's application to narrow circumstances, the majority's rationale actually leads to an inapposite result.

The dissenting Justices believed the majority's rule was inappropriate and suggested a different standard. Justice Breyer expanded on his critique of the majority's approach, asserting that the bright line rule could harm creditors.[172] The threat of losing the stamp tax exemption may influence the debtor to forego the extra revenue generated in a quick asset sale in order to protect the exemption under the longer confirmation process.[173] This forgone revenue in turn decreases the amount of money available to the estate and to creditors. Frustrated by these results, Justice Breyer advocated for a more flexible standard.[174]

> What conceivable reason could Congress have had for silently writing into the statute's language a temporal distinction with such consequences? The majority can find none. It simply says that the result is not 'absurd' and notes the advantages of a 'bright line rule.' . . . I agree that the majority's interpretation is not absurd and do not dispute the advantages of a clear rule. But I think the statute supplies a clear enough rule—transfers are exempt when there is confirmation and are not exempt when there is no confirmation. And I see no reason to adopt the majority's preferred construction where it conflicts with the statute's purpose.[175]

Breyer intended his proposed rule to be administratively workable, while at the same time, avoiding results that appear contrary to the statute's purpose.

Ultimately, while the Supreme Court's decision does offer a bright line rule, the Court only chose the lesser of two evils; the majority sided with the temporal limitation interpretation, while the dissenters endorsed the necessity interpretation. Unfortunately, the Court provided no new insight or solutions, and the problems associated with the stamp tax exemption and both interpretations remain.

170. *Id.* at 2342.
171. *Id.*
172. *Id.*
173. *Id.*
174. *Id.* at 2341.
175. *Id.* at 2343.

As the rule currently stands, the end result is less money for creditors, regardless of which route a debtor chooses. On one hand, if the debtor chooses to continue with a pre-plan asset sale, the debtor will generally be able to realize a higher value for the assets through higher and more numerous bids but will be forced to pay the tax. On the other hand, if the debtor waits until there is a confirmed plan in order to take advantage of the tax exemption, the debtor runs the risk of a lowered bid (if any), the depreciation of the asset, as well as the administrative costs of owning and maintaining the asset before plan confirmation. Indeed, by choosing to sell its assets before its reorganization plan was confirmed, Piccadilly was able to realize a sale of $80 million through the bidding war created by the pre-plan asset sale process.[176] This sale price is significantly higher than the $54 million offer made before Piccadilly filed for bankruptcy.[177] These results do not fit with the legislative intent behind the stamp tax exemption, and in the end, if the *Piccadilly* ruling does not comport with the policies of bankruptcy, then Congress must reevaluate the provision.

V. CONGRESSIONAL INTERVENTION

The Supreme Court's decision in *Piccadilly* and adoption of the temporal limitation interpretation has resulted in a strict rule that, while easy to apply, is riddled with problems. The Court imposed an arbitrary timing requirement, completely disregarded congressional intent, and failed to develop a rule that comports with the practical realities of bankruptcy. With the increase in pre-confirmation asset sales, the tax exemption provision, specifically carved out by Congress over 100 years ago, will eventually lose its utility, if it has not already.

In response to these concerns, many commentators have called for congressional intervention.[178] Removing the temporal limitation and adding a notice provision will satisfy the critics while maintaining the benefits of the bright line rule. Combining established boundaries with a more flexible provision that comports with the practical realities of bankruptcy will increase transparency and not only strike a middle ground between debtors and the state taxing authorities, but also further the Code's underlying purpose.

176. *See supra* notes 108–09.

177. *See* Fla. Dep't of Rev. v. Piccadilly Cafeterias, Inc. (*In re* Piccadilly Cafeterias, Inc.) (*Piccadilly I*), 379 B.R. 215, 218 (S.D. Fla. 2006), *aff'd*, 484 F.3d 1299, 1301 (11th Cir. 2007), *rev'd*, 128 S. Ct. 2326 (2006).

178. Indeed, the majority in *Piccadilly* noted that Congress is the one who must determine if the provision should be revised. *Piccadilly III*, 128 S. Ct. at 2339 ("It is incumbent upon the Legislature, and not the Judiciary, to determine whether § 1146 is in need of revision.").

The following discussion urges Congress to implement a proposed revision and details the proposal's advantages, such as its furtherance of the purposes of the Bankruptcy Code and its more accurate tracking of the legislative intent. Next, the discussion explains the problems with removing the timing requirement and suggests a notice requirement. Finally, this discussion addresses potential concerns with the proposed revision.

A. Removal of the Temporal Limitation

Congress's most straightforward option is to remove the temporal limitation from the stamp tax exemption altogether. Aligning with the view adopted by the Second and Eleventh circuits pre-*Piccadilly*, such a revision would allow for the exemption of both pre- and post-confirmation transfer taxes. The most sensible version to adopt is the version proffered by the Eleventh Circuit in *Piccadilly*, which would remove the temporal limitation, restrict the exemption to only those transactions that are necessary to the confirmation of the plan, and require a nexus between the sale and the confirmation of the plan.

First, to avoid confusion, the suggested new provision should include the language used in the previous versions of the stamp tax exemption; specifically, the revised stamp tax exemption should use the language, "to make effective a plan" rather than "under a plan confirmed." This revision would remove the temporal limitation while retaining the requirement of a nexus between the transfer and the eventual plan confirmation. The tax exemption would apply to both pre- and post-confirmation transfers, but it would only be valid if the transfer was a part of the debtor's plan, which could be confirmed before or after the transfer.

Unfortunately, the above revision does little to appease the many critics of the current stamp tax exemption or to address the reasons the exemption was the subject of litigation. States would still not receive notice of these transactions, and the revision would still place the heavy administrative burden of preventing abuse of the exemption solely on the state. In addition, the lack of regulation surrounding the provisions would increase the probability of overly expansive use.[179] This problem, however, can be remedied with a simple notice provision.

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179. *See, e.g.*, Fla. Dep't of Rev. v. Piccadilly Cafeterias, Inc. (*In re* Piccadilly Cafeterias, Inc.) (*Piccadilly II*), 484 F.3d 1299, 1301 (11th Cir. 2007), *rev'd*, 128 S. Ct. 2326 (2008). One of Florida's arguments for finding a temporal limitation within the tax exemption provision is the complete lack of notice of these transfers provided to states. *See* Reply Brief of Petitioner at 5, *Piccadilly III*, 128 S. Ct. 2326 (2008) (No 07-312), 2008 WL 742920.

B. Notice Provision

With the current provision, there is inadequate notice because, although a pre-plan asset sale order will contain the court's order exempting the parties from the stamp tax, only parties in interest[180] are notified of the pre-plan sale.[181] The state taxing authority is not considered a party in interest and thus never hears of the exemption and has no opportunity to object to its use. This problem was exemplified in *NVR*, where over 5,000 transfers of property occurred, each one exempt from stamp taxes.[182] The state never received notice of these transactions.[183] In order to provide some semblance of enforcement of the provision, the state bore the high costs of monitoring the parties' actions. Taxing authorities argue that to force the authorities to monitor pre-plan transactions completely contradicts the premise behind stamp taxes, which are to be virtually automatic upon recording.[184]

Fortunately, these concerns can be resolved easily with a notice provision either included as a statutory revision within the Code, or, as this author suggests, promulgated by the Supreme Court in the Federal Rules of Bankruptcy Procedure.[185] In relevant part, the proposed notice provision would provide:

> **Notice to Taxing Authorities.** The clerk, or some other person as the court may direct, shall give the debtor, all creditors, and indenture trustees not less than 20 days notice by mail of any proposed tax exemption pursuant to § 1146(a) of the Code. All notices required by this subdivision shall be mailed to the Internal Revenue Service at its address set out in the register maintained under Rule 5003(e) in which the case is pending; and to any state taxing authority to which the debtor or any other party to the issuance, transfer, or exchange of a security, or the making or delivery of an instrument of transfer will become indebted to as a result of the issuance, transfer, or exchange of a security, or the making or delivery of an

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180. The Code does not expressly define the term "party in interest." *See generally* 11 U.S.C. § 101 (2009). However, under Chapter 11, it is generally stated that "[a] party in interest, including the debtor, the trustee, a creditor's committee, an equity security holders' committee, a creditor, an equity security holder, or an indenture trustee, may raise and may appear and be heard on any issue in a case under this chapter." *Id.* § 1109(b).

181. FED. R. BANKR. P. 2002.

182. NVR Homes, Inc. v. Clerks of the Circuit Courts (*In re* NVR, L.P.), 189 F.3d 442, 448 (4th Cir. 1999).

183. *Id.*

184. *See* Transcript of Oral Argument at 24, *Piccadilly III*, 128 S. Ct. 2326 (No. 07-312), 2008 WL 791974.

185. 28 U.S.C. § 2075 (2009). Congress has authorized the federal judiciary to prescribe the rules of practice, procedure, and evidence for the federal courts, subject to the ultimate legislative right of Congress to reject, modify, or defer any of the rules. *Id.* The authority and procedures for promulgating rules are set forth in the Rules Enabling Act. *Id.* §§ 2071–2077.

> instrument of transfer. Notice of a tax-exempt issuance, transfer, or exchange of a security, or the making or delivery of an instrument of transfer shall include the time and place of any public sale, the terms and conditions of any private sale, and the time fixed for filing objections. Notice shall also include the amount of the tax to be exempt and a general description of the property at issue.

In the cases where the transfer is eventually part of the confirmed plan, the above notice provision will address many of the state taxing authorities' concerns regarding the lack of notice and the high monitoring costs. The concerns that still need to be addressed include issues that arise where the plan is never confirmed and the case is either dismissed or converted to a Chapter 7 proceeding. The following discussion addresses how the proposed notice provision will affect these situations.

The proposed revision will solve the problem of applying the tax exemption to unconfirmed plans. As previously noted, only 25% of plans are confirmed.[186] The vast majority of the cases are dismissed or converted to a Chapter 7 proceeding.[187] With the proposed notice provision, these cases will no longer present an issue to the state taxing authorities. Although the state taxing authorities will still bear some monitoring costs, those costs will be greatly reduced because the notice provision will take the guessing game out of the process. Simply stating in the proposed order that "any transfer taxes are exempt" would no longer be sufficient. The debtor would be required to include specifics relating to the proposed transfers. This reporting would require minimal paperwork for the debtor and the state taxing authorities would now have detailed information about each potential stamp tax exemption.

The notice provision will also allow the state to plan accordingly, to ensure it gets priority over other creditors. For example, consider a pre-confirmation asset sale, which has to be approved by the court. As soon as the taxing authority receives notice of the proposed sale, it could submit its own proposed order stating that in the event the plan is not confirmed, the state already has an allowed administrative claim for the amount of the stamp or transfer tax.[188] Then, if the debtor converts from

186. *See supra* note 71.

187. *Id.*

188. "[A] governmental unit shall not be required to file a request for the payment of an expense described in subparagraph (B) or (C), as a condition of its being an allowed administrative expense." 11 U.S.C. § 503(b)(1)(D) (2009). Subparagraph (B) states that "any tax—incurred by the estate, whether secured or unsecured, including property taxes for which liability is in rem, in personam, or both, except a tax of a kind specified in section 507(a)(8) of this title." 11 U.S.C. § 503(b)(1)(B) (2009).

Chapter 11 to Chapter 7, this administrative claim will become a pre-petition claim.[189]

By claiming the tax as an administrative claim, the state taxing authority would be securing its position in line with other creditors. With the exceptions of secured claims and domestic support obligations, administrative expenses have the highest priority in a bankruptcy proceeding.[190] However, it is unlikely that there would be any domestic support obligations in a former Chapter 11 case, thus placing the administrative expenses at the front of the distribution line. While Chapter 7 administrative expenses would be paid before Chapter 11 administrative expenses,[191] it is entirely possible that there would be enough money in the estate for both Chapter 7 and Chapter 11 administrative claims, meaning the state taxing authority would be sure to receive payment. In the alternative, when there is enough money for Chapter 7 administrative claims but not quite enough to cover all of the Chapter 11 administrative claims, the Chapter 11 administrative claims would still be entitled to receive a pro rata distribution.[192]

The only scenario in which the state taxing authority would not be paid on its administrative claims is if the debtor is "administratively insolvent," meaning there are insufficient funds in the case to pay all the expenses of administration[193] or any unsecured creditors. This result is not uncommon within the Code, however, because one of the main purposes behind the Code is to treat each similarly situated creditor the same. The state taxing authority cannot fault the Code for this result, nor should it expect to receive any special treatment.

Some courts and commentators have suggested the use of escrow accounts to help solve this problem.[194] However, a notice requirement is a superior solution. The escrow scheme, as used in *In re 310 Associates*

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189. 11 U.S.C. § 348(d) (2009).

> A claim against the estate or the debtor that arises after the order for relief but before conversion in a case that is converted under section 1112, 1208, or 1307 of this title, other than a claim specified in section 503(b) of this title, shall be treated for all purposes as if such claim had arisen immediately before the date of the filing of this petition.

Id.

190. *Id.* §§ 507(a)(1)–(2) (2009).

191. *Id.* § 726(b).

192. *See id.*

193. A debtor is deemed "administratively insolvent" when there is insufficient unencumbered cash in the case to pay all expenses of administration under 11 U.S.C. § 503(b)(1) in full.

194. *See*, *e.g.*, Transcript of Oral Argument at 18, 30–32, *Piccadilly III*, 128 S. Ct. 2326 (No. 07-312), 2008 WL 791974 (questioning the use of escrow accounts, Justice Souter asked, "[I]sn't it odd that the Congress would have required, we will assume, this escrow procedure when the odds are three to one against the non-taxability?").

L.P.,[195] allows for the sale to take place and the stamp tax to be placed in an escrow account. The amount of the stamp tax remains in the escrow account until the debtor is able to confirm the plan. If the transfer is made under a confirmed plan, then the funds in the escrow account are refunded to the debtor. Conversely, if the transfer is not under the confirmed plan or a plan is never confirmed (e.g., if the debtor converts to Chapter 7), the funds in the escrow account are transferred to the appropriate taxing authority.

Though use of escrow accounts resolves part of this problem, their use in fact fails to comport with the policies behind the Code because such accounts would upend the priority structure and ruin the distribution scheme. The use of an escrow account would give the taxing authority priority over all creditors. The taxing authority, as a government entity, is already accounted for within the administrative expenses provision. To remove them from this category, and give them ultimate priority over all other creditors would again subvert the Code's purpose of providing equal treatment to all similarly situated creditors.

Further, the taxing authority's concern that the case might ultimately be dismissed rather than converted does not warrant the use of escrow accounts. When a Chapter 11 case is dismissed, either voluntarily or involuntarily, the taxing authority would still be treated as a post-petition creditor because the claim arose after the debtor filed for bankruptcy. Whether considering dismissal or conversion, the court must decide which route is in the best interest of the creditors, including those with post-petition claims.[196] Making this decision means that if a Chapter 11 case has been dismissed, the court has decided that the creditors, including the state tax authority, will fare better outside of bankruptcy. Again, the state can have little issue with this position. By explicitly setting forth a procedure, the Code has been designed to allow for this uncertainty and to give the state any other position goes against the Code in its entirety.

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195. 282 B.R. 295, 297-98 (S.D.N.Y. 2002). The bankruptcy court's order approving the transfer agreement between the debtor and the purchaser provided as follows:

> As soon as practicable after the Closing, the Debtor shall be, and hereby is, authorized to deposit in a separate, interest bearing escrow account, monies from the Account (as defined herein below [sic]), earmarked "310 Associates, L.P.-City 1146(c) taxes," the sum of $100,000, or such other amount as may be necessary (the "Escrowed Funds") to pay any City real property transfer tax or any other City stamp or similar tax, and any potential interest and/or penalties thereon that may be due on the recordation of any documents or instruments reflecting the sale of the Assets subject to this Order. . . . If a Plan of Reorganization in this case ultimately is not confirmed, the City may apply to this Court for appropriate relied, and this Order is without prejudice to the rights of the City in such eventuality.

196. 11 U.S.C. § 1112(b)(1) (2009).

With the proposed notice provision, the situation in *Piccadilly* could have been avoided. The Florida Department of Revenue would have received notice of the sale without the unnecessary and burdensome monitoring costs, and *Piccadilly* would have still benefited from the stamp tax exemption. In essence, the application of the stamp tax exemption would no longer be a zero sum game. Analyzing the *Piccadilly* decision in this way highlights the restrictive nature of the temporal limitation and just how simple it would be to ensure the policy behind the Bankruptcy Code is supported.

VI. CONCLUSION

With the current economic crisis upon us, the reality is that the stamp tax exemption will have little effect on either a debtor's ability or willingness to reorganize. The excessive debt leverage, economic downturn, and lack of available credit in the credit market will force more and more companies into pre-confirmation asset sales. It is unlikely that lenders will be willing to risk the additional time and cost of confirming the plan needed for reorganization. If the purpose behind the special tax provisions is to promote reorganization and provide a greater chance of emerging on the other side, as this author believes it to be, then Congress must consider revising the provision or risk losing the provision's utility. In revising the provision, Congress should require a nexus between any transfer and the confirmed plan as well as the use of a notice provision in order to provide safeguards for both the states and the debtors alike.