

## Memorandum

To: Honorable Betty T. Yee, Chairwoman  
Honorable Judy Chu, Ph.D., Vice Chairman  
Honorable Bill Leonard  
Honorable Michelle Steel  
Honorable John Chiang

Date: January 22, 2008

From: Kristine Cazadd  
Chief Counsel 

Subject: **February 1, 2008 Board Hearing**  
**Item M 3 – Other Chief Counsel Matters**  
*State of Florida, Department of Revenue v. Piccadilly Cafeteria, Inc.*  
**No. 07-312, cert. granted December 7, 2007**  
**Authorization for the Office of the California Attorney General to Join in the State of Illinois**  
**Amicus Brief Supporting Florida**

Pending before the United States Supreme Court is the State of Florida's appeal from the order of a federal bankruptcy court in the Chapter 11 bankruptcy case of *Florida Department of Revenue v. Piccadilly Cafeteria, Inc.* that allowed the debtor-in-possession (Piccadilly) to avoid stamp tax or similar tax (including sales tax) under Bankruptcy Code section 1146(c) on the sale of its assets pursuant to a motion under Bankruptcy Code section 363, before the confirmation of a Chapter 11 plan. The Florida Department of Revenue argues in its appeal that the plain language of section 1146(c) allows avoidance of stamp tax or similar tax under Bankruptcy Code section 1146(c) *only* pursuant to a *confirmed* Chapter 11 plan. The Illinois Attorney General is preparing an amicus brief in support of the Florida position and through the National Association of Attorneys General is seeking to join other states and jurisdictions. The California Attorney General has inquired whether the Board of Equalization has an interest in having the California Attorney General join in the amicus brief of the Illinois Attorney General. The California Attorney General makes an independent decision whether to join in a Supreme Court amicus brief based upon its own review and analysis of the issues and the impact on the State of California, but wishes to consider the Board's view. The Legal Department believes that the Board does have an interest in supporting a decision by the California Attorney

General to join in the Illinois amicus brief for the reasons set forth below. Due to a January 28, 2008 deadline to join in the Illinois amicus brief, Board legal staff has informed the California Attorney General of this interest. Should the Board Members decide that the Board does not have such an interest, legal staff will so advise his office.

In recent years, the Board of Equalization has encountered numerous Chapter 11 bankruptcy cases in which debtors-in-possession have filed motions to sell assets pursuant to Bankruptcy Code section 363 and to avoid stamp tax and many other taxes pursuant to Bankruptcy Code section 1146(c) (this provision to 1146(a) in 2005). Often, in these 363 sale motions, debtors-in-possession have attempted to extend the avoidance of stamp tax and similar tax to sales and use tax, by arguing that sales and use tax is *similar* to stamp tax. When properly noticed of these attempts, the Board's Legal Department has defeated them either by filing written opposition to the motions or by threatening to file such opposition. However, this requires the expenditure of significant resources even while the statutory language clearly does not apply to sales and use tax. Also, when the Board is not properly noticed of these motions, bankruptcy court orders are sometimes entered authorizing sales of assets under Bankruptcy Code section 363, which express language that avoids stamp tax and similar tax, including sales and use tax. When this occurs, debtors-in-possession usually do not report and pay sales and use tax as required under the California Revenue and Taxation Code. If Board staff does not learn of this failure to report and pay, the sales and use tax will go unpaid. When Board staff does learn of this failure to report and pay taxes, we file an administrative claim for unpaid sales or use tax in the Chapter 11 case. In response, the debtors in possession often object to the Board's proofs of claim on grounds that the language of the section 363 sale order precludes the imposition of sales and use tax.

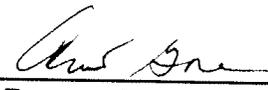
For example, in the Chapter 11 bankruptcy case of *In re GST, Inc.* filed in the Delaware District Court, the debtor-in-possession obtained a court order authorizing it to sell substantially all of its assets under Bankruptcy Code section 363. The order included language that referenced Bankruptcy Code section 1146(c) and specifically precluded, among other things, the imposition of all stamp tax, transfer tax, sales tax, and use tax. The Board was not properly notified of the debtor-in-possession's motion. GST did not report and pay sales tax on the sale of its assets. Subsequently, the Board staff learned of the asset sale and asserted an administrative expense claim in the bankruptcy court for the amount of approximately \$17,000,000. The debtor-in-possession disputed the Board's claim on the grounds that the language of the order authorizing the sale of assets precluded the imposition of sales tax on the asset sale. Together with outside bankruptcy counsel, the Board staff litigated the Board's claim with significant effort and tenacity over the following two years. Finally, the debtor-in-possession agreed to a stipulation approved by the bankruptcy court, which resulted in the Board receiving payment of approximately \$10,500,000 on the sales tax claim. The costs for the litigation and the expenditure of attorneys' fees to reach this result were more than \$900,000.

If the Florida Department of Revenue's appeal in the *Piccadilly Cafeteria, Inc.* case is successful, it will preclude debtors-in-possession (like GST), bankruptcy trustees, and others from attempting to avoid stamp tax and similar tax (as well as sales and use tax) under Bankruptcy Code section 1146(a) in connection with asset sale motions under Bankruptcy Code section 363 for the following reasons. There would be a Supreme Court decision clarifying that avoidance of stamp tax or similar tax under Bankruptcy Code section 1146(c) is authorized *only pursuant to a confirmed* Chapter 11 plan; not before a plan is confirmed. Confirmation of a Chapter 11 plan is problematic, and many cases never reach confirmation. Confirmation of a Chapter 11 plan requires (1) full disclosure of the specific terms of the plan, (2) notice to creditors of the confirmation hearing, (3) an opportunity to object to confirmation, and (4) a right to vote on the plan if a creditor's claim is impaired. Under these circumstances, a debtor-in-possession's opportunities to avoid stamp tax and similar tax are restricted and the Board's ability to protect tax revenue from avoidance under Bankruptcy Code section 1146(a) will be enhanced. Further, the Supreme Court may possibly clarify that the language for avoidance of stamp tax and similar tax does not include sales and use tax.

For these reasons, the Legal Department believes that the Board has an interest in supporting a decision by the California Attorney General to join in Illinois in an amicus brief. Please feel free to contact Acting Assistant Chief Counsel Robert Stipe at (916) 324-2737 for any questions.

KC:cp

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Approved   
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