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**IN THE UNITED STATES BANKRUPTCY COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK**

In re:)	
)	Chapter 11
ALLEGIANCE TELCOM, INC.,)	Case No. 03-13057 (RDD)
et al.,)	(Jointly administered)
)	Hearing: June 18, 2004
Debtors.)	10:00 a.m.
)	Obj. deadline: June 15, 2004

**PARTIAL OBJECTION OF STATE OF ILLINOIS TO DEBTORS MOTION PURSUANT
TO SECTIONS 105(a), 363, 365 and 1146(c) SEEKING AUTHORITY TO SELL
ASSETS OF THE ESTATE TO WEBONTAP.COM OR OTHER HIGHER BIDDER
WITHOUT PAYMENT OF STAMP AND SIMILAR TAXES**

The State of Illinois, Department of Revenue (Illinois), by its attorney, Lisa Madigan, Illinois Attorney General, hereby objects to the portion of Debtors motion for authority to sell assets of the estate to Webontap.com or other higher bidder to the extent the motion seeks a declaratory judgment that the proposed sale is exempt from stamp and similar taxes pursuant to 11 U.S.C. Section 1146(c). In support of this objection, Illinois states as follows:

1. On May 14, 2003, the Debtors filed bankruptcy petitions under Chapter 11

of the Bankruptcy Code and have acted as debtors-in-possession since that time.

2. Since the filing of the petitions, the Debtors have sold off various assets of the estate pursuant to prior Section 363 orders.

3. In the instant motion, the Debtors seek authority to sell assets of the estate outside of a confirmed plan and ask the Court to declare that the exemption from stamp and similar taxes under Section 1146(c) applies to the sale.

4. To date, the Debtors have not confirmed a plan of reorganization.

5. In attempting to justify their claim to the Section 1146(c) exemption, the Debtors state that they have filed the Second Amended Joint Plan of Reorganization which, according to the Debtors, contemplates the instant sale. They therefore assert an entitlement to claim the the Section 1146(c) exemption.

6. Section 1146(c) provides:

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.

7. The exemption does not apply to pre-confirmation sales.

The two circuit courts of appeal to decide the issue of whether the Section 1146(c) tax exemption extends to pre-confirmation sales made pursuant to Section 363 have both concluded that it does not. See *In re Hechinger Investment Co. of Delaware, Inc.*, 335 F. 3d 243 (3rd Cir. 2003); *In re NVR, LP*, 189 F. 3d 442 (4th Cir. 1999). In reaching their respective conclusions, both courts concluded that to qualify for the Section 1146(c) exemption, the transfer would have to be authorized by the terms of the confirmed plan. *Hechinger* at 257; *NVR* at 457-8.

8. Illinois recognizes that this issue has not yet been decided by the Second Circuit and that there are lower court decisions in this circuit extending the exemption to pre-confirmation sales. See *In re Smoss Enterprises Corp.*, 54 B.R. 950 (E.D.N.Y. 1985); *In re Permar Provisions, Inc.*, 79 B.R. 530 (Bankr. E.D.N.Y. 1987). However, the undeniable trend of recently reported cases clearly supports the position that Section 1146(c), as a tax exemption in derogation of a state's taxing authority, is to be narrowly construed to apply only to those transfers made pursuant to the authority of a confirmed plan. See *Hechinger, supra*, *NVR, supra*, *States of Illinois and Washington v. National Steel Corp.*, 2003 WL 22089881 (N.D. Ill. 2003). And in *In re 310 Associates, LP*, 282 B.R. 295, 300-301 (S.D.N.Y. 2002), the district court in this district, in reversing the bankruptcy court, held that the exemption does not extend to pre-confirmation sales, at least where no plan has been filed.

9. Illinois submits that under settled rules of statutory construction, Section 1146(c) must be construed to apply the transfers authorized by the terms of a confirmed plan only.

10. The exemption of Section 1146(c) does not extend to sales and use taxes or to fees or charges.

11. The motion, as well as the proposed sale order, seek to exempt so called transfer taxes but does further define or list the taxes that it seeks to have exempted. In the Asset Purchase Agreement, however, the parties define Transfer Taxes to include any sales, use, transfer, conveyance, documentary transfer, recording or other similar tax, fee or charge. There is no authority for the proposition that Section 1146(c) applies to sales and use taxes or that it applies to non-tax fees and charges. See *In re*

GST, Telecom, Inc., 2002 U.S. Dist. LEXIS 4662 (D. Del., 2002)(does not apply to sales and use taxes.)

12. Furthermore, it is a violation of due process to attempt to obtain relief which exceeds that requested in the motion.

13. The court should make no determination at this time of the applicability of Section 1146(c) to sales closed post-confirmation.

Although there apparently is a possibility that the sale may be closed after confirmation of a plan, it is not appropriate for the Court to decide at this time as part of the hearing on the Debtors Section 363 Sale Motion whether and under what circumstances the exemption might apply for two reasons.

14. First, it is speculative whether a plan will be confirmed, much less whether it will be confirmed prior to the closing of the sale.

15. Second, under a proper construction of Section 1146(c), the sale or transfer must be authorized by the confirmed plan in order to qualify for the exemption. The mere fact that a sale authorized under Section 363 closes after confirmation of a plan does not necessarily mean that the sale is authorized by the confirmed plan and that the exemption therefore applies. Such a determination can not be made where there is no plan on file and any issues involving plan confirmation are not even before the Court.

16. For example, it should be noted that the order that the Debtors currently seek is an order pursuant to Section 363. Under Section 363, the Court can authorize the Debtors to sell assets of the estate. The legal effect of plan confirmation under Section 1141, however, is to revest the assets of the estate in the debtor. Whether the

Debtors intend to seek authority as part of plan confirmation for the transfer of assets as authorized by Section 1123(b)(4) is unknown.

17. Illinois submits that while it may be possible to deal with these and related issues in the drafting of a plan in a manner that allows the Debtor to take advantage of the Section 1146(c) tax exemption, it is inappropriate for the Court to predetermine the legal effect of possible plan provisions where a plan has yet to be filed and confirmation is not before the Court.

WHEREFORE, Illinois requests that the Court deny the Debtors request for a declaratory judgment that the Section 1146(c) exemption applies to the proposed sale without prejudice to raising the issue as part of plan confirmation if the sale has not previously closed.

LISA MADIGAN
Illinois Attorney General

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CERTIFICATE OF SERVICE

The undersigned, an attorney, certifies that he served a copy of this **PARTIAL OBJECTION** on:

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by faxing a copy on May 17, 2004.

/s/ James D. Newbold
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