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Florida Department of Revenue v. Piccadilly Cafeterias, Inc.: Bankruptcy Transfer-Tax Exemption Requires Sale Pursuant to Confirmed Plan

On June 16, 2008, in *Florida Department of Revenue v. Piccadilly Cafeterias, Inc.*,[1] the United States Supreme Court (Thomas, J.) reversed a lower-court decision exempting a sale of assets by a debtor in bankruptcy from the imposition and collection of transfer taxes, even though the sale was closed prior to the confirmation of a plan of reorganization,[2] and held that the bankruptcy transfer-tax exemption applies only to sales undertaken pursuant to a plan that has already been confirmed by the bankruptcy court.[3]

I. BACKGROUND

The primary goal of Chapter 11 bankruptcy is to restructure a debtor's outstanding obligations, whether through a new investment, conversion of debt to equity, a sale of some or all assets, or some combination thereof. Often, bankruptcy culminates in the confirmation of a plan of reorganization, which provides (among other things) for the treatment of the various classes of creditors and interest holders and the means for implementation of the plan. The plan process, which usually takes at least several months and sometimes years, involves negotiations, a solicitation period, and voting by parties-in-interest, and the plan must satisfy a number of statutory criteria to be confirmed by the bankruptcy court.

In some situations, it makes business sense for the debtor to sell some or substantially all of its assets prior to the completion of the plan process. For example, certain of the debtor's assets or business may be substantially declining in value on an ongoing basis or otherwise cannot survive long enough to allow the debtor to confirm a plan. Or, the debtor may be losing money as it operates, and nobody is willing to fund such losses. Alternatively, maybe the debtor has received an enticing offer with an impending deadline from a buyer who is willing to provide consideration that the parties believe is more than the value that will exist at the end of the plan process and/or is not willing to assume the risks and costs associated with an extended plan process. In such situations, the best way to maximize the debtor's value for the benefit of its creditors and others and possibly the only way to avoid a disastrous result is to effectuate a Section 363 bankruptcy sale and deal with the terms of the plan -- and even whether there will ever be such a plan -- after the debtor's assets are converted to cash.

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1 *Florida Dept. of Revenue v. Piccadilly Cafeterias, Inc.*, No. 07-312, 2008 LEXIS 5025 (U.S. June 16, 2008).

2 *Id.* at 5.

3 *Id.* at 10-34.

Under Bankruptcy Code Section 1146(a),[4] "the making or delivery of an instrument of transfer under a plan confirmed under section 1129 [of the Bankruptcy Code], may not be taxed under any law imposing a stamp tax or similar tax." While the language clearly provides that state and local taxing authorities may not assess or collect any transfer taxes on bankruptcy sales pursuant to a plan, it had become relatively common for the debtor to seek, and frequently to obtain, a bankruptcy court finding that the exemption applied as well to a sale not directly connected with a plan, typically on the basis that the sale was necessary and/or integral to the debtor's plan of reorganization, even if ultimately the debtor would be filing a liquidating plan.

In recent years, there was a split of authority on this issue, with the United States Courts of Appeals for the Third and Fourth Circuits rejecting the application of the transfer-tax exemption to pre-plan sales,[5] while the Eleventh Circuit [6] and influential lower courts[7] held that it does apply pre-plan when the sale is necessary and/or integral to the debtor's plan of reorganization.

In *Piccadilly*, the Supreme Court resolved the issue and definitively held that the transfer-tax exemption is limited to sales consummated pursuant to a plan of reorganization (and after confirmation thereof), and not to Section 363 bankruptcy sales occurring prior to confirmation of a plan. Absent changes to the Bankruptcy Code, this decision will effectively require asset sales with significant transfer-tax exposure to be consummated pursuant to a plan, unless the debtor (and other parties-in-interest) are prepared to absorb the additional cost and pay any applicable transfer taxes.

II. FACTS AND PROCEDURAL HISTORY

The *Picadilly* debtor was one of the largest cafeteria chains in the United States, and after experiencing financial difficulties and soliciting offers to buy its assets, it received an offer contingent on a bankruptcy filing and filed for Chapter 11 bankruptcy protection on October 29, 2003. The following day, it filed a motion to sell substantially all of its assets to a particular buyer for $54 million and seeking, among other things, a transfer-tax exemption under Section 1146(a).

On March 16, 2004, after conducting an auction, the debtor closed the sale of its assets for $80 million to a different buyer, with the order authorizing such sale (entered on February 13, 2004) providing for an exemption from state and local transfer taxes.[8] At the hearing to consider the sale, the bankruptcy court overruled an objection to the exemption filed by Florida, but it reserved Florida's right to assert such objection at a later time.

The debtor first filed a plan of reorganization on March 26, 2004, which was subsequently amended, and the bankruptcy court confirmed the debtor's plan on October 21, 2004, more than seven months after its asset sale was completed. Prior to the hearing to consider the debtor's plan, Florida objected, seeking a finding that approximately $40,000 in transfer taxes related to the asset sale was not covered by the exemption contained in the sale order.[9]

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4 Prior to the enactment of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, this provision of the Bankruptcy Code was located at Section 1146(c).

5 *See In re Hechinger Inv. Co. of Del.*, 335 F.3d 243 (3rd Cir. 2003); *In re NVR, LP*, 189 F.3d 442 (4th Cir. 1999).

6 *See In re Piccadilly Cafeterias, Inc.*, 484 F.3d 1299 (11th Cir. 2007).

7 *See, e.g., In re Beulah Church of God in Christ Jesus, Inc.*, 316 B.R. 41 (Bankr. S.D.N.Y. 2004).

8 *Piccadilly*, 2008 LEXIS 5025, at 5-7.

9 *Id.* at 7-8.

On summary judgment, the bankruptcy court found that because the asset sale was necessary to fund a plan, any related transfer was effectively "under a plan confirmed," even though a plan had not yet been filed when the exemption was granted. The United States District Court for the Southern District of Florida[10] and the United States Court of Appeals for the Eleventh Circuit[11] each affirmed, holding that the Section 1146(a) exemption may apply to asset transfers that occur prior to the confirmation of a plan of reorganization.[12]

III. RATIONALE OF THE SUPREME COURT

Adopting a stringent reading of Section 1146(a), the Supreme Court rejected the debtor's argument that the statutory language did not impose an unambiguous temporal, stringent requirement that a plan must be confirmed before a transfer-tax exemption may apply.[13] The Supreme Court found Florida's reading of Section 1146(a) that *under* means *with the authorization of*, and that *confirmed* is a past participle that modifies plan and indicates completed action, "is clearly the more natural,"[14] and it concluded that the use of the phrase *plan confirmed* (rather than *confirmed plan* or some other more explicit phrase) was merely designed to avoid an interpretation that applicable sales had to be approved under Bankruptcy Code Section 1129, which sets forth the requirements for a plan of reorganization and does not concern asset sales, which are primarily governed by Bankruptcy Code Section 363.[15]

Additionally, the Supreme Court rejected the debtor's argument that other sections of the Bankruptcy Code support an interpretation that permits pre-plan transfer-tax exemptions under Section 1146(a).[16] In particular, the Supreme Court rejected the debtor's comparison of the use of *under* contained in Bankruptcy Code Sections 111, 303, 1104, and 1127, and its attempt to use prior Supreme Court precedent under Bankruptcy Code Section 365(g)(1),[17] to show that *under* must be construed broadly,[18] and the Supreme Court concluded (after giving weight to the title of the subchapter in which Section 1146(a) appears in the Bankruptcy Code -- "Postconfirmation Matters" -- even though such a classification is normally ignored) that *under a plan confirmed* requires a confirmed plan at or prior to the time of the transfer.[19]

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10 *See In re Piccadilly Cafeterias, Inc.*, 379 B.R. 215 (S.D. Fla. 2006).

11 *See Piccadilly*, 484 F.3d 1299.

12 *Id.* at 8.

13 *Piccadilly*, 2008 LEXIS 5025, at 11-15.

14 *Id.* at 14.

15 *Id.* at 14-15.

16 *Id.* at 15-16.

17 *See NLRB v. Bildisco & Bildisco*, 465 U.S. 513 (1984), wherein the Supreme Court interpreted "under a plan confirmed" in Bankruptcy Code Section 365(g)(1) to give a debtor until a plan is confirmed (rather than after confirmation) to make assumption/rejection decisions. In distinguishing this case, and a debtor's assumption/rejection decision from the applicability of Section 1146(a), the Supreme Court stated that it "agree[s] with *Bildisco*'s commonsense observation that the *decision* whether to reject a contract or lease must be made before confirmation. But that in no way undermines the fact that the rejection takes *effect* upon or after confirmation of the Chapter 11 plan (or before confirmation if pursuant to §365(d)(2))." *Piccadilly*, 2008 LEXIS 5025, at 22-24 (emphasis in original).

18 *Piccadilly*, 2008 LEXIS 5025, at 17-20.

19 *Id.*

Finally, the Supreme Court discussed several canons of judicial interpretation, especially those pro-federalism canons that discourage interference with a state's tax scheme,[20] and rejected contrary canons emphasized by other courts and discussed in the dissent that would promote the general bankruptcy theme of maximization of asset values.[21] Thus, after concluding that Congress had not specifically expressed a desire to exempt pre-confirmation sales from state and local transfer taxes,[22] the Supreme Court ultimately held that "Section 1146(a) affords a stamp-tax exemption only to transfers made pursuant to a Chapter 11 plan that has been confirmed."[23]

IV. DISSENTING OPINION

Justice Breyer, joined by Justice Stevens, dissented from the majority opinion, noting that the language of Section 1146(a) is "perfectly ambiguous" and that it should not matter when a plan is confirmed for the transfer-tax exemption to apply.[24] Emphasizing generally accepted bankruptcy goals of seeking to preserve going-concern value and to maximize distributions to a debtor's creditors, the dissent opined that the majority's reasoning fails because its "interpretation ... reduces the funds made available ... [and] inhibits [Section 1146(a)'s] efforts to achieve its basic objectives."[25] The dissent warned that the majority decision could threaten or delay decisions to sell, with creditors and other parties-in-interest suffering significant harm because of potential decreased recoveries,[26] and concluded that a simple rule should be employed to determine when the exemption should apply: "transfers are exempt when there is confirmation and are not exempt when there is no confirmation," even if plan confirmation occurs subsequent to such transfers.[27]

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If you have any questions about the issues addressed in this memorandum or if you would like a copy of any of the materials mentioned, please do not hesitate to call or email Joel Levitin at (212) 701-3770 or jlevitin@cahill.com; Richard Stieglitz Jr. at (212) 701-3393 or rstieglitz@cahill.com.

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20 *Id.* at 26-28.

21 *Id.* at 29-32.

22 *Id.* at 31.

23 *Id.* at 34.

24 *Id.* at 35-37.

25 *Id.*at 39-44.

26 *Id.* at 44-45.

27 *Id.* at 45.