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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: February 19, 2004
Debtors.)	10:00 a.m.

**PARTIAL OBJECTION OF STATE OF ILLINOIS TO MOTION OF DEBTORS FOR AN
ORDER APPROVING ASSET PURCHASE AGREEMENT WITH PROPOSED
PURCHASER, AUTHORIZING SALE OF SUBSTANTIALLY ALL OF DEBTORS'
ASSETS FREE AND CLEAR OF LIENS, CLAIMS AND ENCUMBRANCES AND
RELATED RELIEF**

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 substantially all assets of the estate that 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. After the filing of their bankruptcy petitions, the Debtors explored the possibility of attempting a “stand alone” reorganization. Subsequently, at the urging of the Creditors’ Committee and the secured lenders, the Debtors explored the option of selling substantially all of their assets.

3. On December 18, 2003, the Debtors filed the instant motion seeking to establish procedures for the sale of substantially all assets of the estate to Qwest or some other higher bidder. As part of the relief requested, the Debtors asked 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 filed a plan or disclosure statement. On January 15, 2004, the Court entered an order extending the exclusive filing period through March 15, 2004.

5. In attempting to justify their claim to the Section 1146(c) exemption, the Debtors suggest that the sale may close after confirmation pursuant to the terms of the confirmed plan. At paragraphs 46-47 of the sale Motion (p. 32-33), the Debtors state that the closing of the sale is conditioned on the prior confirmation of a plan but then admit that the Debtors are free to waive the condition. Notwithstanding the fact that the sale may take place outside of a confirmed plan, the Debtors still assert an entitlement to the tax exemption on the basis that “the Sale Transaction will provide the funds necessary for the Debtors to proceed toward confirmation and consummation of a plan on a rational basis.” Sale Motion at para. 47, p. 33.

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 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 remote 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.

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

12. 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.

13. 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 reconstitute 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.

14. 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.

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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 February 11, 2004.

/s/ James D. Newbold
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