IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF DELAWARE

IN RE:	)	
	)	
GST Telecom, Inc., et al.	)	Chapter 11
	)	
	)	Case No. 00-1982 GMS
Debtors.	)	
	)	Jointly Administered
	)	

MEMORANDUM AND ORDER

I. INTRODUCTION

On February 12, 2002, the court held a Confirmation Hearing in this case. Prior to the hearing, the State of Washington submitted an objection to the plan. Washington claims that the debtor must pay use taxes imposed by the state. The Debtor asserts that section 1146(c) of the Bankruptcy Code, 11 U.S.C. § 1146(c), exempts it from paying the tax. Washington responds that the debtor is not exempt because the property transfers which the debtor seeks to exempt occurred prior to the confirmation of the plan, or in the alternative, that the use tax is not a "stamp tax or similar tax" as contemplated by section 1146(c).

The court agrees that property transfers made prior to confirmation may be protected under section 1146(c). However, the court also finds that the particular tax in question is not a "stamp tax or similar tax." The court will, therefore, sustain Washington's objection to the plan. The court will now explain the reasons for its decision.

II. FACTS[1]

GST Telecommunications was a telecommunications firm founded in 1994. The corporation grew rapidly in its early years. It operated in eight western states, including Washington. By 1999, however, the company had experienced a reversal of fortune, and subsequently filed for bankruptcy under Chapter 11. Upon filing bankruptcy, the debtor began searching for a purchaser for its assets. Time Warner Telecom eventually agreed to purchase the assets. The court approved the asset sale on September 21, 2000. The reorganization plan has not yet been confirmed.

After court approval of the sale but prior to the confirmation of the plan, the debtor began selling assets to Time Warner. Some of these assets included personal property and realty located in Washington state. The assets in question -- primarily personal property -- are worth approximately $68 million dollars. Washington state levied a use tax against Time Warner in connection with the sale and use of the assets. The state of Washington imposes a 6.5 % tax on the value of the asset used.[2] [3] Washington defines use to include "any act by which the person using the same takes or assumes dominion or control [over the property]."[4]

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[1] Given the lengthy factual record in this case, the court will only provide the few facts that are essential for the resolution of this objection.

[2] *See* WASH. REV. CODE ANN. § 82.12.020 ("The [use] tax shall be levied and collected in an amount equal to the value of the article used by the taxpayer multiplied by the rate in effect for the retail sales tax under RCW 82.08.020."); WASH. REV. CODE ANN. § 82.12.020 ("There . . . shall be collected a tax on each retail sale in this state equal to six and five-tenths percent of the selling price.").

[3] Although the State of Washington imposes a tax rate of 6.5 %, when city, county, and other local use taxes are included, the total tax rate lies somewhere between 7.5% and 8.0%.

[4] WASH. ADMIN. CODE § 485-20-178(3).

III. DISCUSSION

Section 1146(c) of the Bankruptcy Code states:

> The issuance, transfer, or exchange of a security, or the making or delivery of an instrument of transfer under a plan confirmed under section 1129 of this title, may not be taxed under any law imposing a stamp tax or similar tax.

11 U.S.C. § 1146(c). The parties here dispute whether the transfer at issue occurred "under a plan confirmed" and whether the Washington use tax is a "stamp or similar tax." The court will first discuss whether the transfer occurred under a plan and will then determine whether the Washington use tax is a "stamp tax or similar tax."

A. "Under a Plan Confirmed"

Washington argues that the transfer here is not protected by section 1146(c) because the transfer took place before the plan was confirmed. The state cites *In re NVR, Ltd.*, 189 F.3d 442 (4th Cir. 1999), in support of its position. The *NVR* court held that only transfers occurring after the consummation of the plan are entitled to protection. The court stated, "We must conclude that Congress, by its plain language ["under a plan confirmed"], intended to provide exemptions only to those transfers reviewed and confirmed by the court." *Id.* at 458.

The *NVR* court, however, is not the only court to address this issue. In *In re Jacoby Bender*, 758 F.2d 840 (2d Cir. 1985), the Second Circuit rejected the proposition that the transfer must occur prior to confirmation. The court noted that if the transfers are "necessary to the confirmation of a plan," they may be eligible for 1146(c) protection. *See id.* at 842.

Since the Third Circuit has not yet addressed this issue, this court must determine which of these differing views to adopt. The court is persuaded that the approach taken by the Second Circuit presents the better view. The purpose of 1146(c) is to facilitate reorganization by providing tax relief to debtors and purchasers. *See id.* at 841. Although a debtor may attempt to wait until after confirmation to sell certain assets, this approach may not be viable in all cases. There are times when it is more advantageous for the debtor to begin to sell as many assets as quickly as possible in order to insure that the assets do not lose value.[5] As a result of this and other factors, it is actually more likely (and, sometimes, more wise) for debtors to sell assets prior to confirmation. *See In re Hechinger Investment Co.*, 254 B.R. 306, 320 (Bankr. D. Del. 2000) (noting that only "a very distinct minority of [bankruptcy] cases" consistently sell assets after plan confirmation). Given the reality of business and bankruptcy practice, adopting a rule that requires all bankruptcy transfers to occur post-confirmation would seem to frustrate section 1146(c)'s stated purpose of facilitating reorganization in a large number of cases.

The court also disagrees with the *NVR* court's conclusion that Congress clearly intended to exclude transfers occurring prior to confirmation. The statute requires that the transfer occur "under a plan confirmed." Congress failed to use any temporal modifiers (e.g., before, after) in the clause. Therefore, rather than being clear, the absence of a modifier renders the language subject to at least two interpretations - "under a plan *previously* confirmed" and "under a plan *subsequently* confirmed." Although section 1146(c) does not expressly state that the plan must be approved prior to the transfer, Congress has used temporal modifiers and far more specific language describing

[5] Indeed, in the present case, since the sale to Time Warner Telecom, the debtor's assets have become worthless. If the debtor had waited for confirmation of the plan (which has not yet occurred) the assets would have been difficult, if not impossible, to sell.

when the action must occur in relation to plan confirmation in other sections of the Bankruptcy Code.[6] The failure to do so in section 1146(c) would seem to indicates that Congress did not intend to restrict the section to those transfers occurring after confirmation. Moreover, the legislative history of section 1146(c) does not demonstrate a Congressional intent to impose such a restriction. *See* H.R. REP. 95-595 (1977) (failing to mention any temporal restrictions). Thus, the court is not convinced that Congress clearly intended to protect only those transfers occurring after confirmation. Given Congress's failure to explicitly exclude such transfers, a construction of "under a plan" that includes transfers made in anticipation or contemplation of a plan seems appropriate. Again, given the realities of business and bankruptcy practice, such a construction is also practical. Thus, the court is not persuaded by Washington's argument on this issue.

B. "Stamp Tax or Similar Tax"

Courts employ a five part test to determine whether a tax is a stamp or similar tax for 1146(c) purposes. The court must consider whether:

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

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[6] *See Hechinger,* 254 B.R. at 318-19. ("When Congress wants to impose a temporal conditional on a bankruptcy transaction, it does so expressly.") (citing *, e.g.,* 11 U.S.C. § 1104(a) ("At any time *after* the commencement of the case but *before* the confirmation of a plan . . .") (emphasis added); § 1105 ("At any time *before* confirmation of a plan . . .")(emphasis added); § 1121(b) ("only the debtor may file a plan until *after* 120 days after the date of the order for relief.")(emphasis added)).

In re 995 Fifth Avenue Assoc., 963 F.2d 503, 511-12 (2d Cir. 1992).

The parties apparently agree that four of the five of the elements are met here. However, the major point of contention is whether Washington's use tax is a relatively small percentage of the consideration for the underlying transfer. Washington argues that its 6.5 % tax is significantly higher than most taxes found to be stamp taxes. The debtor argues that the amount of use taxes paid amounts to a fractional percentage of the overall transaction, and is *de minimis* when compared to income taxes or other such taxes.

The court rejects the debtor's argument on this point. The *995 Fifth Avenue* court surveyed a number of cases and statutes concerning stamp taxes. *See id.* at 511-12 (collecting cases and statutes from Florida, Vermont, Connecticut, and New York). None of the taxes imposed were greater than one percent. Thus, the court concluded, "Stamp and documentary transfer taxes impose a low tax rate, typically about one percent or less of the consideration for the underlying transfer." *Id.* at 513. Based on this conclusion, the court held that New York's capital gains tax, which imposed a ten percent tax rate, "greatly exceed[ed] the tax rate used in any stamp or documentary tax." *Id.* The court therefore held that section 1146(c) did not exempt the debtor from paying the tax. *Id.*

The court is persuaded by the reasoning of the *995 Fifth Avenue* court. Since stamp taxes are generally low, only taxes with rates nearly equivalent to a one percent stamp tax rate should be considered "similar" to a stamp tax under section 1146(c). In the present case, however, Washington's 6.5% use tax is roughly six times greater than the average one percent stamp tax. The

court has not found -- and the debtor has not provided -- a single case wherein a court has held that a tax as large as the one here falls within the scope of section 1146(c). The court therefore finds that the 6.5 % use tax here is more similar to the ten percent capital gains tax in *995 Fifth Avenue*. Similar to the *995 Fifth Avenue* court, the court finds that Washington's use tax, at a rate of 6.5 %, is too large to qualify as a stamp or similar tax under section 1146(c). Thus, the debtor is not exempt from paying the tax.[7]

IV. CONCLUSION

For the foregoing reasons, the state of Washington's objection to the debtor's plan of reorganization is sustained.[8]

NOW, THEREFORE, IT IS HEREBY ORDERED that:

1. The State of Washington's objection to the debtor's plan (D.I. 2051) is SUSTAINED;

2. The Debtor is hereby ordered to AMEND its plan consistent with this ruling.

Dated: March 20, 2002

Gregory M. Sleet
UNITED STATES DISTRICT JUDGE

[7] The court further notes that although the Supreme Court has not addressed the 1146(c) issue, the Court has stated that it is not unconstitutional for a state to impose a use tax on a bankrupt estate. *See California Sate Board of Equalization v. Sierra Summit*, 490 U.S. 844, 849 (1989) ("[There is no constitutional impediment to the imposition of a sales tax or use tax on a liquidation sale.").

[8] During the confirmation hearing, Washington disclaimed any sovereign immunity arguments on this point. (Conf. Hrg. Tr. at 80)("I am not raising sovereign immunity."). In light of the court's ruling, however, any sovereign immunity arguments are moot.