

# A NEW SOLUTION: 11 U.S.C. § 1146(A) AND THE ORDINARY COURSE OF BUSINESS DISTINCTION

## INTRODUCTION

Businesses that seek protection from creditors under Chapter 11 of the Bankruptcy Code enter bankruptcy with the goal of reorganizing and emerging as profitable entities. The provisions in Chapter 11 aid the debtor in achieving this goal by giving a business time to reorganize and maximize the value of its assets.<sup>1</sup> Section 1146(a)<sup>2</sup> of the Bankruptcy Code is one tool a debtor may use to maximize the value of its assets. It states, “[t]he 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*.”<sup>3</sup> Plainly speaking, § 1146(a) allows a debtor to issue securities or transfer real property without paying a “stamp tax or similar tax.”<sup>4</sup> Courts have established criteria for determining whether a given transaction constitutes a “stamp tax or similar tax.”<sup>5</sup> Bankruptcy and circuit courts have held that real estate transfer and recordation taxes are included in this definition, and thus, these obligations are exempt from taxation under § 1146(a).<sup>6</sup> Debtors routinely use § 1146(a) to sell assets without incurring transfer taxes to improve liquidity, satisfy creditors, or simply free themselves of a depreciating or underperforming asset. Whether a transfer or sale occurred “under a plan confirmed” was the subject of dispute in courts for over twenty years; however, the Supreme Court resolved the circuit split when it

---

<sup>1</sup> See 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, 840–41, 856 (2005).

<sup>2</sup> 11 U.S.C.A. § 1146(a) (West 2008).

<sup>3</sup> *Id.* (emphasis added).

<sup>4</sup> *Id.*

<sup>5</sup> Some common characteristics of stamp and similar taxes include: (1) they are imposed only at time of transfer; (2) the amount due is determined by consideration, irrespective of whether the transferor gained or suffered; and (3) the tax is a relatively small percentage of the consideration. See 995 Fifth Ave. Assocs., L.P. v. New York State Dep’t of Taxation & Fin. (*In re* 995 Fifth Ave. Assocs., L.P.), 963 F.2d 503, 511 (2d Cir. 1992).

<sup>6</sup> See, e.g., *City of New York v. Jacoby-Bender, Inc.* (*In re* Jacoby-Bender, Inc.), 758 F.2d 840 (2d Cir. 1985); *NVR Homes, Inc. v. Clerks of the Circuit Courts for Anne Arundel County, Md.* (*In re* NVR, LP), 189 F.3d 442 (4th Cir. 1999). This issue does not appear to be in dispute by any courts.

decided *Florida Department of Revenue v. Piccadilly Cafeterias, Inc.* in 2008.<sup>7</sup> The Supreme Court's decision is inadequate because it ignores the intent of the statute and creates loopholes by being over-inclusive in some situations and under-inclusive in others. Congress should rewrite § 1146(a) to nullify the Supreme Court's decision and implement the statute's goal.

The circuit split existing before *Piccadilly* was based on when the transfer was made in relation to the reorganization plan being confirmed.<sup>8</sup> Plan confirmation is the final step a debtor must take to emerge successfully from Chapter 11 bankruptcy and is the result of compromises by the debtor and creditors. One court interpretation of "under a plan confirmed" stated that transfers can take place *before or after* the plan is confirmed and be eligible for tax relief under § 1146(a) as long as the transfer was *essential to the plan's confirmation*.<sup>9</sup> The other interpretation of "under a plan confirmed" stated that the transfer must occur *after* the plan's confirmation to be eligible for tax relief under § 1146(a).<sup>10</sup> This interpretation did not consider the character of the transfer; instead, it solely relied on this timing distinction.

The Supreme Court resolved the circuit split in June 2008 when it adopted the circuit court interpretation that limited § 1146(a) to transfers that occur after the plan's confirmation.<sup>11</sup> While both interpretations were reasonable, an ordinary course of business distinction is superior. The ordinary course of business distinction would eliminate the timing distinction between which the circuit courts are deciding, and it would better serve debtors, creditors, and the state that is attempting to tax the transfers. The ordinary course of business distinction would focus on a transaction's nature, not its timing. Under the distinction, transfers that occur during the ordinary course of business would not be eligible for tax exemption under § 1146(a) while transfers that occur outside the ordinary course would be eligible. Current scholarship<sup>12</sup> and many

---

<sup>7</sup> 128 S. Ct. 2326 (2008).

<sup>8</sup> Compare *Jacoby-Bender, Inc.*, 758 F.2d at 841 with *NVR*, 189 F.3d at 458.

<sup>9</sup> *City of New York v. Smoss Enters. Corp. (In re Smoss Enters. Corp.)*, 54 B.R. 950 (E.D.N.Y. 1985).

<sup>10</sup> *NVR*, 189 F.3d at 456–58.

<sup>11</sup> *Piccadilly*, 128 S. Ct. at 2339.

<sup>12</sup> See Karen Cordry, *The Incredible Expanding § 1146(c)*, 21 AM. BANKR. INST. J. 10 (2003); Leake & Douglas, *supra* note 1; John Murray, *Transfer-Tax Considerations in Real Estate Bankruptcy Proceedings*, 38 REAL PROP. PROB. & TR. J. 377 (2003); David Stratton, *Real Property Transfers and Bankruptcy Tax Exemptions: In re Hechinger and 11 U.S.C. § 1146(c)*, 22 AM. BANKR. INST. J. 32 (2003); 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).

courts<sup>13</sup> have overlooked this distinction and focused entirely on the competing interpretations adopted by the circuit courts. However, the taxing authority in one landmark case on this issue argued for a similar, yet incomplete ordinary course of business standard.<sup>14</sup> Adopting an ordinary course of business distinction eliminates the arbitrary pre/post confirmation test and replaces it with a substantive analysis. This new distinction would create the best standard and would be beneficial to all parties.

This Comment will explore the circuit courts' and Supreme Court's focus and reasoning and the origin and development of the dominant interpretations of the language "under a plan confirmed" in § 1146(a). First, it will explain the problems inherent in both interpretations that made them inadequate. Then, it will detail the Supreme Court's decision and the problems that remain. Finally, this Comment argues Congress should reject the Supreme Court's interpretation and revise the statute to implement an ordinary course of business distinction. It explains what the distinction is, why it is superior to the circuit and Supreme Court interpretations, how it could be applied during bankruptcy, the potential problems it raises, and how it would affect the outcome of the landmark cases already decided by the circuit courts and the Supreme Court.

## I. THE CIRCUIT COURTS' FOCUS

Debtors and states have spent significant time and money litigating the scope of § 1146(a), and prior to this year, the circuit courts were split on their interpretations of this statute. Two main problems in § 1146(a) have driven most of the litigation. The first problem is defining what a "stamp tax or similar tax" is and then applying that definition to various state taxes.<sup>15</sup> The second problem is determining when a transfer must take place for it to be exempt from taxes "under a confirmed plan."<sup>16</sup>

Until *Piccadilly*, the circuit courts were divided over the scope of the time period to which § 1146(a) applied, and no dominant standard emerged to

---

<sup>13</sup> See, e.g., *Piccadilly*, 128 S. Ct. 2326; *In re Hechinger Inv. Co. of Del., Inc.*, 335 F.3d 243 (3d Cir. 2003); *NVR*, 189 F.3d at 442; *Jacoby-Bender*, 758 F.2d at 841.

<sup>14</sup> *NVR*, 189 F.3d at 456.

<sup>15</sup> See, e.g., *995 Fifth Ave. Assocs., L.P. v. New York State Dep't of Taxation & Fin.* (*In re 995 Fifth Ave. Assocs., L.P.*), 963 F.2d 503, 509 (2d Cir. 1992). This problem is not relevant to the issues discussed in this Comment.

<sup>16</sup> *Leake & Douglas*, *supra* note 1, at 839, 841.

determine whether a transfer or sale took place “under a plan confirmed.”<sup>17</sup> The circuit courts developed two divergent views on what transactions or sales qualify for the exemption.<sup>18</sup> The major distinction between the two interpretations was based on timing. The views taken by the Courts of Appeals for the Second and Eleventh Circuits can be labeled the “expansive interpretation,” while the views taken by the Courts of Appeals for the Third and Fourth Circuits can be labeled the “restrictive interpretation.”

Before these interpretations are explained, a brief history of the origin of § 1146(a) is helpful to understand part of the problem in interpreting the statute. Section 1146(a) arose when § 77B(f) was enacted as part of the Bankruptcy Act of 1898.<sup>19</sup> In its original form, § 77B(f) stated that certain taxes could not be applied to “the issuance, transfers, or exchanges of securities or making of conveyances *to make effective any plan of reorganization confirmed under the provisions of this section.*”<sup>20</sup> One purpose of the statute was to “exempt the debtor from the payment of a federal stamp tax on new securities issued pursuant to a plan of reorganization that required the debtor to modify the terms of outstanding securities.”<sup>21</sup> In the Chandler Act of 1938, Congress replaced § 77B(f) with § 267, which stated, “[t]he issuance, transfer, or exchange of securities, or the making or delivery of instruments of transfer *under any plan confirmed* under this chapter, shall be exempt from any stamp taxes.”<sup>22</sup> The amended statute under § 267 changed the statute’s language from “to make effective a plan” to “under any plan.”<sup>23</sup> The legislative history neither explains why Congress made the language change, nor reveals the actual congressional intent for enacting the original tax provision.<sup>24</sup>

The Bankruptcy Reform Act of 1978 replaced § 267 with § 1146(a).<sup>25</sup> The replacement brought little change to the wording. Section 1146(a) now states

---

<sup>17</sup> See *id.* at 839, 840–41, 856.

<sup>18</sup> Throughout this paper, the two predominant views will be referred to as the “expansive interpretation” and the “restrictive interpretation.”

<sup>19</sup> 48 Stat. 911, 919 (1934) (repealed 1935).

<sup>20</sup> *Id.* (emphasis added).

<sup>21</sup> 995 Fifth Ave. Assocs., L.P. v. New York State Dep’t of Taxation & Fin. (*In re* 995 Fifth Ave. Assocs., L.P.), 963 F.2d 503, 510 (2d Cir. 1992) (discussing whether the New York City gains tax was a stamp or similar tax).

<sup>22</sup> 52 Stat. 840, 903–04 (1938) (repealed 1978).

<sup>23</sup> Compare *id.* with Bankruptcy Act of 1898 § 77B(f), 48 Stat. at 919.

<sup>24</sup> H.R. REP. No. 95-595, at 275 (1977), reprinted in 1978 U.S.C.C.A.N. 5963, 6232.

<sup>25</sup> Pub. L. No. 95-598, 92 Stat. 2641 (codified as amended at 11 U.S.C.A. § 1146(a) (West 2008)) (section 1146(c) was redesignated as of 2005 to § 1146(a)).

that “[t]he 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 taxes.”<sup>26</sup> The only significant change in 1978 was that Congress clearly expanded the scope of the exemption to include taxes similar to stamp taxes.<sup>27</sup> This language was not amended when the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (“BAPCPA”) was enacted.<sup>28</sup> Ultimately, these predecessors did not clarify what is meant by “under a plan confirmed.”<sup>29</sup>

Under the expansive interpretation, both pre- and postconfirmation transfers qualified as occurring “under a plan confirmed” if the court deemed that the transfers were essential to the plan’s confirmation.<sup>30</sup> The necessity of the transfer, not its timing, was the ultimate factor in this interpretation. This interpretation was based upon the theory that § 1146(a), as part of a Chapter 11 reorganization, was meant to facilitate reorganization, and therefore, the tax exemption should not be limited.<sup>31</sup>

However, under the restrictive interpretation adopted by the Supreme Court, only transfers that occur postconfirmation qualify as “under a plan confirmed” because “under” means “with the authorization of.”<sup>32</sup> This interpretation is based upon the theory that the only reasonable reading of “under a plan confirmed” is that the transfer occurs after the plan is confirmed.<sup>33</sup> The main thrust of the circuit split was based on a timing distinction of when the transfers occurred. The split needed to be resolved to give debtors certainty in jurisdictions that had yet to interpret the statute. Also, a uniform standard benefits debtors, creditors, and the state when a debtor is deciding whether and when to sell assets during bankruptcy.

Scholarship before the Supreme Court decision was mixed. Some scholarship summarized the status of the split by explaining each side of the

---

<sup>26</sup> *Id.*

<sup>27</sup> 995 Fifth Ave. Assocs., L.P. v. New York State Dep’t of Taxation & Fin. (*In re* 995 Fifth Ave. Assocs., L.P.), 963 F.2d 503, 510 (2d Cir. 1992).

<sup>28</sup> The only change was the subsection letter, changing from 1146(c) to 1146(a).

<sup>29</sup> *In re* Permar Provisions, Inc., 79 B.R. 530, 533 (Bankr. E.D.N.Y. 1987) (stating that “legislative history to section 1146(c) is scant”).

<sup>30</sup> *See, e.g.,* City of New York v. Jacoby-Bender, Inc. (*In re* Jacoby-Bender, Inc.), 758 F.2d 840 (2d Cir. 1985).

<sup>31</sup> *See, e.g., id.* at 841.

<sup>32</sup> *See* Fla. Dep’t of Revenue v. Piccadilly Cafeterias, Inc., 128 S. Ct. 2326, 2332 (2008).

<sup>33</sup> *Id.*

argument.<sup>34</sup> Other scholarship embraced one interpretation and argued its merits. David Stratton rebuked the restrictive interpretation in his article *Real Property Transfers and Bankruptcy Tax Exemptions: In re Hechinger and 11 U.S.C. 1146(c)*.<sup>35</sup> Stratton argued that the restrictive interpretation used in a Third Circuit opinion was “easy to apply but effectively eviscerates the exemption.”<sup>36</sup> Stratton then sided with the expansive interpretation by stating that the statute’s legislative history and policy “militate in favor of a substantive determination of the appropriateness of the exemption to any given transfer—as opposed to a temporally formulaic application.”<sup>37</sup> Conversely, Karen Cordry supported the restrictive interpretation in her article *The Incredible Expanding § 1146(c)*.<sup>38</sup> Cordry argued against the expansive interpretation, claiming that it was impractical and that it inappropriately added a “necessary” limitation into the statute.<sup>39</sup> Cordry then supported the restrictive interpretation by agreeing with the Third Circuit’s statement that “Congress struck a most reasonable balance. If a debtor is able to . . . obtain confirmation, then the debtor is to be afforded relief from certain taxation.”<sup>40</sup> The scholarship did not explore new solutions; instead, it remained entrenched in the battle between the then current interpretations.

## II. THE HISTORY AND ORIGINS OF THE TWO INTERPRETATIONS OF § 1146(A) USED BY THE CIRCUIT COURTS AND THEIR INHERENT FLAWS

The circuit split that created uncertainty over the scope of § 1146(a) developed in 1999 when the Fourth Circuit embraced the restrictive interpretation in *In re NVR*.<sup>41</sup> The *NVR* decision split from the Second Circuit’s adoption of the expansive interpretation in 1985 when it decided *In re Jacoby-Bender, Inc.*<sup>42</sup> The split caused uncertainty for Chapter 11 debtors who transferred assets that were subject to a “stamp tax or similar tax” during the

---

<sup>34</sup> Leake & Douglas, *supra* note 1, at 839; Murray, *supra* note 12, at 389; PHILIP V. MARTINO & JODIE BUCHMAN, *Which Chapter 11 Asset Sales Are Tax Free?*, DLA PIPER, May 2007, [http://www.dlapiper.com/tax\\_free\\_chapter11\\_sales/](http://www.dlapiper.com/tax_free_chapter11_sales/).

<sup>35</sup> Stratton, *supra* note 12.

<sup>36</sup> *Id.* at 35.

<sup>37</sup> *Id.*

<sup>38</sup> Cordry, *supra* note 12 (citing *NVR Homes, Inc. v. Clerks of the Circuit Courts for Anne Arundel County, Md.* (*In re NVR, LP*), 189 F.3d 442 (4th Cir. 1999)).

<sup>39</sup> *Id.* at 48.

<sup>40</sup> *Id.*

<sup>41</sup> *NVR*, 189 F.3d 442.

<sup>42</sup> *City of New York v. Jacoby-Bender, Inc.* (*In re Jacoby-Bender, Inc.*), 758 F.2d 840, 849 (2d Cir. 1985).

course of their reorganization in jurisdictions that had yet to interpret “under a plan confirmed.” Also, the split was harmful because both interpretations hindered reorganization. The following discussion will explain in detail the origin, history, and difference between the two interpretations and expose the weaknesses contained in the differing interpretations.

#### A. *The Expansive Interpretation of the Scope of § 1146(a) Transfers*

The origin of the expansive interpretation reaches back to the 1985 case of *Jacoby-Bender*, when the Second Circuit affirmed a lower court decision that applied § 1146(a) to a transfer of real property not specifically mentioned in the plan of reorganization.<sup>43</sup> The expansive interpretation has become the predominant interpretation in bankruptcy courts<sup>44</sup> and has been embraced by states that handle a majority of bankruptcy proceedings, namely Delaware and New York.<sup>45</sup>

##### 1. *The History and Evolution of the Expansive Interpretation of § 1146(a)*

The genesis of the expansive interpretation of “under a plan confirmed” occurred when a New York bankruptcy court decided *In re Jacoby-Bender, Inc.*<sup>46</sup> In that case, the debtor sold one of its real estate assets outside of the ordinary course of business to the Hearst Corporation.<sup>47</sup> Although the exact definition of what a transfer “outside the ordinary course of business” means will be discussed in detail below, it is sufficient to say in this case the debtor sold one of its buildings in order to fund payments for its bankruptcy plan.<sup>48</sup> While the confirmation of the plan was dependent on the sale of the company’s real estate asset,<sup>49</sup> the plan that was approved neither specifically mentioned the sale of the building nor authorized the debtor to make the transfer.<sup>50</sup> The debtor claimed that § 1146(a) exempted it from paying the New York City real property transfer tax on the deed for the real estate that it delivered to the

---

<sup>43</sup> *Id.* at 841–42.

<sup>44</sup> Leake & Douglas, *supra* note 1, at 856.

<sup>45</sup> *See, e.g., In re Decora Indus., Inc.*, No. 00-4459 JFF, 2002 WL 32332749, at \*1 (D. Del. May 20, 2002); *City of New York v. Smoss Enters. Corp. (In re Smoss Enters. Corp.)*, 54 B.R. 950 (Bankr. E.D.N.Y. 1985).

<sup>46</sup> 40 B.R. 10, 11 (Bankr. E.D.N.Y. 1984), *aff’d*, 758 F.2d 840 (2d Cir. 1985).

<sup>47</sup> *Jacoby-Bender*, 758 F.2d at 840–41.

<sup>48</sup> *In re Jacoby-Bender, Inc.*, 34 B.R. 60, 61 (Bankr. E.D.N.Y. 1983).

<sup>49</sup> *Jacoby-Bender*, 40 B.R. at 11.

<sup>50</sup> *Id.*

Hearst Corporation.<sup>51</sup> The City of New York argued that § 1146(a) could not apply to the transfer because “under a plan confirmed” meant that the transfer must be stated in the confirmed plan.<sup>52</sup>

The bankruptcy court, whose decision was later affirmed by the district court, held that § 1146(a) applied to the transfer of the deed, and the debtor was exempt from paying the New York City real property transfer tax.<sup>53</sup> The City of New York appealed to the Second Circuit, claiming that the delivery was not “under” a plan because the plan did not mention or authorize the transfer.<sup>54</sup>

The Second Circuit affirmed the bankruptcy court’s ruling and gave credibility to the expansive interpretation.<sup>55</sup> The Second Circuit based its decision on Congress’s apparent purpose in enacting § 1146.<sup>56</sup> The court reasoned that § 1146 was enacted to “facilitate reorganizations through giving tax relief” and that this purpose was served regardless of whether the specific transfer was mentioned in the plan.<sup>57</sup> The court continued:

[T]he plan’s consummation depended almost entirely upon the sale of the building,” the sale in turn depending upon the delivery of the deed. That the plan did not empower the debtor to make a specific sale or deliver a specific deed is irrelevant to our determination that the delivery of the deed took place “under” the plan within the meaning of section 1146(a).<sup>58</sup>

The Second Circuit concluded that when a transfer is necessary for a plan to be consummated, the transfer and the transfer instrument are inherently “under” the plan despite the fact that the transfer was not mentioned specifically.<sup>59</sup> Thus the Second Circuit’s decision, while being the origin of the expansive interpretation of § 1146(a), only stated that the confirmed plan need not

---

<sup>51</sup> *Jacoby-Bender*, 758 F.2d at 840–41. The court held the New York City Real Property Transfer Tax to be a “similar tax” under 11 U.S.C.A. § 1146(a) (West 2008). *Id.*

<sup>52</sup> *Id.* New York City also argued that because *Jacoby-Bender, Inc.* sought approval for the sale pursuant to § 363(b) of the Bankruptcy Code that § 1146(a) should not apply. *Id.*

<sup>53</sup> *Id.*

<sup>54</sup> *Id.*

<sup>55</sup> *Id.* at 841.

<sup>56</sup> *Id.*

<sup>57</sup> *Id.*

<sup>58</sup> *Id.*

<sup>59</sup> *Id.* at 842.

specifically mention a transfer so long as that transfer was necessary for the plan's consummation.<sup>60</sup>

Bankruptcy and district courts soon began expanding upon the Second Circuit's decision in *Jacoby-Bender* by applying § 1146(a) to transfers that took place *before* the reorganization plan was confirmed.<sup>61</sup> The first expansion of the *Jacoby-Bender* decision by the lower courts was to extend the timing of § 1146(a) to sales that took place before a reorganization plan was confirmed. A prime example of this expansion is *In re Smoss Enterprises Corp.*<sup>62</sup> In *Smoss*, the debtor made a prebankruptcy petition contract to sell its only asset, a parcel of land.<sup>63</sup> After the debtor entered Chapter 11 bankruptcy, the debtor and the beneficiary of the contract for the sale of the land worked out a deal whereby the debtor would transfer the land to a third party.<sup>64</sup> This transfer occurred outside the ordinary course of business<sup>65</sup> because in this case it was the sale of the debtor's only asset.<sup>66</sup> The transfer was executed before the Chapter 11 plan<sup>67</sup> was confirmed.<sup>68</sup> The bankruptcy court granted the debtor's request to have the transfer exempt from transfer taxes pursuant to § 1146(a).<sup>69</sup> The City appealed the decision of the bankruptcy court to the District Court for the Eastern District of New York, arguing that the transfer was not made "under a plan confirmed" because it occurred before the plan was confirmed.<sup>70</sup>

The district court upheld the bankruptcy court's ruling that the transfer was exempt under § 1146(a).<sup>71</sup> The court cited *Jacoby-Bender* and rejected the City's claim that because the transfer was made pursuant to a prepetition contract, it was not "under a plan."<sup>72</sup> In doing so, the district court adopted the reasoning in *Jacoby-Bender* that if a transfer is *necessary to the consummation*

---

<sup>60</sup> *Id.* at 841.

<sup>61</sup> *See, e.g., In re Decora Indus., Inc.*, No. 00-4459 JJF, 2002 WL 32332749, at \*7 (D. Del. May 20, 2002); *City of New York v. Smoss Enters. Corp. (In re Smoss Enters. Corp.)*, 54 B.R. 950, 950 (Bankr. E.D.N.Y. 1985).

<sup>62</sup> *Smoss*, 54 B.R. at 950.

<sup>63</sup> *Id.* at 951.

<sup>64</sup> *Id.*

<sup>65</sup> As mentioned earlier, the distinction between transfers that occur during the ordinary course of business and outside the ordinary course will be discussed in detail in Part V.

<sup>66</sup> *Smoss*, 54 B.R. at 951.

<sup>67</sup> This was really a liquidation plan because the debtor was selling his only asset; however, bankruptcy rules allow debtors to liquidate under a Chapter 11 plan.

<sup>68</sup> *Smoss*, 54 B.R. at 951.

<sup>69</sup> *Id.*

<sup>70</sup> *Id.* at 950-51.

<sup>71</sup> *Id.* at 952.

<sup>72</sup> *Id.* at 951.

of a plan, it is “under a plan” within the meaning of § 1146(a).<sup>73</sup> The court then expanded the scope of § 1146(a) by stating that the transfer is “under a plan confirmed” if it “[is] essential to the confirmation of the plan.”<sup>74</sup> By subtly changing “consummation” as used in *Jacoby-Bender* to “confirmation,” the district court extended the scope of § 1146(a) to include transfers made before a plan was confirmed because if a transfer is essential to a plan’s confirmation, it must take place before confirmation is achieved.

After extending the scope of the language from *Jacoby-Bender* to include transfers that occur prior to the plan’s confirmation, the district court in *Smoss* used the same reasoning as *Jacoby-Bender*, basing its decision on the apparent purpose of § 1146(a).<sup>75</sup> The court stated that “[t]he plan was confirmed after the delivery of the deed because the plan depended entirely on the sale of property” and that the transfer was a “precondition to the confirmation and implementation of the plan.”<sup>76</sup> The court then reasoned that § 1146(a) “was surely designed to reach the one transfer on which the plan hinged and which the court had to approve prior to the confirmation.”<sup>77</sup> By relying on an apparent purpose argument and a subtle word change, the district court in *Smoss* substantially expanded the scope of “under a plan confirmed” in § 1146(a).

The scope of “under a plan confirmed” in § 1146(a) has not only been extended to transfers that take place before a plan is confirmed, but also to ones that occur during the ordinary course of the debtor’s business.<sup>78</sup> The bankruptcy court decision in *NVR* is a prime example of a lower court making this extension.<sup>79</sup> In that case, the debtor was a successful homebuilder primarily located in Virginia and Maryland in the early 1980s and had experienced significant growth over that time period.<sup>80</sup> In the early 1990s, the debtor experienced financial difficulties that caused it to file for Chapter 11 in 1992.<sup>81</sup> From the debtor’s petition date to when it emerged from Chapter 11 in 1993, the company made more than 5,571 transfers of real property in the

---

<sup>73</sup> *Id.*

<sup>74</sup> *Id.* (emphasis added).

<sup>75</sup> *Id.*

<sup>76</sup> *Id.*

<sup>77</sup> *Id.*

<sup>78</sup> See *In re NVR, L.P.*, 206 B.R. 831 (Bankr. E.D. Va. 1997), *rev’d*, 189 F.3d 442 (4th Cir. 1999).

<sup>79</sup> *Id.*

<sup>80</sup> *NVR Homes, Inc. v. Clerks of the Circuit Courts for Anne Arundel County, Md. (In re NVR, LP)*, 189 F.3d 442, 448 (4th Cir. 1999).

<sup>81</sup> *Id.*

ordinary course of business.<sup>82</sup> In other words the debtor sold 5,571 homes or lots between the time it filed for bankruptcy and the time the reorganization plan was confirmed. The debtor incurred extensive transfer and recordation taxes and paid over \$8 million to state and local authorities to satisfy these taxes.<sup>83</sup>

Upon the confirmation of the plan, the debtor sought to have the taxes refunded pursuant to § 1146(a).<sup>84</sup> The debtor's argument was that the confirmed plan exempted from transfer and recordation taxes "the transfer of . . . any property of any Debtor under, in furtherance of, or in connection with the Plan."<sup>85</sup> The taxing authority argued that the preconfirmation transfers should not be exempt under § 1146(a) because they occurred in the ordinary course of business.<sup>86</sup> Both the bankruptcy court and the district court applied the expansive interpretation of § 1146(a) articulated by the Second Circuit in *Jacoby-Bender* and ruled that the debtor was exempt from paying transfer or recordation taxes on transfers that occurred before the plan's confirmation.<sup>87</sup>

The district court affirmed the bankruptcy court for two reasons: (1) the broad language that the expansive interpretation uses and (2) a notice argument.<sup>88</sup> First, the district court relied upon the expansive interpretation of § 1146(a) when it stated that the preconfirmation transfers were "essential to the formulation, confirmation and consummation of the Confirmed Plan."<sup>89</sup> The district court reasoned that the transfers were crucial to the formation of a plan because they "enabled NVR to remain a viable operation and avoid liquidation."<sup>90</sup> It stated that preconfirmation transfers are "essential to the success of both the plan of reorganization and the debtor's emergence from bankruptcy."<sup>91</sup> Second, the district court affirmed because the preconfirmation transfers were included in the plan.<sup>92</sup> The court stated "it seems quite clear,

---

<sup>82</sup> *Id.*

<sup>83</sup> *Id.*

<sup>84</sup> *NVR*, 206 B.R. at 835.

<sup>85</sup> *Clerk of the Circuit Court for Anne Arundel County, Md. v. NVR Homes, Inc.*, 222 B.R. 514, 518 (E.D. Va. 1998) (alteration in original), *rev'd sub nom. NVR Homes, Inc. v. Clerks of the Circuit Courts for Anne Arundel County, Md. (In re NVR, LP)*, 189 F.3d 442 (4th Cir. 1999).

<sup>86</sup> *NVR*, 189 F.3d at 456.

<sup>87</sup> *Id.* at 454.

<sup>88</sup> *NVR Homes*, 222 B.R. at 514.

<sup>89</sup> *Id.* at 519 (citation omitted).

<sup>90</sup> *Id.*

<sup>91</sup> *Id.*

<sup>92</sup> *Id.*

given the nature of NVR's business, that the language of [the Plan] provided adequate notice to creditors and the bankruptcy court that real property transfers in the ordinary course of that business were covered by the Plan."<sup>93</sup> The court concluded "because the real property transfers . . . fall squarely 'under' the Plan within the meaning of § 1146(a), the bankruptcy court properly held them exempt."<sup>94</sup> As such, the district court expanded the scope of § 1146(a) to include transfers that take place preconfirmation and are made in the ordinary course of business. However, this decision was overruled by the Fourth Circuit, which reasoned that "under a plan confirmed" meant "authorized by the plan," thus precluding all preconfirmation transfers.<sup>95</sup> The Court's interpretation gave rise to the restrictive interpretation discussed below and caused the circuit split that existed until *Piccadilly*.<sup>96</sup>

Recently, the Eleventh Circuit embraced the expansive interpretation of § 1146(a) with its *Piccadilly* decision.<sup>97</sup> In doing so, the Eleventh Circuit became the first circuit court to say expressly that preconfirmation sales are eligible for tax relief pursuant to § 1146(a).<sup>98</sup> In *Piccadilly*, the debtor executed an asset purchase agreement with Piccadilly Acquisition Corporation ("PAC") under which PAC would purchase substantially all of the debtor's assets.<sup>99</sup> The agreement was reached the day before the debtor filed for bankruptcy.<sup>100</sup> The nonordinary course of business sale was completed before a plan had been confirmed, and the judge held that the sale was exempt from "stamp or similar" taxes pursuant to § 1146(a).<sup>101</sup> The Department of Revenue initiated an action before the plan was confirmed.<sup>102</sup> The bankruptcy court ruled that the sale was "under a plan confirmed" because "the sale was necessary to consummate the plan."<sup>103</sup> The district court affirmed and an appeal was brought before the Eleventh Circuit.<sup>104</sup>

---

<sup>93</sup> *Id.*

<sup>94</sup> *Id.*

<sup>95</sup> *NVR Homes, Inc. v. Clerks of the Circuit Courts for Anne Arundel County, Md. (In re NVR, LP)*, 189 F.3d 442, 457 (4th Cir. 1999).

<sup>96</sup> *Id.*

<sup>97</sup> *Fla. Dep't of Revenue v. Piccadilly Cafeterias, Inc. (In re Piccadilly Cafeterias, Inc.)*, 484 F.3d 1299 (11th Cir. 2007), *rev'd*, 128 S. Ct. 2326 (2008).

<sup>98</sup> *Id.* at 1304.

<sup>99</sup> *Id.* at 1301.

<sup>100</sup> *Id.*

<sup>101</sup> *Id.*

<sup>102</sup> *Id.*

<sup>103</sup> *Id.*

<sup>104</sup> *Id.* at 1301–02.

The Eleventh Circuit affirmed the bankruptcy court's decision and stated that the expansive interpretation was a better-reasoned approach because it looked to the necessity of the transfers, not their timing.<sup>105</sup> It stated that § 1146(a) is ambiguous, but a temporal restriction should not be followed because the Bankruptcy Code is clear when it establishes a time constraint.<sup>106</sup> Then, the court rebutted the reasoning of the restrictive interpretation by stating that a statute should not be construed so narrowly as to abrogate the statute's purpose.<sup>107</sup> The Eleventh Circuit reasoned that § 1146(a) should apply to preconfirmation transfers because of the practical realities of Chapter 11.<sup>108</sup> It stated that having to wait until after a plan's confirmation to effectuate a sale is impractical because "a debtor may need to close a sale as a condition precedent to the parties' willingness to proceed with confirmation."<sup>109</sup> The court's decision expanded on the *Jacoby-Bender* decision by expressly providing that preconfirmation transfers were eligible for tax relief under § 1146(a).

The expansive interpretation began when the Second Circuit affirmed the lower court's decision in *Jacoby-Bender* over twenty years ago. Since that decision, bankruptcy and district courts, as well as one circuit court, endorsed and expanded on the original expansive interpretation. Courts embracing this interpretation of "under a confirmed plan" applied it to transfers both before and after the plan's confirmation and to transfers both in and out of the ordinary course of business. Unfortunately, the application and extension of the expansive interpretation of § 1146(a) created problems that called into doubt this interpretation's viability.

## 2. *Problems with the Application of the Expansive Scope of § 1146(a)*

The expansive interpretation accounts for business and economic realities, but is problematic because it is an imprecise standard that creates a windfall for debtors and creditors at the taxpayers' expense. The current state of the expansive interpretation of "under a confirmed plan" applies the tax exemption to transfers that take place before and after the plan is confirmed and to transfers in and out of the ordinary course of business.<sup>110</sup> This interpretation

---

<sup>105</sup> *Id.* at 1303–04.

<sup>106</sup> *Id.* at 1303.

<sup>107</sup> *Id.*

<sup>108</sup> *Id.*

<sup>109</sup> *Id.* at 1304.

<sup>110</sup> *See supra* Part II.A.1.

appears to bolster the apparent purpose of § 1146: to aid debtors in rehabilitating and emerging from bankruptcy.<sup>111</sup> The problem with this interpretation is that the phrase “essential to the plan’s confirmation” is vague and susceptible to abuse by debtors. With no clear standard for what makes a transfer or sale “essential” to a plan’s confirmation, litigation will continue as debtors attempt to mask as many transfers as possible as “essential” and taxing authorities continue to resist.

An example of how the expansive interpretation can be imprecise and interpreted too broadly by lower courts is seen in the bankruptcy court’s decision in *NVR* discussed above. The bankruptcy court in *NVR* stated that the transfers “were made clearly ‘in furtherance of’ and ‘in connection with’ the Plan.”<sup>112</sup> The language “in furtherance of a plan” expanded the standard stated in *Smoss* “essential to the confirmation of the plan,”<sup>113</sup> which had already expanded *Jacoby-Bender*’s language of “necessary to the consummation of a plan.”<sup>114</sup> In other words, the lower court’s language in *NVR* was a liberal interpretation of an already liberal standard.<sup>115</sup>

The bankruptcy court’s latitude in *NVR* in interpreting the limits of “essential to a plan’s confirmation” demonstrates the flaw in the expansive interpretation: it can be stretched until it is almost limitless. The bankruptcy court’s application of § 1146(a) to the debtor’s sales of homes during its ordinary course of business went beyond the statute’s scope. For example, the bankruptcy court in *In re Hechinger* stated that “Congress apparently enacted § 1146(a) to encourage chapter 11 plans by providing chapter 11 debtors with tax relief when they are *compelled by business realities to sell certain assets*.”<sup>116</sup> In *NVR*, the debtor was not compelled by business realities to sell certain assets to fund a plan of reorganization. Its business was selling real estate assets. The debtor was no more compelled to sell the homes it built than a widget manufacturer is compelled to sell widgets. On appeal, the district

---

<sup>111</sup> *City of New York v. Jacoby-Bender, Inc. (In re Jacoby-Bender, Inc.)*, 758 F.2d 840, 841 (2d Cir. 1985).

<sup>112</sup> *NVR Homes, Inc. v. Clerks of the Circuit Courts for Anne Arundel County, Md. (In re NVR, LP)*, 189 F.3d 442, 455 n.6 (4th Cir. 1999).

<sup>113</sup> *City of New York v. Smoss Enters. Corp. (In re Smoss Enters. Corp.)*, 54 B.R. 950, 951 (E.D.N.Y. 1985).

<sup>114</sup> *Jacoby-Bender*, 758 F.2d at 842.

<sup>115</sup> *Compare Smoss*, 54 B.R. at 951 with *In re NVR, L.P.*, 206 B.R. 831, 831 (Bankr. E.D. Va. 1997), *rev’d*, 189 F.3d 442 (4th Cir. 1999).

<sup>116</sup> *In re Hechinger Inv. Co. of Del.*, 254 B.R. 306, 317 (Bankr. D. Del. 2000), *rev’d*, 335 F.3d 243 (3d Cir. 2003) (emphasis added).

court added that selling the houses enabled the debtor to remain a viable operation and avoid liquidation.<sup>117</sup> This is true of any business. All businesses must sell their respective products or services to remain viable and avoid going out of business. The purpose of the debtor's sale of homes was not facilitating a plan of reorganization, but selling its product in the ordinary course of business. The bankruptcy and district courts failed to ask an important question that would have shed light on the necessity of the transaction: Would the company have sold or transferred this asset if it were not in Chapter 11? If the debtor would not have sold the asset outside of Chapter 11, then the court should exempt the sale from transfer taxes pursuant to § 1146(a).

The imprecision and boundlessness of the expansive interpretation creates a windfall for debtors and creditors at the expense of taxpayers. The windfall occurs in cases like *NVR* when ordinary course of business transactions are exempted from transfer and recordation taxes because of a bankruptcy court's loose reasoning.<sup>118</sup> If the debtor had not been in bankruptcy, then the ordinary course of business transfers still would have occurred and the states would have received millions in tax dollars from the transactions. Instead, the bankruptcy court ruled that the transfers were exempt.<sup>119</sup> As a result, the state was deprived of tax money that it ordinarily would collect and the citizens of the state were denied that revenue.

The expansive interpretation embraced by the Eleventh Circuit and a majority of lower courts is flawed because it sets a vague standard to be applied by the courts. This application allows § 1146(a) to apply to all preconfirmation transfers or sales so long as the transaction was "in furtherance of" or "essential to the confirmation of the plan."<sup>120</sup> While the standard seems balanced and flexible, the lower courts have been too loose with the standard which has enabled debtors to receive tax benefits from transactions not contemplated by § 1146(a). As the bankruptcy court in *In re Hechinger* stated, § 1146(a) was designed to aid debtors who were "compelled by business realities to sell certain assets."<sup>121</sup> Instead of using the "compelled by business realities" test, lower courts, like the bankruptcy court in *NVR*, have

---

<sup>117</sup> *NVR*, 189 F.3d at 455 n.6.

<sup>118</sup> Clerk of the Circuit Court for Anne Arundel County, Md. v. *NVR Homes, Inc.*, 222 B.R. 514, 519 (E.D. Va. 1998), *rev'd sub nom.* *NVR Homes, Inc. v. Clerks of the Circuit Courts for Anne Arundel County, Md. (In re NVR, LP)*, 189 F.3d 442 (4th Cir. 1999).

<sup>119</sup> *Id.*

<sup>120</sup> *See Smoss*, 54 B.R. at 951.

<sup>121</sup> *See Hechinger*, 254 B.R. at 317 (emphasis added).

applied § 1146(a) to asset sales that took place in the ordinary course of business and were not in furtherance of a plan.<sup>122</sup>

### *B. The Restrictive Interpretation of § 1146(a) Transfers*

Until 1999 the expansive interpretation of § 1146(a) was the only interpretation endorsed by a circuit court. In 1999 the Fourth Circuit reversed the bankruptcy and lower courts' use of the expansive interpretation in *NVR* and created the restrictive interpretation.<sup>123</sup> Soon after the *NVR* decision, the restrictive interpretation was followed by the Third Circuit in *In re Hechinger*.<sup>124</sup> These are the only circuit courts that have followed the restrictive interpretation. Two important attributes of the restrictive interpretation are that it creates an absolute bar from applying § 1146(a) to preconfirmation transfers and it does not distinguish between transfers based on whether they were essential to the plan's confirmation.<sup>125</sup> If the transfer occurs after the plan is confirmed and is included in the plan, then the transfers are eligible for tax relief under § 1146(a). The following discussion tracks the origins and development of the restrictive interpretation. It also discusses the problems that this interpretation implicates and why it is not suitable for adoption by the Supreme Court or Congress.

#### *1. The Origin and Development of the Restrictive Interpretation of § 1146(a)*

The restrictive interpretation began when the Fourth Circuit reversed the bankruptcy and district courts' decisions to apply the expansive interpretation to "under a plan confirmed" in the *NVR* case.<sup>126</sup> As discussed above, both the lower courts exempted some of the debtor's transfers from recordation and transfer taxes.<sup>127</sup> They reasoned that *NVR*'s transfers took place "under a plan confirmed" because they were "in furtherance of" and "in connection with" the

---

<sup>122</sup> Compare *id.* at 317 with *In re NVR, L.P.*, 206 B.R. 831, 831 (Bankr. E.D. Va. 1997), *rev'd*, 189 F.3d 442 (4th Cir. 1999).

<sup>123</sup> See generally *NVR*, 189 F.3d at 442.

<sup>124</sup> *Baltimore County, Md. v. Hechinger Liquidation Trust (In re Hechinger Inv. Co. of Del.)*, 335 F.3d 243, 254 (3d Cir. 2003).

<sup>125</sup> See generally *NVR*, 189 F.3d at 442.

<sup>126</sup> *Id.*

<sup>127</sup> *Id.* at 455.

Plan.”<sup>128</sup> The Fourth Circuit discounted this reasoning in favor of an absolute temporal restraint on “under a plan confirmed.”<sup>129</sup> The Fourth Circuit stated:

[T]ransfers taking place prior to the date of a reorganization plan’s confirmation are not covered by 1146[(a)]. *First*, § 1146[(a)] exclusively, and not a plan’s provisions, control the extent of the statute’s own operation. *Second*, the language of § 1146[(a)] is plain and requires no great manipulation to interpret its terms.<sup>130</sup>

The Fourth Circuit’s language accomplished several things. In particular, it defined the restrictive interpretation as a timing distinction. Transfers contemplated under § 1146(a) that occur prior to a plan’s confirmation are barred from receiving the tax exemption, whereas eligible transfers that occur after the plan is confirmed may receive the exemption regardless of if they were in furtherance of, necessary, or essential to the plan’s confirmation or consummation.<sup>131</sup> The court based its reasoning on four assumptions: (1) there is no ambiguity in § 1146(a); (2) § 1146(a) is governed by its own language, not the language used by a plan; (3) the expansive interpretation, as used today, is flawed and different from the language used in *Jacoby-Bender*; and (4) courts should adhere to a policy of construing tax exemptions narrowly.<sup>132</sup>

The Fourth Circuit’s decision in *NVR* starts with the assumption that the only reasonable interpretation of “under a plan confirmed” is that it strictly applies to transfers that occur after a plan is confirmed.<sup>133</sup> The court stated, “Congress, by its *plain language*, intended to provide exemptions only to those transfers reviewed and confirmed by the court.”<sup>134</sup> The Fourth Circuit eliminated the possibility that “under” could extend to preconfirmation transfers by opening two dictionaries.<sup>135</sup> First it used *Black’s Law Dictionary*, which states that “under” means “‘inferior’ or ‘subordinate.’”<sup>136</sup> Next the court turned to *Webster’s* dictionary and found that “under” could also mean “‘with the authorization of.’”<sup>137</sup> Then the court read these definitions “logically” in the context of § 1146(a) and concluded that it could not say that

---

<sup>128</sup> *Id.* at 455 n.6.

<sup>129</sup> *Id.* at 456.

<sup>130</sup> *Id.* at 456–57 (footnote omitted).

<sup>131</sup> *Id.* at 456.

<sup>132</sup> *Id.* at 456–58.

<sup>133</sup> *Id.* at 458.

<sup>134</sup> *Id.* (emphasis added).

<sup>135</sup> *Id.* at 457.

<sup>136</sup> *Id.* (quoting BLACK’S LAW DICTIONARY 1525 (6th ed. 1990)).

<sup>137</sup> *Id.* (quoting WEBSTER’S II NEW RIVERSIDE UNIVERSITY DICTIONARY 1256 (1988)).

a transfer made before a plan is confirmed “could be subordinate to, or authorized by, something that did not exist at the date of transfer—a plan confirmed by the court.”<sup>138</sup>

The Fourth Circuit’s decision also was based on the idea that § 1146(a) is governed by its own language, not the language of the reorganization plan. The lower courts in *NVR* resolved the question of whether a transfer was “under” a plan by looking to see if the transfer was mentioned in the plan.<sup>139</sup> The Fourth Circuit recognized that one must look to the reorganization plan to determine if any transfers fall within the scope of § 1146(a), but stated that § 1146(a) “determines the ultimate extent of its operation.”<sup>140</sup> The Fourth Circuit then determined that the lower courts’ method was “fundamentally flawed” because it “makes a plan’s terms the master of § 1146[(a)], instead of deferring to the statute itself.”<sup>141</sup> Therefore, the court ruled “the proposition that every transfer necessary to the confirmation of a plan is ‘under a plan confirmed’” is without basis.<sup>142</sup>

The *NVR* court also relied on the Supreme Court decision *California State Board of Equalization v. Sierra Summit, Inc.*, which held that courts should construe tax exemptions narrowly.<sup>143</sup> The court stated that allowing the extent of a tax exemption to be determined by the person paying the tax should not be permitted because the tax payer would “pursue every possible tax advantage.”<sup>144</sup> Basically, the court was worried that debtors will classify as many transfers as they can as “under a plan confirmed” so they will receive favorable tax treatment.

The Fourth Circuit in *NVR* carefully distinguished the facts of this case from those in *Jacoby-Bender* in an attempt to avoid a circuit split.<sup>145</sup> The court stated, “[u]nlike the case before us, *Jacoby-Bender* did not deal with a preconfirmation transfer, but a postconfirmation transfer that, although not *specifically* authorized . . . was clearly necessary to the confirmed plan’s

---

<sup>138</sup> *Id.*

<sup>139</sup> Clerk of the Circuit Court for Anne Arundel County, Md. v. NVR Homes, Inc., 222 B.R. 514, 519 (E.D. Va. 1998), *rev’d sub nom.* NVR Homes, Inc. v. Clerks of the Circuit Courts for Anne Arundel County, Md. (*In re NVR, LP*), 189 F.3d 442 (4th Cir. 1999).

<sup>140</sup> *NVR*, 189 F.3d at 455.

<sup>141</sup> *Id.* at 456.

<sup>142</sup> *Id.*

<sup>143</sup> *Id.* at 457. *See generally* Cal. State Bd. of Equalization v. Sierra Summit, Inc., 490 U.S. 844 (1989).

<sup>144</sup> *NVR*, 189 F.3d at 457.

<sup>145</sup> *Id.* at 455–56.

*consummation.*”<sup>146</sup> Thus the Fourth Circuit restricted the *Jacoby-Bender* interpretation to postconfirmation transfers that are not specifically set forth in the plan.<sup>147</sup> The court claimed that the lower courts’ extension of the reasoning in *Jacoby-Bender* to preconfirmation transfers that are necessary to the plan’s confirmation is incorrect.<sup>148</sup> The Fourth Circuit correctly characterized *Jacoby-Bender* and noted that the lower courts have expanded its scope. However, the Fourth Circuit’s decision is too restrictive and creates problems itself.

Although the Fourth Circuit in *NVR* established an absolute timing restraint, it did not differentiate between the types of transfers made after a plan’s confirmation. Interestingly, the court’s decision restricted the scope of § 1146(a) in a different conceptual way than the taxing authority in the case argued. The taxing authority argued that transfers in the ordinary course of business, regardless of when they were executed, should not be exempt by § 1146(a) because these transfers were not done to facilitate or fund a reorganization plan.<sup>149</sup> The Fourth Circuit stated, however, “we think it irrelevant under § 1146[(a)] whether the transfer took place in the ordinary course of business.”<sup>150</sup> Thus, the Fourth Circuit in *NVR* first articulated a restrictive interpretation of “under a plan confirmed” by deciding that all preconfirmation transactions are not exempt under the statute, and all postconfirmation transfers are eligible for the tax exemption.

Four years later in *Hechinger*,<sup>151</sup> the Third Circuit adopted the same timing distinction that the Fourth Circuit articulated in *NVR*.<sup>152</sup> In *Hechinger*, the debtor was a retailer of home and garden products with approximately two hundred stores nationwide.<sup>153</sup> After attempting to reorganize, the debtor declared that it would cease operations and liquidate.<sup>154</sup> The debtor sought permission to liquidate its assets, including its properties and leases before the

---

<sup>146</sup> *Id.* at 455.

<sup>147</sup> *Id.* at 456.

<sup>148</sup> *Id.*

<sup>149</sup> *Id.*

<sup>150</sup> *Id.*

<sup>151</sup> *Baltimore County, Md. v. Hechinger Liquidation Trust (In re Hechinger Inv. Co. of Del.)*, 335 F.3d 243 (3d Cir. 2003).

<sup>152</sup> *Id.* at 255.

<sup>153</sup> *In re Hechinger Inv. Co. of Del.*, 254 B.R. 306, 309 (Bankr. D. Del. 2000), *rev'd*, 335 F.3d 243 (3d Cir. 2003).

<sup>154</sup> *Id.*

plan was confirmed.<sup>155</sup> The debtor claimed the “sales were necessary to reduce [its] indebtedness, improve liquidity, and to facilitate the formulation and ultimate confirmation of a [C]hapter 11 plan.”<sup>156</sup> The debtor then argued that § 1146(a) exempted it from any transfer taxes because the phrase “under a plan confirmed” meant only that the plan must ultimately be confirmed.<sup>157</sup> The taxing authorities argued that the term “under a plan confirmed” requires that the transfer occur after the plan is confirmed.<sup>158</sup> The bankruptcy and district courts sided with the debtor, distinguishing *NVR*<sup>159</sup> and claiming that a restrictive interpretation would frustrate congressional intent.<sup>160</sup>

The Third Circuit reversed the bankruptcy court’s decision in favor of the Fourth Circuit’s restrictive approach announced in *NVR*.<sup>161</sup> The court posited that a natural reading of “under” meant “authorized by;”<sup>162</sup> thus, “under a plan confirmed” means “authorized by a plan confirmed.”<sup>163</sup> The Third Circuit’s interpretation of § 1146(a) made the transactions in *Hechinger* ineligible for the tax exemption.<sup>164</sup> It stated that the word “under” is used in other parts of the Code and has the meaning of “authorized by,” and that tax exemptions should be construed narrowly.<sup>165</sup>

The Third and Fourth Circuits have adopted a restrictive interpretation of the scope of § 1146(a). Courts that follow these decisions eliminate the possibility of using § 1146(a) to gain tax relief for any transfers that occur preconfirmation, regardless of whether they are made during the ordinary course of business. The circuit courts’ reasoning primarily depends on a strict

---

<sup>155</sup> *Id.* Briefly, debtors need court permission to sell assets outside the ordinary course of business during bankruptcy pursuant to § 363(b) of the Bankruptcy Code, whereas sales within the ordinary course of business generally are covered by the court’s first day orders. Also, bankruptcy courts allow liquidation through Chapter 11 reorganization plans. Elizabeth B. Rose, Comment, *Chocolate, Flowers, and § 363(b): The Opportunity for Sweetheart Deals without Chapter 11 Protections*, 23 EMORY BANKR. DEV. J. 249, 253 (2006).

<sup>156</sup> *Hechinger*, 254 B.R. at 309.

<sup>157</sup> *Id.* at 316.

<sup>158</sup> *Id.* This is the same argument that the Fourth Circuit articulated in *NVR*.

<sup>159</sup> The lower court tried to distinguish *Hechinger* from *NVR* because the transfers in *NVR* took place during the ordinary course of business whereas in *Hechinger* the transfers were outside the ordinary course.

<sup>160</sup> *Baltimore County, Md. v. Hechinger Liquidation Trust (In re Hechinger Inv. Co. of Del.)*, 335 F.3d 243, 254–56 (3d Cir. 2003).

<sup>161</sup> *Id.* at 257.

<sup>162</sup> *Id.* at 253.

<sup>163</sup> *Id.* at 257.

<sup>164</sup> *Id.*

<sup>165</sup> *Id.* at 255.

interpretation of “under a plan confirmed,” whereby the tax exemption only applies to transfers “authorized by” a reorganization plan that is confirmed.

In summary, the restrictive interpretation of “under a confirmed plan” emerged when the Fourth Circuit decided the *NVR* case, and it gained momentum when the Third Circuit followed it in *Hechinger*. This interpretation reads “under a plan confirmed” narrowly and restricts the application of § 1146(a) to postconfirmation transfers. This interpretation is based largely on a “natural” reading of the word “under” to mean “authorized by.” While this interpretation has merit, it also suffers from many problems.

## 2. *Problems with the Current Restrictive Interpretation of § 1146(a)*

The interpretation of “under a plan confirmed” followed by the Third and Fourth Circuits is inequitable and imprecise. By narrowly interpreting the scope of § 1146(a) to apply only to postconfirmation transfers, the circuit courts have subverted the goals of § 1146(a)<sup>166</sup> and Chapter 11,<sup>167</sup> which are to facilitate reorganization and rehabilitation of debtors. Also, the narrow interpretation fails to deal with the business and economic realities a corporation faces in Chapter 11 bankruptcy.<sup>168</sup>

The restrictive interpretation of “under a plan confirmed” is imprecise because it does not allow for preconfirmation transfers. This imprecision makes the interpretation underinclusive. One of the goals of § 1146(a) is to give a debtor tax relief while also facilitating the sales of assets in bankruptcy to increase the debtor’s chances for a successful reorganization.<sup>169</sup> The restrictive interpretation of § 1146(a) is underinclusive because it does not extend the tax benefit to debtors who need to sell assets to fund a reorganization plan. Debtors often are forced to sell assets outside the ordinary course of business to fund a reorganization plan, and “there would be no rational basis for Congress to create a tax benefit for all debtors and then simultaneously limit that benefit to a small subset of debtors on an ostensibly arbitrary basis.”<sup>170</sup>

---

<sup>166</sup> See *In re Kerner Printing Co.*, 188 B.R.121 (Bankr. S.D.N.Y. 1995) (holding that §1146(c) provides the debtor with the fastest and most efficient means possible to distribute assets and discharge obligations).

<sup>167</sup> See Leake & Douglas, *supra* note 1, at 840–41, 856.

<sup>168</sup> See *id.* at 842–43; see also *In re Cantrup*, 53 B.R. 104, 106 (Bankr. D. Colo. 1985) (holding that an imposition of real estate transfer tax certainly will affect the price received by the estate).

<sup>169</sup> See Leake & Douglas, *supra* note 1, at 840.

<sup>170</sup> Stratton, *supra* note 12, at 32.

For example, imagine that a hypothetical company (“ABC”) that manufactures widgets files for Chapter 11 reorganization. During the reorganization period, the company realizes that if it can sell manufacturing plant A without paying any transfer taxes it will be able to pay off its largest creditor and free up enough cash to fund a successful reorganization. ABC cannot wait until after confirmation to sell this plant because it needs the cash to get the creditor’s committee to approve the reorganization plan, but the funds it receives from the sale will not be sufficient if it has to pay state and local property transfer taxes. Surely, this is a situation that § 1146(a) was enacted to prevent.<sup>171</sup>

The restrictive interpretation also is problematic because it defines “under” to mean “authorized by.”<sup>172</sup> The Supreme Court has stated that normal statutory construction assumes identical words throughout an act are intended to have the same meaning.<sup>173</sup> The restrictive interpretation defines “under” to mean “authorized by,” but this definition cannot be applied consistently throughout the Bankruptcy Code.<sup>174</sup> The lack of consistent application was one of the reasons for Judge Nygaard’s dissent from the Third Circuit’s decision in *Hechinger*.<sup>175</sup> In his dissent, Judge Nygaard stated:

The code accepts that some transactions may take place prior to confirmation and still be “under a plan.” Section 1129 sets out the requirements for confirmation, including: “(a) The court shall confirm a plan only if . . . (4) Any payment *made or to be made* by the proponent . . . *under the plan* . . . has been approved by, or is subject to the approval of, the court as reasonable.” If “under the plan” means “authorized by” an already confirmed plan, then there could never be a payment made under a plan prior to confirmation. Such a reading would read out the past tense “made” in the above phrase.<sup>176</sup>

Judge Nygaard’s reasoning highlights the fact that “authorized by” is just one interpretation of “under” and probably not the correct one for interpreting “under a plan confirmed.” Adhering to the restrictive interpretation goes

---

<sup>171</sup> See *In re Hechinger Inv. Co. of Del.*, 254 B.R. 306, 317 (Bankr. D. Del. 2000), *rev’d*, 335 F.3d 243 (3d Cir. 2003); see also *In re Permar Provisions, Inc.*, 79 B.R. 530, 533–34 (Bankr. E.D.N.Y. 1987).

<sup>172</sup> *NVR Homes, Inc. v. Clerks of the Circuit Courts for Anne Arundel County, Md. (In re NVR, LP)*, 189 F.3d 442, 457 (4th Cir. 1999).

<sup>173</sup> *Sorenson v. Sec’y of the Treasury of U.S.*, 475 U.S. 851, 860 (1986).

<sup>174</sup> *Hechinger*, 335 F.3d at 258 (Nygaard, J., dissenting).

<sup>175</sup> *Id.* at 257.

<sup>176</sup> *Id.* at 258 (citation omitted).

against the proposition that words in a code should have the same meaning throughout the code.<sup>177</sup>

Moreover, the Fourth Circuit's reasoning that the plain language of § 1146(a) creates a timing restriction that the transfer must occur after the plan's confirmation is questionable.<sup>178</sup> Courts adhering to the restrictive interpretation and the expansive interpretation have *both* based their reasoning on the plain language of the statute.<sup>179</sup> This occurrence bolsters the conclusion that § 1146(a)'s plain language is ambiguous. Congress could have made the meaning clear with little effort. Judge Wilkinson's concurring opinion in *NVR* illustrated this when he wrote "[i]f Congress used the words 'under a plan ultimately confirmed,' . . . [o]r . . . 'under a confirmed plan,' that would have made its intentions obvious."<sup>180</sup> The plain meaning of § 1146(a) is not clear, and the statute's intent and purpose should be analyzed to ascertain its meaning.

The basis that the Fourth Circuit used for creating the restrictive interpretation that tax exemptions should be read narrowly is misplaced for two reasons.<sup>181</sup> First, the Fourth Circuit read the statute so literally that it essentially defeated the statute's purpose.<sup>182</sup> Second, this basis runs contrary to the proposition that "a remedial statute such as the bankruptcy law should be liberally construed."<sup>183</sup> Therefore, § 1146(a) should be construed liberally, not narrowly.

Also, the restrictive interpretation of § 1146(a) does not account for business and economic realities that distressed companies face. For instance, this interpretation fails to realize that failing businesses do not have the resources or leverage to wait to sell or transfer property because postpetition financing is difficult to obtain on reasonable terms.<sup>184</sup> As shown in the above hypothetical, it is conceivable that a business cannot wait until its Chapter 11

---

<sup>177</sup> See *Sorenson*, 475 U.S. at 860.

<sup>178</sup> *NVR Homes, Inc. v. Clerks of the Circuit Courts for Anne Arundel County, Md. (In re NVR, LP)*, 189 F.3d 442, 457 (4th Cir. 1999).

<sup>179</sup> Compare *id. with In re Lopez Dev., Inc.*, 154 B.R. 607, 609 (Bankr. S.D. Fla. 1993) (holding that the plain meaning of § 1146(c) includes preconfirmation transfers).

<sup>180</sup> *NVR*, 189 F.3d 442, 458–59 n.\* (Wilkinson, C.J., concurring).

<sup>181</sup> *Id.* at 457 (majority opinion).

<sup>182</sup> See *Baltimore County, Md. v. Hechinger Liquidation Trust (In re Hechinger Inv. Co. of Del.)*, 335 F.3d 243, 259 (3d Cir. 2003) (Nygaard, J., dissenting). A purposive analysis of § 1146(c) is detailed *infra*.

<sup>183</sup> *CCA P'ship v. Dir. of Revenue of Del. (In re CCA P'ship)*, 70 B.R. 696, 698 (Bankr. D. Del. 1987).

<sup>184</sup> The Bankruptcy Code acknowledges this by giving substantial perks to those who will grant financing. See 11 U.S.C. § 364 (2006).

plan is confirmed to transfer or sell some of its assets because confirmation of the plan might be contingent upon the asset being sold. Yet, the restrictive interpretation provides an “incentive for debtors to retain unnecessary assets until confirmation.”<sup>185</sup> This interpretation will result in either fewer funds for the company to use during reorganization or a smaller distribution to creditors. The restrictive interpretation also ignores the business and economic reality that requiring a company in Chapter 11 to wait until confirmation to sell and get the tax benefit may not allow it to take advantage of market conditions. The average Chapter 11 reorganization can last years and the markets can change much faster.

Additionally, the restrictive interpretation effectively eliminates extending the benefit of § 1146(a) to preconfirmation sales.<sup>186</sup> Applying this bright-line rule undermines the apparent purpose of § 1146(a) which is to facilitate the debtor’s ability to effectively reorganize. In addition to undermining the statute’s apparent purpose,<sup>187</sup> the restrictive interpretation also fails to take into account the business and economic reality that failing companies might not have the option to wait to transfer assets. Based on this interpretation, businesses in Chapter 11 will structure their transactions to take place after the plan’s confirmation.<sup>188</sup> The net result will be that some debtors cannot restructure their transactions and will either lose money on the transfer or fail to reorganize and be forced to liquidate. Both scenarios ensure that the company’s creditors will feel the loss.<sup>189</sup>

Furthermore, a restrictive application of § 1146(a) leads to inequitable treatment of debtors during postconfirmation sales specifically because it does not differentiate between sales in the ordinary course of business and sales outside of it.<sup>190</sup> A tax break for a company that sells its products in the ordinary course of business during Chapter 11 is not what Congress intended when it enacted § 1146(a).<sup>191</sup> Sales of a company’s inventory, which are sales during the ordinary course of business, likely are worth the same to creditors as cash (postsale) or inventory (presale). So, it is inequitable to allow a

---

<sup>185</sup> Stratton, *supra* note 12, at 34.

<sup>186</sup> *Id.* at 35.

<sup>187</sup> See *In re Hechinger Inv. Co. of Del.*, 254 B.R. 306, 317 (Bankr. D. Del. 2000), *rev’d*, 335 F.3d 243 (3d Cir. 2003).

<sup>188</sup> Stratton, *supra* note 12, at 35.

<sup>189</sup> *Id.*

<sup>190</sup> See *NVR Homes, Inc. v. Clerks of the Circuit Courts for Anne Arundel County, Md. (In re NVR, LP)*, 189 F.3d 442, 456 (4th Cir. 1999).

<sup>191</sup> See *Hechinger*, 254 B.R. at 317.

company's inventory to be exempt from transfer taxes postconfirmation because it is not what Congress intended<sup>192</sup> and doing so benefits certain debtors arbitrarily.

The Fourth Circuit's decision in *NVR* demonstrates the inequity of applying § 1146(a) to ordinary course of business sales.<sup>193</sup> In *NVR* the debtor-homebuilder used § 1146(a) to avoid paying local and state transfer taxes on real estate that it was selling in the ordinary course of business.<sup>194</sup> The Fourth Circuit upheld the exemption on all transfers that took place after the plan's confirmation.<sup>195</sup> Therefore, the debtor in *NVR* received a significant tax break under § 1146(a) for selling its inventory in the ordinary course of business.<sup>196</sup> Compare this holding to the hypothetical widget manufacturer discussed above. The widget manufacturer does not get the benefit of § 1146(a) for the widgets it sells while trying to emerge from Chapter 11. By not distinguishing between sales in and out of the ordinary course of business, the restrictive interpretation inequitably advantages a debtor whose inventory and ordinary business activities involve transfers and sales of real property. The same inequity would exist for any debtor who sells assets that are subject to "stamp or similar" taxes.

The restrictive interpretation embraced by the Third and Fourth Circuits is flawed in its application to both pre- and postconfirmation sales. With respect to preconfirmation sales, the bright-line restrictive interpretation undermines the apparent intent of Congress in enacting the statute, is underinclusive, and ignores business and economic realities faced by struggling companies. Thus, the distinction is arbitrary in regards to postconfirmation sales, and it inequitably advantages some debtors over others.

The circuit split over the scope of § 1146(a) is the result of different conceptual frameworks. Courts that support the expansive interpretation begin their analyses by acknowledging that the phrase "under a plan confirmed" is ambiguous.<sup>197</sup> Based on the perceived ambiguity, these courts posit that a flexible interpretation, which exempts debtors from paying stamp or similar

---

<sup>192</sup> A detailed discussion on the intent of § 1146(c) will be discussed *infra*.

<sup>193</sup> See generally *NVR*, 189 F.3d at 454–58.

<sup>194</sup> *Id.*

<sup>195</sup> *Id.* at 458.

<sup>196</sup> *NVR* was seeking exemption from over 8 million dollars in transfer and recordation taxes. Only the transfers that occurred postconfirmation were granted tax relief pursuant to § 1146(c). *Id.*

<sup>197</sup> *In re Hechinger Inv. Co. of Del.*, 254 B.R. 306, 318 (Bankr. D. Del. 2000), *rev'd*, 335 F.3d 243 (3d Cir. 2003).

taxes on all bankruptcy transfers that are essential to the plan's confirmation, comports with the intent of Congress in enacting the statute.<sup>198</sup> While a majority of lower courts adopted the expansive view articulated by the Second Circuit,<sup>199</sup> the restrictive view recently prevailed when the Supreme Court decided *Florida Department of Revenue v. Piccadilly Cafeterias, Inc.*<sup>200</sup> Courts that follow the restrictive approach see no ambiguity in the phrase "under a plan confirmed." Based on the perceived clarity of the statute, these courts hold that § 1146(a) only applies to postconfirmation transfers.

Both the restrictive and expansive methods for interpreting "under a plan confirmed" in § 1146(a) of the Bankruptcy Code are flawed. The restrictive interpretation used by the Third and Fourth Circuits and the Supreme Court sets a strict timing limitation on the applicability of § 1146(a) and ignores the type of transaction and the purpose behind it.<sup>201</sup> Using this interpretation creates inequities for both preconfirmation and postconfirmation asset sales. For preconfirmation sales the restrictive interpretation is a poor standard, because it removes the tax benefit of § 1146(a) from debtors who need financing to get a plan confirmed or must sell the asset as a condition precedent to plan confirmation. Removing the benefit from preconfirmation debtors undermines the apparent purpose and intent of § 1146(a) and of Chapter 11.<sup>202</sup> For postconfirmation sales the restrictive interpretation creates an unfair benefit for certain debtors over others because it does not analyze the type of, or the reason for, the transaction.<sup>203</sup> Debtors that sell real property or issue securities in the ordinary course of business may have all of their state and local "stamp or similar taxes" exempted under § 1146(a) solely because of their line of business.<sup>204</sup> Again, this was not the reason why § 1146(a) was enacted.<sup>205</sup>

The expansive interpretation used by the Eleventh Circuit and a majority of lower courts set an equitable standard, but this standard was flawed because it was too vague and was used too broadly. The standard set in *Jacoby-Bender*

---

<sup>198</sup> See *City of New York v. Jacoby-Bender, Inc. (In re Jacoby-Bender, Inc.)*, 758 F.2d 840, 841 (2d Cir. 1985); *In re Permar Provisions, Inc.*, 79 B.R. 530, 533–34 (Bankr. E.D.N.Y. 1987).

<sup>199</sup> Leake & Douglas, *supra* note 1, at 855.

<sup>200</sup> 128 S. Ct. 2326, 2326 (2008).

<sup>201</sup> See *NVR*, 189 F.3d at 455–57.

<sup>202</sup> See *In re Kerner Printing Co.*, 188 B.R. 121, 124–25 (Bankr. S.D.N.Y. 1995); see also Leake & Douglas, *supra* note 1, at 840–41, 856.

<sup>203</sup> See *NVR*, 189 F.3d at 455–57.

<sup>204</sup> This was the case in the Fourth Circuit's *NVR* decision. See *NVR*, 189 F.3d at 458.

<sup>205</sup> See *Kerner*, 188 B.R. at 124–25.

and *Piccadilly* applied the § 1146(a) tax benefit to debtors regardless of the timing and the type of transaction as long as the transaction was essential to the plan's confirmation.<sup>206</sup> The broad standard led to lower courts applying the tax benefit to transfers that were ancillary to the plan's confirmation at best.<sup>207</sup> This application of § 1146(a) went against the goal of the statute to provide a tax benefit when business realities compelled such a sale.<sup>208</sup> Both interpretations of § 1146(a) inadequately interpreted "under a plan confirmed," and were improper for adoption by the Supreme Court. This, however, did not stop the Supreme Court from adopting the restrictive interpretation in *Piccadilly*.<sup>209</sup> Congress should amend the Bankruptcy Code to nullify the Supreme Court's decision and adopt an ordinary course of business distinction to determine whether a transfer is exempt from transfer taxes.

### III. THE SUPREME COURT'S DECISION AND ANALYSIS IN *FLORIDA DEPARTMENT OF REVENUE V. PICCADILLY CAFETERIAS, INC.*

The Supreme Court resolved the circuit split in 2008 by adopting the restrictive interpretation of "under a plan confirmed" in *Florida Department of Revenue v. Piccadilly Cafeterias, Inc.*<sup>210</sup> *Piccadilly* filed for Chapter 11 bankruptcy in 2003.<sup>211</sup> Under Chapter 11, *Piccadilly* sought to "sell substantially all its assets outside the ordinary course of business pursuant to § 363(b)(1)."<sup>212</sup> In order for the sale to be approved, *Piccadilly* entered into a "global settlement agreement" with its secured and unsecured creditors regarding priority of the sale proceeds.<sup>213</sup> The bankruptcy court approved the preconfirmation sale and *Piccadilly*'s request that the sale be exempt from transfer taxes pursuant to § 1146(a).<sup>214</sup> The Florida Department of Revenue appealed the bankruptcy court's decision to exempt the transfer from Florida transfer taxes.<sup>215</sup> The Eleventh Circuit affirmed the bankruptcy court, and held that the expansive interpretation of "under a plan confirmed" was

---

<sup>206</sup> See *City of New York v. Smoss Enters. Corp.* (*In re Smoss Enters. Corp.*), 54 B.R. 950, 951 (E.D.N.Y. 1985).

<sup>207</sup> See *NVR*, 189 F.3d at 457–58.

<sup>208</sup> *In re Hechinger Inv. Co. of Del.*, 254 B.R. 306, 317 (Bankr. D. Del. 2000), *rev'd*, 335 F.3d 243 (3d Cir. 2003).

<sup>209</sup> Fla. Dep't of Revenue v. *Piccadilly Cafeterias, Inc.*, 128 S. Ct. 2326, 2330 (2008).

<sup>210</sup> *Id.*

<sup>211</sup> *Id.*

<sup>212</sup> *Id.*

<sup>213</sup> *Id.*

<sup>214</sup> *Id.*

<sup>215</sup> *Id.*

appropriate.<sup>216</sup> The Florida Department of Revenue appealed to the Supreme Court, which granted certiorari to resolve the circuit split.<sup>217</sup>

The Supreme Court reversed the Eleventh Circuit and held that § 1146(a) only applies to postconfirmation transfers because that is the “most natural reading” of the statute’s text.<sup>218</sup> The Court’s analysis mirrored that of the Third and Fourth Circuits. After detailing both the restrictive and expansive interpretations of “under a plan confirmed,” the Court acknowledged that both interpretations were credible, but that the Florida Department of Revenue’s argument for the restrictive interpretation was the “better one.”<sup>219</sup> The Supreme Court held that the language “under a plan confirmed” is not ambiguous, but even assuming it was, the Court reasoned that statutory canons of interpretation and a natural reading of the statute supported the restrictive interpretation.<sup>220</sup> The Court stated that Piccadilly’s argument that “under” should read “in accordance with” does not make sense in this situation because the bankruptcy court exempted the transfer before the debtor submitted its confirmation plan.<sup>221</sup> Thus, the transfer was not “in accordance with” a plan.<sup>222</sup> Then, the Court accepted the state’s argument that “Congress ratified this longstanding interpretation when, in its most recent amendments to the Code, it ‘readopted’ the stamp-tax provision verbatim.”<sup>223</sup> The Court agreed that tax exemption statutes should be read narrowly, and discounted the argument that remedial statutes should be construed liberally, because the Bankruptcy Code is “not a remedial statute in that sense.”<sup>224</sup> Thus, the Supreme Court adopted the restrictive interpretation and used the same arguments on which the Third and Fourth Circuits relied.

Justice Breyer dissented, arguing that the expansive interpretation is appropriate.<sup>225</sup> The dissent employed the same arguments that the Eleventh Circuit and several bankruptcy courts used.<sup>226</sup> First, Justice Breyer stated that a statute’s purpose should be considered when interpreting the statute, and the

---

<sup>216</sup> *Id.*

<sup>217</sup> *Id.*

<sup>218</sup> *Id.* at 2339.

<sup>219</sup> *Id.* at 2331–32.

<sup>220</sup> *Id.* at 2333–38.

<sup>221</sup> *Id.* at 2335.

<sup>222</sup> *Id.*

<sup>223</sup> *Id.* at 2336.

<sup>224</sup> *Id.* at 2338–39.

<sup>225</sup> *Id.* at 2340–43 (Breyer, J., dissenting).

<sup>226</sup> *Id.*

“majority’s reading of temporal limits in § 1146(a) serves *no reasonable congressional purpose at all.*”<sup>227</sup> Justice Breyer continued by highlighting the benefits of the expansive interpretation, including the fact that it would allow for a quick sale, which can often result in more revenue available to creditors.<sup>228</sup> Justice Breyer concluded by chiding the majority’s decision for reading a timing distinction into the statute and providing no reason for doing so.<sup>229</sup> Unfortunately, the Supreme Court’s majority decision and Justice Breyer’s dissent failed to add any new insights or solutions for the problems associated with § 1146(a). Instead, the majority followed the restrictive interpretation arguments stated by the Third and Fourth circuits, and the dissent restated the expansive interpretation arguments put forth by the Eleventh Circuit.

#### IV. CONGRESS SHOULD ADOPT AN ORDINARY COURSE OF BUSINESS DISTINCTION BECAUSE IT ADEQUATELY RESOLVES THE PROBLEM IN INTERPRETING THE MEANING OF “UNDER A PLAN CONFIRMED”

Using an ordinary course of business distinction to determine whether the transfer was “under a plan confirmed” provides a clear, realistic, and equitable benchmark for courts to follow. This distinction erases the arbitrary timing requirement set by the Third and Fourth Circuits and the Supreme Court,<sup>230</sup> and it sets a standard that is easier to follow than the “necessary to the confirmation” requirement embraced by the Second and Eleventh Circuits.<sup>231</sup> The taxing authorities in *NVR* made a similar argument to the district court.<sup>232</sup> In *NVR*, the taxing authorities argued that the debtor’s preconfirmation ordinary course of business sales should not be exempt from the § 1146(a) taxes.<sup>233</sup> However, this argument was not a complete ordinary course of business distinction because it did not argue for taxing the ordinary course of

---

<sup>227</sup> *Id.* at 2341.

<sup>228</sup> *Id.* at 2342.

<sup>229</sup> *Id.* at 2343.

<sup>230</sup> *See* *NVR Homes, Inc. v. Clerks of the Circuit Courts for Anne Arundel County, Md.* (*In re NVR, LP*), 189 F.3d 442, 458 (4th Cir. 1999); *see also* *Baltimore County, Md. v. Hechinger Liquidation Trust* (*In re Hechinger Inv. Co. of Del.*), 335 F.3d 243, 252–54 (3d Cir. 2003).

<sup>231</sup> *See* *Fla. Dep’t of Revenue v. Piccadilly Cafeterias, Inc.* (*In re Piccadilly Cafeterias, Inc.*), 484 F.3d 1299, 1304 (11th Cir. 2007), *rev’d*, 128 S. Ct. 2326 (2008); *City of New York v. Jacoby-Bender, Inc.* (*In re Jacoby-Bender, Inc.*), 758 F.2d 840, 841 (2d Cir. 1985).

<sup>232</sup> *NVR*, 189 F.3d at 456–57.

<sup>233</sup> *Id.*

business sales that occurred postconfirmation.<sup>234</sup> The district court ruled against this distinction because it adhered to the expansive interpretation.<sup>235</sup> The Fourth Circuit, adhering to the restrictive interpretation of “under a plan confirmed,” considered this claim irrelevant and never reached its merits.<sup>236</sup>

The following discussion defines the ordinary course of business distinction for determining whether a sale is “under a plan confirmed.” It details the advantages of the distinction that make it preferable for adoption by Congress. Among the advantages is the fact that it is more in line with legislative intent and the apparent purpose of § 1146(a), and it provides a standard that is equitable to all debtors. Next, this discussion details the process of implementing the distinction and the potential problems that adopting the distinction may create. Finally, this discussion demonstrates how the ordinary course of business distinction would affect the outcome of three cases that circuit courts have decided and why the outcome under the new standard is equitable.

#### A. *Defining the Ordinary Course of Business Distinction*

The ordinary course of business distinction is found in the Bankruptcy Code and can be applied easily to determine whether a transfer took place “under a plan confirmed.” An explanation of the distinction between ordinary and nonordinary course of business transactions in bankruptcy is helpful to understand the analysis. This distinction already exists in the Bankruptcy Code in § 363<sup>237</sup> and has important ramifications for debtors looking to sell assets. The Bankruptcy Code contemplates the use of transactions both in the ordinary course of business and outside the ordinary course during the reorganization process.<sup>238</sup> Ordinary course of business transactions are defined as “[t]he normal routine in managing a trade or business,”<sup>239</sup> and as the “[d]aily or regular routine peculiar to a firm or trade, involving purchase, production, and sale of usual goods and/or services, and payment and receipt of money.”<sup>240</sup> This type of transfer differs significantly from transfers outside the ordinary course of business.

---

<sup>234</sup> *Id.*

<sup>235</sup> For a full analysis of this decision, see *supra* text and accompanying notes 78–96.

<sup>236</sup> *NVR*, 189 F.3d at 456–57.

<sup>237</sup> Compare 11 U.S.C. § 363(b) (2000) with 11 U.S.C. §363(c).

<sup>238</sup> See generally 11 U.S.C. §363(b)–(c).

<sup>239</sup> BLACK’S LAW DICTIONARY 378 (8th ed. 2004).

<sup>240</sup> BusinessDictionary.com, Course of Business Definition, <http://www.businessdictionary.com/definition/course-of-business.html> (last visited Sept. 30, 2008).

Section 363(c) allows for sales during the ordinary course of business without court permission or notice and a hearing for creditors, even if the property is subject to liens.<sup>241</sup> The reasoning behind this relaxed standard is that ordinary course transactions are completed frequently and requiring permission for each one would be expensive, inefficient, and administratively impossible.<sup>242</sup> A good illustration of this would occur if Wal-Mart filed for Chapter 11. Any inventory it sells postpetition does not need to be approved by a court or creditor. Instead, a bankruptcy court generally approves the sale of goods in the ordinary course of business by the debtor in its first day orders. Transactions that occur outside the ordinary course of business are subject to a different analysis.

Section 363(b) allows for sales outside the ordinary course of business subject to court approval after notice to and a hearing with creditors.<sup>243</sup> A clear example of this type of transaction would be Wal-Mart selling its delivery truck subdivision, or land it had purchased and improved in anticipation of the development of a store. Creditor notice, a hearing, and subsequent court approval are required for nonordinary course of business transactions.<sup>244</sup> The creditors' notice and hearing requirements underscore the point that these transactions are abnormal, probably large in dollar amount, and have a substantial effect on the debtor's goal of obtaining plan confirmation. Commentators have stated that outside the ordinary course of business, sales can be "an invaluable tool for generating value for a bankruptcy estate that can be used to fund a plan of reorganization."<sup>245</sup> Nonordinary course of business transactions are by definition *not* ordinary; they are subject to higher levels of scrutiny and require court and creditor approval.

The Bankruptcy Code distinguishes between ordinary and nonordinary course of business transactions, and it has different standards for each. Ordinary course of business transactions are normal, day-to-day transactions that are vital to the business albeit not vital to its reorganization. Nonordinary course of business transactions are not a part of the debtor's ongoing business. These require more court oversight because although vital for reorganization,

---

<sup>241</sup> 11 U.S.C. § 363(c). Cash collateral is an exception and requires creditor permission, but this provision is irrelevant for the purposes of this Comment.

<sup>242</sup> Leake & Douglas, *supra* note 1, at 843.

<sup>243</sup> *Id.* § 363(b).

<sup>244</sup> *Id.*

<sup>245</sup> See Leake & Douglas, *supra* note 1, at 842.

they can harm creditors. For similar reasons, § 1146(a) should only apply to these transactions and not to ordinary course transactions.

*B. Applying the Ordinary Course of Business Distinction to Determine Whether a Transfer Was “Under a Plan Confirmed” for § 1146(a)*

The ordinary course of business distinction would bar transfers that occur during the ordinary course of business from being considered “under a plan confirmed.” This distinction would include ordinary course of business transfers that occur both before and after a plan is confirmed<sup>246</sup> and would prohibit all ordinary course of business transfers from qualifying for transfer or recordation tax exemptions pursuant § 1146(a). Ordinary course of business transactions are excluded entirely from exemption under § 1146(a) because they do not affect a reorganization plan. These transactions are not necessary for funding a plan because they would occur as part of the day-to-day function of the business regardless of its financial state.<sup>247</sup> Ordinary course of business transactions are by definition ordinary and do not give rise to the special circumstances of bankruptcy reorganization. Because ordinary course of business transactions are so common and have little to do with funding or formation of a reorganization plan, courts do not require creditor or court approval.<sup>248</sup>

The argument that ordinary course of business transactions are essential to a plan of reorganization because they enable the company to remain viable<sup>249</sup> is misleading. It is true that if a business in Chapter 11 does not continue to sell its goods or services, it may never be able to form a plan or have such a plan approved by the court. However, these ordinary course transactions do not provide the funding for a reorganization plan because they occur regardless of bankruptcy. A better characterization of these transactions is that they prevent the company from sinking further into debt while plan negotiation and confirmation take place.

---

<sup>246</sup> This is different from what the taxing authorities argued in *NVR*. The differences between that case and this standard will be discussed *infra*. See generally *NVR Homes, Inc. v. Clerks of the Circuit Courts for Anne Arundel County, Md. (In re NVR, LP)*, 189 F.3d 442, 457 (4th Cir. 1999).

<sup>247</sup> See *In re Hechinger Inv. Co. of Del.*, 254 B.R. 306, 319 (Bankr. D. Del. 2000), *rev'd*, 335 F.3d 243 (3d Cir. 2003).

<sup>248</sup> See 11 U.S.C. § 363(c).

<sup>249</sup> See *NVR*, 189 F.3d at 455, n.6. (noting this same argument as used in lower court decisions for *NVR* and affirming district court’s postconfirmation transfer tax exemptions under § 1146(c)).

Transactions that take place outside the ordinary course of business during a bankruptcy should be categorized as “under a plan” because debtor’s engage in the transactions to maximize the value of assets or increase liquidity to fund a plan of reorganization.<sup>250</sup> This position is supported by several propositions. First, businesses enter into Chapter 11 because they are unable to pay creditors, or lack liquid assets. Second, preconfirmation sales outside the ordinary course of business enable debtors to pay debts and fund a plan because these sales are quick, efficient, and require little haggling.<sup>251</sup> Third, creditors are required to receive notice and can request a hearing to dispute all nonordinary course of business transfers.<sup>252</sup> The creditor’s ability to receive the details of a sale and request a hearing is a powerful tool to ensure the sale is essential because the sale directly affects the creditor’s payout. Because debtors are in business to make money, it is not likely that they will sell income producing assets of the business unless it is necessary to reorganize. Thus, it is reasonable to claim that a debtor selling assets outside the ordinary course of business during bankruptcy is doing so in order to either fund a plan or satisfy creditors so the plan can be confirmed. This claim is bolstered by the fact that creditors, who are interested in self-protection during bankruptcy, can object to these transfers.<sup>253</sup>

An argument against the ordinary course of business distinction is that it is too broad because it grants § 1146(a) tax exemptions to preconfirmation transfers that may occur before a plan is written.<sup>254</sup> If the transfer occurs before the plan is written, how can it be “under” a plan? This is a valid question, but there is a logical answer. The intent of the statute and origin of the word “under” in § 1146(a) enables the exemption to extend to transfers that occur before a plan is written. This point will be discussed in detail later.

Additionally, debtors are in Chapter 11 because creditors are demanding more than the debtor is able to pay. It follows that a debtor reasonably can anticipate the need to create more liquid assets to satisfy creditors, get a plan confirmed, and emerge from bankruptcy all before a plan is written. It seems unlikely that Congress intended to punish forward thinking debtors who take

---

<sup>250</sup> See Jason Brege, *An Efficiency Model of Section 363(b) Sales*, 92 VA. L. REV. 1639, 1644 (2006); Harvey R. Miller & Shai Y. Waisman, *Chapter 11: An Acquisition Opportunity for Financial and Strategic Buyers*, BANKR. STRATEGIST, July 2001, at 1–2.

<sup>251</sup> Brege, *supra* note 250, at 1644.

<sup>252</sup> 11 U.S.C. § 363(b).

<sup>253</sup> *Id.*

<sup>254</sup> See, e.g., *New York City Dep’t of Fin. v. 310 Assocs., L.P. (In re 310 Assocs. L.P.)*, 282 B.R. 295, 299–301 (S.D.N.Y. 2002) (limiting the expansive view by arguing that the distinction is too broad).

advantage of good market conditions by selling some assets before a plan is written. If a debtor concludes that it is essential to sell assets outside the ordinary course of business in order to get a plan confirmed, then the transfers are just as essential to the plan as if they had occurred before the plan was written. Another reason that the ordinary course of business distinction should apply to preconfirmation transactions outside the ordinary course of business is because limiting the distinction to transfers that occur after a plan is written causes uncertainty. What does “written” mean? Does it apply to the first draft, or only the final draft that is to be sent to the creditors’ committee for approval? The argument against applying the ordinary course of business distinction to preconfirmation transfers is arbitrary and causes uncertainty; therefore, § 1146(a) should extend broadly to all preconfirmation nonordinary course of business transfers.

The ordinary course of business distinction should also apply to postconfirmation transfers. As mentioned above, the local taxing authorities in *NVR* argued for a similar ordinary course of business standard but only wanted to apply the distinction for preconfirmation transfers.<sup>255</sup> Ending the ordinary course of business distinction once a plan has been confirmed does not logically follow. Doing so would retain the timing element of the restrictive method, which is an ineffective tool to implement the statute’s purpose. Furthermore, if ending the distinction at confirmation was allowed, the ordinary course of business distinction would be unable to remedy another problem the alternative interpretations suffer from—allowing the plan to dictate the extent and control of the statute.<sup>256</sup> A plan eventually does need to be confirmed for § 1146(a) to apply, and the debtor must request that the transfer be exempt from transfer and recordation taxes pursuant § 1146(a). However, whether a requested transfer falls “under a plan confirmed” should be governed solely by the statute. As such, including ordinary course of business transfers in the confirmation plan should not automatically entitle these transactions to the tax benefit under § 1146(a). If this were allowed, the plan would still be dictating the extent of the statute. Only transfers that are essential to a plan should be exempt from transfer taxes under § 1146(a), and only nonordinary course of business transactions fulfill the requirement. Thus, courts would be unwise to alter an ordinary course of business distinction

---

<sup>255</sup> *NVR Homes, Inc. v. Clerks of the Circuit Courts for Anne Arundel County, Md. (In re NVR, LP)*, 189 F.3d 442, 456–57 (4th Cir. 1999).

<sup>256</sup> *Id.* at 456.

based on whether the transfer took place before or after the plan was confirmed.

The ordinary course of business distinction should provide an absolute bar against granting tax relief pursuant to § 1146(a) for transfers that are in the ordinary course of business. The distinction should grant the § 1146(a) tax exemption to transfers that occur outside the ordinary course of business. Ordinary course of business transactions occur regardless of the financial state of a company and therefore are not used to fund or gain confirmation of a plan of reorganization. This reasoning applies regardless of whether the transfer takes place before or after the plan is confirmed. Transfers outside the ordinary course of business are essential to plan confirmation either by providing funding for a plan (preconfirmation) or by allowing the plan to be consummated (postconfirmation). The reasoning that exempts transfers pre- and postconfirmation also dictates that transfers which occur prior to a plan being drafted are eligible. Because a plan may leave a transfer's details to be settled in the future,<sup>257</sup> a debtor should not be penalized for recognizing that plan confirmation will require these types of sales for improved liquidity or additional financing. Furthermore, the ordinary course of business standard has more advantages than the restrictive and expansive interpretations.

### *C. Advantages of Using the Ordinary Course of Business Distinction*

Using the ordinary course of business distinction has many advantages which make it more suitable for adoption by Congress. An obvious advantage is that it provides a clear standard that can be followed easily by all courts. The distinction essentially eliminates the gray area in determining whether a § 1146(a) transfer falls “under a plan confirmed.” The following discussion will detail the relevant advantages of using the ordinary course of business distinction. Advantages include that the ordinary court of business distinction: (1) is more in line with the congressional intent and purpose for enacting the statute than the alternative interpretations; (2) creates an equitable standard for debtors; and (3) is beneficial to debtors, creditors, and taxing authorities.

---

<sup>257</sup> City of New York v. Jacoby-Bender, Inc. (*In re Jacoby-Bender, Inc.*), 758 F.2d 840, 841 (2d Cir. 1985).

1. *The Ordinary Course of Business Distinction Is Advantageous Because It Is in Line with the Legislative Intent and Purpose for Enacting § 1146(a)*

Courts should use the ordinary course of business distinction to determine if a transaction is “under a plan” because it is in line with the apparent purpose of Congress in enacting the provision. A purpose-oriented analysis of ambiguous statutes is an accepted method for resolving the ambiguity.<sup>258</sup> Courts and scholars commonly state that one reason Congress enacted § 1146(a) was to facilitate reorganization by providing the debtor with tax relief when it sells assets to fund a plan.<sup>259</sup> The bankruptcy court in *Hechinger* similarly stated that “Congress apparently enacted § 1146[(a)] to encourage Chapter 11 plans by providing Chapter 11 debtors with tax relief when they are compelled by business realities to sell certain assets.”<sup>260</sup>

Neither of the two interpretations of “under a plan confirmed” fulfills the purpose of § 1146(a). The restrictive interpretation fails to serve Congress’s purpose because it interprets “under a plan confirmed” to eliminate all preconfirmation transfers.<sup>261</sup> Given the statute’s purpose, it is not likely that Congress used the word “under” specifically for the purpose of eliminating all transactions that took place prior to confirmation, regardless of their necessity.<sup>262</sup> Additionally, the use of the word “under” does not establish a timing requirement because timing requirements in other sections of the Bankruptcy Code are set out *expressly* by Congress.<sup>263</sup> For example, § 1104(a) states “[a]t any time after the commencement of the case but before confirmation of the plan.”<sup>264</sup> Also, the expansive interpretation fails to serve Congress’s purpose because its language is too broad and its application often allows transactions that are not necessary for the plan’s confirmation to be exempt from tax pursuant to § 1146(a).<sup>265</sup> Thus, neither the restrictive nor the

---

<sup>258</sup> A purpose oriented approach is one of several competing methods of statutory interpretation that are used often by courts.

<sup>259</sup> See Stratton, *supra* note 12, at 3; see also *Jacoby-Bender*, 758 F.2d at 841.

<sup>260</sup> *In re Hechinger Inv. Co. of Del.*, 254 B.R. 306, 317 (Bankr. D. Del. 2000), *rev’d*, 335 F.3d 243 (3d Cir. 2003).

<sup>261</sup> See *NVR Homes, Inc. v. Clerks of the Circuit Courts for Anne Arundel County, Md. (In re NVR, LP)*, 189 F.3d 442, 455–56 (4th Cir. 1999).

<sup>262</sup> See *Hechinger*, 254 B.R. at 318.

<sup>263</sup> *Id.*

<sup>264</sup> 11 U.S.C. § 1104(a) (2006).

<sup>265</sup> See *Clerk of the Circuit Court for Anne Arundel County, Md. v. NVR Homes, Inc.*, 222 B.R. 514, 519 (E.D. Va. 1998), *rev’d sub nom. NVR Homes, Inc. v. Clerks of the Circuit Courts for Anne Arundel County, Md. (In re NVR, LP)*, 189 F.3d 442 (4th Cir. 1999).

expansive interpretation implements Congress's purpose for enacting § 1146(a).

Using the ordinary course of business distinction would fulfill the purpose of the statute because the new distinction would determine whether the transaction facilitated reorganization. The ordinary course of business distinction would serve this purpose because it eliminates the tax benefit for transactions that occur during the ordinary course of business. This distinction requires proof that Congress did not intend transfers in the ordinary course of business to be exempt from stamp or similar taxes. Proving what Congress did or did not intend is near impossible when the legislative history is scant. However, Congress enacted § 1146(a) to grant tax relief for transfers that facilitate plan confirmation.<sup>266</sup> If this is the goal, it seems likely that Congress would exempt only those transfers that are necessary to facilitate the plan and not transactions that would have occurred during the debtor's ordinary course of business.<sup>267</sup> Further, this distinction supports the idea that "under a plan confirmed" only applies to transfers of assets that occur because the company is compelled by business realities to make the sale.<sup>268</sup> Ordinary course of business sales or transfers do not occur because businesses are compelled to make the transaction; rather, they occur in the ordinary course of the company's business.

The apparent purpose of § 1146(a) is to grant tax benefits to transactions that are essential to facilitate a plan's confirmation. The ordinary course of business distinction supports the congressional purpose for enacting § 1146(a) because it eliminates transfers that are not essential to the plan's confirmation. A transaction that would have occurred regardless of whether a plan was confirmed should not be eligible for this tax benefit, and the ordinary course of business distinction ensures this outcome.

## *2. The Ordinary Course of Business Distinction Is Advantageous Because It Provides an Equitable Framework for all Debtors*

Courts using the ordinary course of business distinction would provide a framework that is equitable to all debtors. This distinction is equitable because all transfers that occur in the ordinary course of business would be ineligible

---

<sup>266</sup> Stratton, *supra* note 12, at 3; *see also* City of New York v. Jacoby-Bender, Inc. (*In re* Jacoby-Bender, Inc.), 758 F.2d 840, 841 (2d Cir. 1985).

<sup>267</sup> *Hechinger*, 254 B.R. at 318–19.

<sup>268</sup> *Id.*

for the § 1146(a) tax treatment. Regardless of the timing, debtors are not advantaged or disadvantaged depending on their inventory and the nature of their company.

The ordinary course of business distinction is equitable for preconfirmation transfers because it treats all transfers the same. All ordinary course of business transfers would be excluded from § 1146(a) and all nonordinary course of business transfers would be included. The ordinary course of business distinction effectively levels the playing field for all debtors. This distinction does not necessarily exclude companies such as the debtor in *NVR*, a homebuilder, from gaining the benefits of § 1146(a) for ordinary course of business sales. If a homebuilder sells office space or a processing plant outside the ordinary course of business to facilitate its reorganization plan, it would be exempt pursuant to § 1146(a).

The ordinary course of business distinction levels the playing field for preconfirmation transfers because it does not arbitrarily restrict the use of § 1146(a) like the current interpretation. Presently, a debtor whose business is transferring real estate assets can use § 1146(a) to avoid transfer or recordation taxes it incurs as a “cost of doing the type of business in which it was engaged.”<sup>269</sup> The savings accumulated by companies taking advantage of this loophole is significant.<sup>270</sup> Companies in industries other than real estate receive no such advantage when they enter Chapter 11, and their chances of successful reorganization are hindered because of it. The ordinary course of business distinction eliminates the inequity created by the expansive interpretation. Regardless of what business one is in, one would not get a tax break pursuant to § 1146(a) for preconfirmation transfers that occur in the ordinary course of business.

Furthermore, a court using the ordinary course of business distinction should not alter its analysis if the transaction occurs postconfirmation regardless of whether it was included in the plan. The expansive and restrictive interpretations of “under a plan confirmed” allow ordinary course of business transfers to be exempt under § 1146(a) if they occur postconfirmation.<sup>271</sup> This creates a loophole for ordinary course of business

---

<sup>269</sup> *Id.* at 318.

<sup>270</sup> The tax exemption would have saved *NVR* around \$8 million. *NVR*, 189 F.3d at 448.

<sup>271</sup> The Fourth Circuit in *NVR* stated that § 1146(a) “grants tax exemptions to property transfers occurring under the confirmed Plan, and thus [the] district court’s judgment stands to the extent it covers transfers occurring after the date of Plan confirmation.” *Id.* at 458.

transfers. Most obviously, debtors will simply include in their reorganization plan any ordinary course of business transfers that take place after plan confirmation. Also, this loophole hinders a debtor's chance to reorganize successfully because it may lose funds either by waiting until postconfirmation to sell or by paying the transfer and recordation taxes. If courts continue to make this distinction for postconfirmation transfers, the timing requirement would remain and the inequity would still exist. Leaving this loophole provides debtors with a strategy for improperly avoiding transfer and recordation taxes. Therefore, courts using the ordinary course of business distinction should apply the rule equally for pre- and postconfirmation transfers.

An argument against this proposition is that "under a plan confirmed" includes any transfer mentioned in a confirmed plan and the only real issue is whether it applies to preconfirmation transfers. However, if one accepts that "under a plan confirmed" originated from "to make effective any plan" and was meant to apply to transfers "essential to the plan's confirmation," regardless of timing, then not exempting postconfirmation sales that take place during the ordinary course of business logically follows.

Courts should adopt the ordinary course of business distinction because it eliminates inequities created by the expansive and restrictive interpretations of "under a plan confirmed." It eliminates inequity by not allowing certain debtors additional tax relief based upon the type of business in which they engage. To fully eliminate inequity, this distinction should apply to both pre- and postconfirmation sales.

*3. Another Advantage of the Ordinary Course of Business Distinction Is That It Recognizes the Business and Economic Realities of Bankruptcy While Curbing Potential Abuse*

Courts should adopt the ordinary course of business distinction because it appreciates the business and economic realities of Chapter 11 reorganizations and benefits all parties involved. The three major parties involved in bankruptcy reorganization—the debtor, creditors, and the state—would all benefit from the use of the ordinary course of business distinction. One reason is that the ordinary course of business distinction would create uniformity and predictability. Debtors would benefit because they could act fast and potentially obtain greater value. Creditors would receive more because the debtor would be able to increase its value. States also would benefit because

successful reorganization creates a healthy business paying taxes to the state in the future.<sup>272</sup>

The ordinary course of business distinction appreciates the business and economic realities of distressed companies by allowing them to apply § 1146(a) to preconfirmation transactions. This interpretation realizes the dynamics of bankruptcy reorganization and aids a distressed business in obtaining a premium price for its assets, which in turn creates value in the company, increases its liquidity, and, hopefully, allows it to form a plan that will be confirmed.<sup>273</sup> The bankruptcy court in *Hechinger* illustrated this point well when it stated:

A debtor will often sell assets during the course of its case to maximize proceeds in anticipation of the plan it intends to propose. Confirmation is the final major step . . . . In most cases, a debtor will sell assets throughout the pre-confirmation period because the retention of those assets is incompatible with the business plan for emergence from chapter 11.<sup>274</sup>

Although the Third Circuit ultimately reversed the bankruptcy court in *Hechinger*, the bankruptcy court's analysis demonstrates that allowing preconfirmation exemptions acknowledges the realities of bankruptcy. Thus, the ordinary course of business distinction accounts for business realities.

Comparatively, this distinction makes more business sense than the restrictive and expansive interpretations. The ordinary course of business distinction makes more business sense than the restrictive interpretation because it aids businesses in selling assets when they are most needed: postpetition but preconfirmation, when financing and credit sources are scarce. The debtor is aided because preconfirmation transfers look more attractive if they are not subject to transfer or recordation taxes. Debtors can act fast and not wait until plan confirmation to make these transactions. Additionally, this distinction reduces the incentive to retain unneeded assets that will be incompatible with the newly reorganized business. Thus, the restrictive interpretation encourages this undesirable practice because it creates an

---

<sup>272</sup> See *NVR*, 189 F.3d at 459 (Wilkinson, J., concurring).

<sup>273</sup> This aspect of the ordinary course of business distinction for § 1146(a) is similar to the benefits that the expansive view allows. However, the major distinction between these two views for preconfirmation transfers is that the ordinary course of business distinction does not allow exemptions for ordinary course of business transfers preconfirmation. A detailed analysis comparing the ordinary course of business distinction with the two dominant competing views is discussed *infra*.

<sup>274</sup> *Hechinger*, 254 B.R. at 317.

incentive for debtors to retain unneeded assets until after plan confirmation even though they need the money or may be able to get a better price preconfirmation.<sup>275</sup>

The expansive interpretation produces a result similar to the ordinary course of business distinction. In fact, debtors probably would prefer the expansive interpretation because it is almost boundless. However, this flexibility might not be such a good thing for the debtor. The absence of legal boundaries creates uncertainty and gray areas as to how far the limits may be stretched. In law, uncertainty promotes litigation. This is especially true when a state is being deprived of substantial revenue. The ordinary course of business distinction is a clear standard. The clarity it provides makes the ordinary course of business distinction a better standard than the competing interpretations of “under a plan confirmed.”

A courtwide adoption of the ordinary course of business distinction would benefit creditors because debtors would have a better chance at emerging from Chapter 11. Chapter 11 reorganizations are typically less expensive than Chapter 7 liquidations.<sup>276</sup> The unsecured creditors receive the greatest benefit in this scenario because they “recover about 1/3 to 1/2 of their claims in Chapter 11,” whereas they rarely receive anything in Chapter 7.<sup>277</sup> Also, the ordinary course of business distinction protects investors because it allows preconfirmation transfers. Applying § 1146(a) to more than postconfirmation transfers allows debtors to revive their business “and thereby preserve jobs and protect investors.”<sup>278</sup>

Critics of allowing § 1146(a) to apply to preconfirmation transfers attack the proposition that exempting the transfers from tax will have any effect on whether the deal is completed.<sup>279</sup> The critics claim:

The problem with this reasoning, though, is that it suggests that multi-million dollar deals would flounder if the debtor is required to pay a 1 [percent] recording tax to complete them. By the very nature

---

<sup>275</sup> Stratton, *supra* note 12, at 32.

<sup>276</sup> Arturo Bris, Ivo Welch & Ning Zhu, *The Costs of Bankruptcy: Chapter 7 Cash Auctions vs. Chapter 11 Bargaining* (EFA 2004 Maastricht Meetings, Working Paper No. 05155, 2004).

<sup>277</sup> *Id.*

<sup>278</sup> *NVR Homes, Inc. v. Clerks of the Circuit Courts for Anne Arundel County, Md. (In re NVR, LP)*, 189 F.3d 442, 459 (4th Cir. 1999) (Wilkinson, J., concurring) (citing *Toibb v. Radloff*, 501 U.S. 157, 163 (1991)).

<sup>279</sup> Cordry, *supra* note 12, at 48.

of the § 1146 taxes, it is obvious that the exemption can only have the most trivial effect on the viability of a transaction.<sup>280</sup>

The critique is true in the sense that the transfer or recordation tax probably would not affect whether a preconfirmation sale outside the ordinary course of business occurs. However, it misses a more subtle point: § 1146(a) is meant to aid a debtor's reorganization efforts. One percent of a multimillion dollar deal can equal a million dollars or more. If the debtor can use this million dollar tax break to negotiate for a higher price or a better deal, then § 1146(a) has succeeded. It is successful because the debtor has more money and is leaner, so reorganization is more likely, or, if reorganization fails, the debtor has maximized its assets for its creditors. Creditors benefit because the ordinary course of business standard makes preconfirmation sales attractive. This enables debtors to obtain a maximum value for their assets, which equals a better payout in Chapter 11. Further, if the reorganization fails and is converted to a Chapter 7 liquidation, a creditor will get more if the debtor has maximized its value prior to liquidating.

States gain from the use of the ordinary course of business standard. Unlike both the restrictive and expansive interpretations, the ordinary course of business distinction ensures that states receive transfer and recordation taxes on all transfers that occur during the ordinary course of business, regardless of when the transfer was made. States benefit from a successful reorganization because a successful business in the state results in jobs for its citizens and more tax revenue in the long run. Judge Wilkinson's concurrence in *NVR* affirmed this point when he stated "[t]hese funds would permit the debtor to emerge from bankruptcy and thereby to generate substantial long-term tax revenues."<sup>281</sup> Thus, states benefit from the ordinary course of business distinction because they will receive the same or more money from § 1146(a) taxes.

### *C. Implementation of the Ordinary Course of Business Distinction Does Not Require Any Material Procedural Changes in Bankruptcy Cases*

There are two primary ways in which a debtor can have a transfer exempted from tax pursuant to § 1146(a). First, the debtor can include language in the confirmed reorganization plan that states that any transfers made pursuant to the plan are exempt from stamp, real estate transfer, or

---

<sup>280</sup> *Id.*

<sup>281</sup> *NVR*, 189 F.3d at 459 (Wilkinson, J., concurring).

recording tax pursuant to § 1146(a).<sup>282</sup> Second, the debtor can ask that the transfer be exempt from tax under § 1146(a) before the plan is confirmed when the transfer is being approved by the court.<sup>283</sup> After the debtor makes the request, the judge either grants the application of § 1146(a) or denies it. Thus, there would be no change in the procedure for debtors requesting or the judge granting an exemption from taxes on transfers covered by § 1146(a).

#### *D. Potential Problems of Adopting an Ordinary Course of Business Distinction*

The ordinary course of business distinction is not a miracle cure for the problems associated with determining whether a transfer took place “under a plan confirmed” for purposes of § 1146(a). Some of the problems this distinction raises are inherent, while others accompany any interpretation of a statute.

The ordinary course of business distinction raises a problem because now a judge must decide whether the transfer occurred in the ordinary course of business in order to determine whether it was “under a plan confirmed.” However, judges already do this for preconfirmation financing purposes.<sup>284</sup> This distinction would extend the process to postconfirmation transfers that have yet to occur. Those adhering to the expansive interpretation may see this as trading one ambiguous standard (essential or necessary to confirmation or consummation) for another (transfer occurring during the ordinary course of business). Those adhering to the restrictive interpretation may see this as judges reading words into a statute. However, bankruptcy judges are able to make this distinction. Judges already determine during a bankruptcy proceeding whether a sale was made during the ordinary course under § 363(b), and courts have established tests such as the Business Justification Test to decide how to characterize a transfer.<sup>285</sup>

---

<sup>282</sup> See *NVR*, 189 F.3d at 448. The actual language from the plan in the *NVR* case stated that any property transfer “[p]ursuant to section 1146(c) . . . the transfer of . . . any property of the Debtor under, in furtherance of, or in connection with the Plan shall not be subject to any stamp tax, real estate transfer tax, recording tax, or similar tax.” *Id.*

<sup>283</sup> See *Baltimore County, Md. v. Hechinger Liquidation Trust (In re Hechinger Inv. Co. of Del.)*, 335 F.3d 243, 246 (3d Cir. 2003). Requests made at this time for exemption from § 1146(a) taxes will be nonordinary course of business transactions because ordinary course transactions do not require court approval.

<sup>284</sup> See generally *id.*

<sup>285</sup> Rose, *supra* note 155, at 267.

Another potential problem is that some debtors may take advantage of the standard by selling assets outside the ordinary course of business when such a sale is not necessary for plan's confirmation or consummation. It is logical to assume that debtors make nonordinary course of business transactions during a bankruptcy to promote a plan's success. Intuitively, managers and stockholders want to see their business do well because success results in higher reward. Chapter 11 procedures have given creditors more assurance because for preconfirmation sales that take place outside the ordinary course of business, creditors must be informed of the details of the sale and may request a hearing to object.<sup>286</sup> However, fraud and manipulation can still occur despite the disclosure requirements and hearing.<sup>287</sup>

The major source of fraud for preconfirmation sales outside the ordinary course of business originates from insider and unfair dealing.<sup>288</sup> This type of fraud exists in the bankruptcy process today,<sup>289</sup> and the ordinary course of business distinction does not affect or deter it. Instead, by uniformly offering a tax break on real estate or security transfers preconfirmation, this standard may provide extra incentive for debtors to characterize as many transfers as possible as nonordinary. Empirical data suggest that “§ 363 insider dealing occurs with disproportionate frequency when compared to chapter 11 confirmed plans.”<sup>290</sup> The source of manipulation may be a large unsecured creditor that will not get a large amount in liquidation but whose vote is needed for plan confirmation. If the creditor has enough leverage, it may convince the debtor's management to sell some portion of the company's assets to the creditor or a third party pursuant to § 363(b). This sale may be masked as necessary under the Business Justification Standard<sup>291</sup> and approved by a bankruptcy court. Other situations may include false valuations to justify sales, and deals where part of the debtor's management is hired by the acquiring company.<sup>292</sup> Innocent creditors in this situation are offered some protection through the notice and hearing requirements, but these requirements are less demanding than the

---

<sup>286</sup> 11 U.S.C. § 363(b) (2006).

<sup>287</sup> Rose, *supra* note 155, at 277.

<sup>288</sup> *Id.*

<sup>289</sup> *Id.*

<sup>290</sup> *Id.*

<sup>291</sup> Comm. of Equity Sec. Holders v. Lionel Corp. (*In re Lionel Corp.*), 722 F.2d 1063, 1070 (2d Cir. 1983).

<sup>292</sup> Rose, *supra* note 155, at 277–80.

requirements for plan confirmation.<sup>293</sup> This problem exists under all of the interpretations.

The ordinary course of business distinction may raise problems with the interpretation of what “ordinary course of business” means. It may give incentive or make the use of § 363(b) more profitable for those who sell assets fraudulently preconfirmation under the guise that the sales are necessary for the confirmation of the plan. However, bankruptcy courts often make the distinction between ordinary and nonordinary course of business transfers and extending that process to postconfirmation transfers as well should not be problematic. Also, the potential for fraud already is present during the bankruptcy process and the incentive of a tax-free transfer probably would not increase its occurrence.

V. APPLYING THE ORDINARY COURSE OF BUSINESS DISTINCTION TO THE  
CIRCUIT AND SUPREME COURT CASES INTERPRETING THE MEANING OF  
“UNDER A PLAN CONFIRMED”

The ordinary course of business distinction acts as a compromise between the restrictive interpretation adopted in *Piccadilly* and prior courts’ expansive interpretation. The ordinary course of business distinction can be seen as a compromise because it allows for nonordinary course preconfirmation transfers to be exempt from taxes pursuant to § 1146(a). However, the ordinary course of business distinction’s treatment of postconfirmation transfers deviates from both the restrictive and expansive interpretations because it completely bars postconfirmation ordinary course of business transfers from being exempt from application of § 1146(a). Applying the ordinary course of business distinction to the Supreme Court and circuit court cases interpreting “under a plan confirmed” highlights the new distinction’s qualities.

Applying the ordinary course of business distinction to *Jacoby-Bender* would not change its outcome. Briefly, *Jacoby-Bender* dealt with a real estate transfer outside the ordinary course of business that was approved preconfirmation.<sup>294</sup> This transfer took place outside the ordinary course of

---

<sup>293</sup> *Id.* at 277.

<sup>294</sup> *City of New York v. Jacoby-Bender, Inc. (In re Jacoby-Bender, Inc.)*, 758 F.2d 840, 841 (2d Cir. 1985).

business because it was approved by the court pursuant to § 363(b).<sup>295</sup> The Second Circuit affirmed the bankruptcy and district courts' decisions to grant the § 1146(a) tax exemption.<sup>296</sup> This would not change under the ordinary course of business standard since the transfer was outside the ordinary course of business.

Applying the ordinary course of business distinction to *NVR* best highlights how the distinction differs from the expansive and restrictive interpretations. In *NVR*, the Fourth Circuit held that all of the ordinary course of business transfers that took place preconfirmation were excluded from the § 1146(a) exemption, while all postconfirmation ordinary course of business transfers were included in the exemption.<sup>297</sup> The ordinary course of business standard would lead to the same result for the preconfirmation transfers in this case (all would be ineligible for exemption under § 1146(a)). However, the reason for excluding the preconfirmation transfers under the ordinary course of business distinction is that they occurred during the ordinary course of business. Also, this distinction would create a different result for the postconfirmation ordinary course of business transfers. Now those transfers would be excluded. So, in this case *NVR* loses the tax benefit of § 1146(a) for all of its ordinary course transfers.

The Supreme Court decision in *Piccadilly* would have come out differently under the ordinary course of business distinction. In that case, the Supreme Court held that the taxes on a preconfirmation transfer outside the ordinary course of business were not exempted by § 1146(a) because the transfer occurred before confirmation.<sup>298</sup> Because the ordinary course of business distinction eliminates the timing element from the analysis, § 1146(a) would apply to the transfer in *Piccadilly*, and it therefore would be exempt from transfer taxes. So, *Piccadilly* illustrates the difference between the temporal characteristic under the restrictive interpretation of “under a plan confirmed” and the substantive characteristic of the ordinary course of business distinction.

Reanalyzing these cases using the ordinary course of business distinction highlights the differences and similarities between it and the expansive and restrictive interpretations of “under a plan confirmed.” The conciliatory aspect

---

<sup>295</sup> *Id.*

<sup>296</sup> *Id.* at 842.

<sup>297</sup> *NVR Homes, Inc. v. Clerks of the Circuit Courts for Anne Arundel County, Md. (In re NVR, LP)*, 189 F.3d 442, 458 (4th Cir. 1999).

<sup>298</sup> *Fla. Dep't of Revenue v. Piccadilly Cafeterias, Inc.*, 128 S. Ct. 2326, 2339 (2008).

regarding preconfirmation transfers and the divergent aspect regarding postconfirmation transfers of the ordinary course of business distinction can be seen by comparing the results in *NVR* and *Piccadilly*. *Piccadilly* illustrates the preconfirmation compromise aspect because the nonordinary course of business transfer would be “under a plan” for § 1146(a) purposes even though it was preconfirmation. *NVR* illustrates the conflicting aspect of the ordinary course of business distinction because it excludes both the pre- and postconfirmation ordinary course of business transfers from being “under a plan.”

### CONCLUSION

Recently, the circuit split concerning the two competing interpretations for determining whether a transfer occurs “under a plan confirmed” for § 1146(a) purposes was resolved by the Supreme Court in *Piccadilly*. The Court adopted the restrictive interpretation by deciding *Piccadilly* based on the “most natural reading” of the statute. However, the Court’s decision does not reflect the intent of the statute, nor does it resolve the inadequacies of the restrictive interpretation. Congress should amend the statute to implement its intent and eliminate the loopholes that the expansive and restrictive interpretations permit. The ordinary course of business distinction proposed in this Comment provides the best standard available. It provides a clear, equitable, and substantive distinction that comports with the legislative intent of § 1146(a).

The ordinary course of business distinction is a better benchmark for whether a transfer was “under a plan confirmed” because transfers outside the ordinary course of business are done to promote reorganization and plan confirmation, while ordinary course of business transfers are not. The distinction would allow any transfer outside the ordinary course of business to be eligible for tax relief under § 1146(a). The temporal distinction of the restrictive view should be replaced with a substantive distinction that also eliminates the debtor windfall that can occur under the restrictive and expansive interpretations.

The ordinary course of business distinction has many advantages over the restrictive and expansive interpretations. The distinction differs from the restrictive interpretation because it accounts for business realities by allowing pre- and postconfirmation transfers to be exempt from transfer taxes under § 1146(a). However, the distinction also would restrict the potential for abuse and the subsequent windfall to the debtor by only allowing transfers that occur

outside the ordinary course of business to be eligible for tax relief. The distinction would not be difficult to implement since it already is found in the Bankruptcy Code and judges have established tests to determine whether a sale is outside the ordinary course of business. Congress's purpose in enacting § 1146(a) supports this distinction because it grants tax relief, but only when the assets are sold to fund a plan. Thus, Congress should revise § 1146(a) of the Bankruptcy Code and adopt an ordinary course of business distinction to govern when bankruptcy transfers are exempt from stamp or similar taxes.

JONATHON D. PRESSLEY\*

---

\* Notes and Comments Editor, *Emory Bankruptcy Developments Journal*; J.D. Candidate Emory University School of Law (2009), B.A. University of Florida (2005). I am grateful to my wife Carly, Professor Dorothy Brown, and everyone who helped put together this Comment.