

HERRICK

New York Office

2 Park Avenue

New York, New York 10016

Phone: (212) 592-1400 Fax: (212) 592-1500

Princeton Office

210 Carnegie Center Princeton, New Jersey 08540

Phone: (609) 452-3800 Fax: (609) 520-9095

Newark Office

One Gateway Center Newark, New Jersey 07102

Phone: (973) 274-2000 Fax: (973) 274-2500

LENDING AND RESTRUCTURING ALERT JULY 2008

Supreme Court: Transfer Tax Exemption Applies Only to Post-Confirmation Transfers

Overview

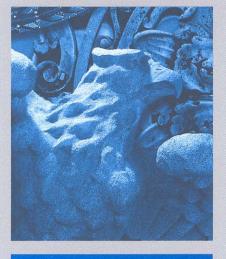
Recently, the United States Supreme Court finally resolved the long-standing dispute over whether the Bankruptcy Code's exemption from stamp or similar taxes—which include state and municipal real property transfer and mortgage recording taxes—applies to assets transferred before a Chapter 11 plan of reorganization is confirmed. In short, the answer is "no." This ruling, which represents a significant victory for taxing authorities, requires debtors to pay transfer taxes unless they postpone closings until after plan confirmation, and will affect the strategic thinking of debtors, asset purchasers, mortgage lenders and others.

Background

Pre-confirmation sales of substantial assets of debtors, generally referred to as "Section 363 sales," have become common. In practice, debtors consummate such sales in order (1) to raise money to fund plans of reorganization; (2) to maximize value as quickly as possible by selling businesses as going concerns shortly after filing for bankruptcy protection, and (3) to garner creditor support for their reorganization plans. In order to afford tax relief to debtors struggling to reorganize, some courts interpreted the Bankruptcy Code to permit debtors to sell assets before plan confirmation and still enjoy the benefit of the stamp tax exemption where the sales turned out to be essential to plan confirmation. But the Supreme Court's ruling denies bankruptcy judges such flexibility.

Impact

This ruling will affect bankruptcy strategy. Real property transfer tax rates vary from jurisdiction to jurisdiction, and you must carefully weigh their impact. In the larger, more complex Chapter 11 cases, particularly those with large real estate assets, debtors will not be able to use the lure of a tax exempt transfer to attract potential purchasers. While purchasers may still be enticed by the prospect of obtaining a court order delivering property free and clear of all liens, claims and encumbrances, and a judicial finding that they have acted in good faith, the elimination of the transfer tax exemption for preconfirmation transfers may dampen the interest of some potential purchasers, and thereby reduce the recoveries that debtors can pay their creditors. Some debtors may have to choose either to delay assets sales, and risk losing buyers, until after plan confirmation, or to accept a reduced net purchase price because the tax must be paid. Larger debtors holding multiple assets who need to dispose of some of them urgently will be harmed more than the



HERRICK

smaller debtors having fewer assets (or perhaps only one), since the smaller debtors may be able to propose and confirm a plan of reorganization in less time.

Lenders holding defaulted mortgage loans sometimes prefer to recover their collateral in a Chapter11 bankruptcy case rather than through a foreclosure sale in order to avoid having to pay state and city transfer taxes. As a result of the Supreme Court's ruling, such lenders will be required to delay taking title to the mortgaged property until after plan confirmation. This may provide some added leverage to other parties in interest in such Chapter 11 cases, who may try to enhance their recoveries or negotiate other demands or requests by attempting to obstruct or delay plan confirmation.

For further information regarding these or other lending issues, you may contact Paul Rubin at 212-592-1448 or prubin@herrick.com.

Herrick's Financial Restructuring, Bankruptcy and Creditors' Rights Practice Group represents debtors, creditors' committees, secured and unsecured creditors, trustees, financial institutions, investment banks, asset-based lenders, insurance companies, pension funds, purchasers of assets, landlords, claims traders, equipment lessors and licensors in workout, restructuring, bankruptcy, and reorganization matters. Our clients range from Fortune 500 corporations to small public and private companies. For more information on our practice, please visit www.herrick.com.

Copyright 2008 Herrick, Feinstein LLP. The Lending and Restructuring Alert is published by Herrick, Feinstein LLP for information purposes only. Nothing contained herein is intended to serve as legal advice or counsel or as an opinion of the firm.