

Florida Department of Revenue v. Piccadilly Cafeterias Inc.:
Another Lesson in Code Reading

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In the past, many bankruptcy courts have allowed real estate sales that took place prior to confirmation of a reorganization plan under chapter 11 to be exempt from certain state stamp or transfer taxes. Courts based this approach on a lenient reading of §1146(a) of the Bankruptcy Code, largely driven by the intention of expediting bankruptcy cases. This will no longer be an acceptable practice.

On June 16, 2008, in *Florida Department of Revenue v. Piccadilly Cafeterias Inc.*, the Supreme Court ruled that real estate sales will only be exempt from state stamp taxes if the transaction takes place pursuant to a reorganization plan. Section §1146(a) allows property transfers which take place as part of a reorganization plan to be exempt from state stamp taxes. In *Piccadilly*, the Supreme Court ruled that 11 U.S.C. §1146(a) does not allow for transactions that take place *prior* to confirmation of a reorganization plan to be exempt.

Justice Thomas wrote the opinion for the Court, which turned immediately to the question of statutory construction. Rejecting any reading that would apply the exemption to §363 sales, he stated that the Court found “nothing justifying such a curious interpretation.”¹ Justice Thomas’s decision hinged on two attributes of §1146(a): its “ambiguous” language, and the subchapter (“Postconfirmation Matters”) under which §1146(a) appears. Justice Thomas explained that it is not for the Judiciary to clarify; rather “it is incumbent upon the Legislature...to determine whether §1146(a) is in need of

¹*Florida Department of Revenue v. Piccadilly Cafeterias, Inc.*, “Majority Opinion,” 11.

revision.”² With that dismissal, Justice Thomas wrote that the “most natural reading”³ is based on §1146(a)’s seating and context within the Bankruptcy Code.

Justice Thomas maintained that although “a debtor may need to transfer assets to induce relevant parties to endorse the proposed confirmation of a plan,”⁴ this is not reason enough for allowing §1146(a) to apply to preconfirmation sales. Justice Thomas noted that §1146(a) provides that the exemption applied to “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...*”⁵ (Justice Thomas’s emphasis). According to Justice Thomas and the majority, the debate turned on the words “under a plan confirmed under.” Thus, striking an all too common vein, the question becomes one of grammar and syntax. Justice Thomas asked if “plan confirmed” intends a previously confirmed plan or a plan that is confirmed at any time during the chapter 11 case. The Court agreed, that “under a plan confirmed” should be read to mean ‘with the authorization of.’⁶ It followed, according to the Court, that a transfer which takes place preceding confirmation cannot be said to have the “authority” of the plan.

Piccadilly had argued that the language actually meant “in accordance with.” Justice Thomas noted that Piccadilly’s reading would leave the time-frame (prior to confirmation of a plan) totally open. He added that if the Court were to rule in favor of Piccadilly that it would result in an unfair burden on the states and courts. By obligating states to exempt such sales from taxation, the states and the courts would be saddled with

² “Majority Opinion,” 19.

³ “Majority Opinion,” 19.

⁴ “Majority Opinion,” 4.

⁵ “Majority Opinion,” 4.

⁶ “Majority Opinion,” 5.

the unnecessary burden of ensuring that a plan of reorganization is confirmed at some point.

Justice Thomas moved on to a discussion of comparable statutes and canonical references. Piccadilly argued that “the term ‘under’ is ambiguous”⁷ and has no obvious temporal limitations. Piccadilly also argued that the statute should be read in context of “§1146(a)’s obvious purpose: to facilitate the Chapter 11 process.”⁸ Florida countered that “it would have been superfluous for Congress to add any further limitation to §1146(a)’s already unambiguous temporal element.”⁹ Florida contended that the temporality of the exemption was governed by the title of the subchapter under which §1146(a) appears, “*Post*confirmation Matters” (emphasis added). The Majority Opinion stated:

To read the statute as Piccadilly proposes would make §1146(a)’s exemption turn on whether a debtor-in-possession’s actions are consistent with a legal instrument that does not exist—and indeed may not even be conceived of—at the time of the sale.¹⁰

Although there may be a reorganization plan (in the process or otherwise), until it is confirmed by the court, it cannot be relied upon. The Court therefore observed that it would be an unfair burden on the states to allow such an open reading of §1146(a).

Justice Thomas quoted from the *Hechinger Inv. Co.* ruling saying that “courts should ‘proceed carefully when asked to recognize an exemption from state taxation that Congress has not clearly expressed.’”¹¹ In summation, Justice Thomas wrote that based

⁷ “Majority Opinion,” 9.

⁸ “Majority Opinion,” 16.

⁹ “Majority Opinion,” 11.

¹⁰ “Majority Opinion,” 11.

¹¹ “Majority Opinion,” 14.

on the placement of the statute within the Bankruptcy Code, “the most natural reading of §1146(a)’s text...affords a stamp-tax exemption only to a Chapter 11 plan that has been confirmed.”¹² The Court concluded that because it is found under the subchapter “Postconfirmation Matters,” §1146(a) should be understood to only be applicable *after* plan confirmation.

Justice Breyer (joined by Justice Stevens) wrote the Dissent. Justice Breyer opened the body of the Dissent by stating that “[the Court] must ask whether the time of transfer matters.”¹³ The Dissent glibly answered its own question when Justice Breyer flatly stated “I believe that it does not.”¹⁴ Justice Breyer goes on to say that while the linguistic aspect of it is indeed ambiguous, §1146(a) hardly deserves to be read in the way which the Court holds. The Dissent pointed out that:

Linguistically speaking, it is no more difficult to apply the words “plan confirmed” to instances in which the “plan” *subsequently is* “confirmed” than to restrict their application to instances in which the “plan” *already has been* “confirmed.”¹⁵

Justice Breyer noted that, although it searched far and wide, the Court was unable to find a strong comparison to similarly worded parts of the Bankruptcy Code. The Dissent added that “if Congress thought the time of confirmation mattered, why did it not say so expressly as it has done elsewhere in the Code?”¹⁶ In reference to the argument that the statute should be read in context of the subchapter under which it appears (Postconfirmation Matters), Justice Breyer wrote that this is because “the *trigger* for

¹² “Majority Opinion,” 19.

¹³ *Florida Department of Revenue v. Piccadilly Cafeterias, Inc.*, “Dissenting Opinion,” 1.

¹⁴ “Dissenting Opinion,” 2.

¹⁵ “Dissenting Opinion,” 2.

¹⁶ “Dissenting Opinion,” 3.

exemption is plan confirmation”¹⁷ (emphasis added). The Dissent reasoned that §1146(a) appeared where it does because the tax-exemption is dependant upon plan confirmation. Justice Breyer suggested that a reasonable compromise would be for states to charge the stamp-tax but refund it once a reorganization plan is confirmed by the court. The Dissent went on to point out that it was incumbent upon the Court (“consistent with Court precedent”)¹⁸ to ask what possible purpose a temporal limitation would serve in this situation. “In fact,” Justice Breyer wrote, “the majority’s reading of temporal limits in §1146(a) serves *no reasonable congressional purpose at all.*”¹⁹

The Dissent noted that the purpose of §1146(a) was not simple tax relief but was meant to help expedite the sale of assets in bankruptcy; “the purpose of the exemption of [§1146(a)] is to encourage and facilitate bankruptcy asset sales.”²⁰ Justice Breyer noted that the reason that transfers were supposed to take place after confirmation was so that a judge may be certain that the transaction meets the creditors’ approval. “How,” asks the Dissent, “would the majority’s temporal limitation further these statutory objectives? It would not do so in any way.”²¹ Justice Breyer closed the Dissent stating that “the statute supplies a clear enough rule—transfers are exempt when there is confirmation and are not exempt when there is no confirmation.”²² The Dissent observed that it was irrelevant when the confirmation of the plan took place in relation to the transfer of assets, only that a plan was confirmed. “Of course,” adds Justice Breyer, “we should not substitute ““*our view of ... policy*”” for the statute that Congress enacted.... But we certainly should

¹⁷ “Dissenting Opinion,” 3.

¹⁸ “Dissenting Opinion,” 4.

¹⁹ “Dissenting Opinion,” 4.

²⁰ “Dissenting Opinion,” 5.

²¹ “Dissenting Opinion,” 5.

²² “Dissenting Opinion,” 7.

consider Congress' view of the policy for the statute it created, and that view inheres in the statute's purpose."²³

While the Bankruptcy Code is meant to help ameliorate the difficulties associated with financial distress, this ruling squares with the more natural reading of the language of §1146. There is no doubt that the Court's approach strays from a common purpose under the Code, that is, the furtherance of the reorganizational efforts of the business debtor. Moreover, there is no doubt that this reading of the Code will impact negatively on the beneficial practice of §363 sales. Moreover, according to some, although the revenue generated from such taxes amounts to little more than a drop in the bucket at this time, with the trend of increased bankruptcy filings, especially in the real estate market,²⁴ these taxes could start to add up to a significant revenue source for states and drain on reorganization. Justice Breyer's assertion that these taxes will diminish bankrupt estates in a significant way may be a bit of a stretch, but we get the point. Although the Court's opinion gets the law "right," it deviates from sound bankruptcy policy and regular practice. As a matter of policy, it makes no sense to limit the exemption to postconfirmation transactions and deny tax relief for those preconfirmation sales that contemplate a subsequent plan confirmation. But that is an argument better reserved for Congress.

²³ "Dissenting Opinion," 7.

²⁴ Steve Jakubowski, [Bankruptcy Litigation Blog](http://www.bankruptcylitigationblog.com/archives/us-supreme-court-cases-location-location-location-us-supreme-court-holds-the-stamp-tax-exemption-only-applies-to-postconfirmation-asset-transfers.html) "*Location, Location, Location*": US Supreme Court Holds The Stamp Tax Exemption Only Applies To Post-Confirmation Asset Transfers. <http://www.bankruptcylitigationblog.com/archives/us-supreme-court-cases-location-location-location-us-supreme-court-holds-the-stamp-tax-exemption-only-applies-to-postconfirmation-asset-transfers.html>