

UNITED STATES BANKRUPTCY COURT
DISTRICT OF DELAWARE

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In re : **Chapter 11**

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SOUTHERN AIR : **Case No. 12-12690 ()**

HOLDINGS, INC., et al., :

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Debtors.¹ : **Joint Administration Requested**

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**MOTION OF DEBTORS FOR AUTHORITY TO
PAY CERTAIN PREPETITION TAXES AND ASSESSMENTS PURSUANT
TO SECTIONS 105(a), 363(b), 507(a), AND 541 OF THE BANKRUPTCY CODE**

Southern Air Holdings, Inc. (“Holdings”) and its affiliated debtors in the above-referenced chapter 11 cases, as debtors and debtors in possession (collectively, the “Debtors”), submit this motion (the “Motion”) and, in support thereof, respectfully represent as follows:

Jurisdiction

1. This Court has jurisdiction over this matter pursuant to 28 U.S.C. §§ 1334(b) and 157, and the *Amended Standing Order of Reference from the United States District Court for the District of Delaware*, dated as of February 29, 2012. This is a core proceeding pursuant to 28 U.S.C. § 157(b). Venue is proper before this Court pursuant to 28 U.S.C. §§ 1408 and 1409.

¹ The Debtors in these cases, along with the last four digits of each Debtor’s federal tax identification number, are: (i) Southern Air Holdings, Inc., 6605; (ii) Cargo 360, Inc., 4233; (iii) Southern Air Inc., 2187; (iv) Air Mobility Inc., 3824; (v) 21110 LLC, 3761; (vi) 21111 LLC, 8100; (vii) 21221 LLC, 1567; (viii) 21550 LLC, 8103; (ix) 21576 LLC, 6341; (x) 21590 LLC, 8105; (xi) 21787 LLC, 0617; (xii) 21832 LLC, 7893; (xiii) 23138 LLC, 7192; (xiv) 24067 LLC, 6360; (xv) 46914 LLC, 0322; (xvi) Aircraft 21255, LLC, 5500; (xvii) Aircraft 21380, LLC, 1753; and (xviii) CF6-50, LLC, 9733. The address for all Debtors is 117 Glover Avenue, Norwalk, Connecticut 06850.



Background

2. On the date hereof (the “Petition Date”), each of the Debtors commenced with this Court a voluntary case under chapter 11 of title 11 of the United States Code (the “Bankruptcy Code”). The Debtors continue to operate their businesses and manage their properties as debtors in possession pursuant to sections 1107(a) and 1108 of the Bankruptcy Code. No trustee, examiner, or statutory committee of creditors (“Creditors’ Committee”) has been appointed in these chapter 11 cases.

3. Contemporaneously herewith, the Debtors have filed a motion requesting joint administration of the chapter 11 cases pursuant to Rule 1015(b) of the Federal Rules of Bankruptcy Procedure (the “Bankruptcy Rules”).

The Debtors’ Businesses

4. Southern Air Inc. (“Southern Air”), the Federal Aviation Administration certificated, indirect subsidiary of Holdings, is an experienced provider of long-haul, wide-body air cargo transportation services. Southern Air operates a fleet of eleven aircraft, including four Boeing 777s, four Boeing 747-400s, and three Boeing 747-200s. Southern Air’s staff and flight operations are positioned around the world to facilitate global operations for both governmental and commercial customers. Holdings is the direct or indirect parent company of the other Debtors.

5. As of Petition Date, the Debtors employed approximately 611 full-time employees. For the twelve months ended July 31, 2012, the Debtors’ unaudited and consolidated financial statements reflected revenues of approximately \$428.2 million and a net loss of \$159.8 million. As of July 31, 2012, the Debtors’ unaudited and consolidated financial statements reflected assets totaling approximately \$206.9 million and liabilities totaling approximately \$486.5 million.

6. Additional information regarding the Debtors' business, capital structure, and the circumstances leading to this chapter 11 filing is contained in the *Declaration of Daniel J. McHugh in Support of the Debtors' Chapter 11 Petitions and First Day Relief*, filed contemporaneously herewith.

The Debtors' Prepetition Taxes and Assessments

7. In connection with their businesses, the Debtors collect, withhold, or incur an assortment of taxes, including any penalties and interest thereon that have arisen prior to the Petition Date, that they remit periodically to various federal, state, and local government and certain quasi-governmental authorities (the "Taxing Authorities"). The Debtors seek authority to pay, in their sole discretion, certain of these prepetition taxes, fees, and related charges (collectively, "Taxes and Assessments")² (whether asserted before or after the Petition Date), including any Taxes and Assessments subsequently determined upon audit, or otherwise, to be due or owed. The Taxes and Assessments that the Debtors seek authority to pay are Franchise Taxes and Transportation Taxes, each as defined and discussed in more detail below.

A. Franchise Taxes

8. The Debtors are required to pay certain taxes assessed for the privilege of doing business within a particular jurisdiction ("Franchise Taxes"). The Debtors currently owe Franchise Taxes to the Delaware Secretary of State because each Debtor is incorporated in or organized under the laws of the State of Delaware. The Franchise Taxes are collected in the form of an annual fee rather than as a tax on capital stock. The Debtors estimate that, as of the

² By this Motion, the Debtors are not seeking authority to pay (a) employee withholding taxes, which are addressed in a separate motion seeking payment of employee wages and other employee-related benefits or (b) taxes owed to foreign taxing authorities, which are addressed in separate motion seeking payment of obligations to foreign creditors.

Petition Date, approximately \$175,000 in Franchise Taxes relating to the period before the Petition Date have accrued but not yet been paid.

B. Transportation Taxes

9. Pursuant to sections 4271 and 4291 of the Internal Revenue Code, the Debtors are also responsible for the collection of taxes when, among other things, engaged in the business of transporting property by air for hire (“Transportation Taxes”). In December 2011, the Debtors provided supplemental services to the United Parcel Service of America, Inc. (“UPS”) for which the Debtors collected Transportation Taxes from UPS. Such funds are currently held by the Debtors in trust for the United States and, therefore, do not constitute property of the Debtors’ estates. The Debtors estimate that, as of the Petition Date, approximately \$45,875 in Transportation Taxes relating to the period before the Petition Date has not yet been paid to the appropriate Taxing Authority.

Relief Requested

10. By this Motion, the Debtors request, pursuant to sections 105(a), 363(b), 507(a)(8), and 541 of the Bankruptcy Code authority to pay, in their sole discretion, the Taxes and Assessments in an amount not to exceed \$221,000. A list of all known Taxes and Assessments and respective Taxing Authorities is attached hereto as Exhibit A. A proposed order is attached hereto as Exhibit B (the “Proposed Order”).

Basis for Relief Requested

11. The Debtors submit that ample cause exists to authorize payment of the Taxes and Assessments, including that: (a) Transportation Taxes are not property of the Debtors’ estates and must be remitted to the applicable Taxing Authority; (b) Transportation Taxes may be entitled to priority status pursuant to section 507(a)(8) of the Bankruptcy Code and, therefore, payments of prepetition amount only affects timing of payment; (c) failure to pay

Transportation Taxes may subject the Debtors' responsible officers and directors to civil and/or criminal liability during the pendency of these chapter 11 cases; (d) notwithstanding the operation of section 525 of the Bankruptcy Code, the Delaware Secretary of State may seek to prevent the Debtors from conducting business in the State of Delaware if they fail to pay the Franchise Taxes; and (e) the Court has authority pursuant to sections 105(a) and 363(b) of the Bankruptcy to grant the relief sought herein.

A. Transportation Taxes Are Not Property of the Debtors' Estates

12. Section 541 of the Bankruptcy Code provides that all of a debtor's legal and equitable interests in property as of the petition date are property of the bankruptcy estate.

11 U.S.C. §541. Section 541(d) of the Bankruptcy Code provides, in relevant part, that:

Property in which the debtor holds, as of the commencement of the case, only legal title and not an equitable interest . . . becomes property of the estate . . . only to the extent of the debtor's legal title to such property, but not to the extent of any equitable interest in such property that the debtor does not hold.

11 U.S.C. § 541(d).

13. The Transportation Taxes collected by the Debtors from UPS constitute "trust fund" taxes, in which the Debtors hold only legal title and not an equitable interest. *See* 26 C.F.R. § 49.4291-1(Transportation Taxes are held by the collecting agent in trust for the United States). Consequently, the Transportation Taxes are not property of the Debtors' estates under section 541 of the Bankruptcy Code. *See, e.g., Begier v. IRS*, 496 U.S. 53, 59–61 (1990) (withholding taxes are property held by debtors in trust for another and, as such, are not property of debtors' estates); *City of Farrell v. Sharon Steel Corp.*, 41 F.3d 92, 95 (3d Cir. 1994) (withheld taxes were subject to a trust); *Al Copeland Enters., Inc. v. Texas*, 991 F.2d 233, 235 (5th Cir. 1993) (debtors' prepetition collection of taxes and interest thereon held subject to trust and not property of estate); *Shank v. Wash. State Dep't of Revenue (In re Shank)*, 792 F.2d 829,

830 (9th Cir. 1986) (taxes required by state law to be collected by sellers from their customers are “trust fund” taxes); *In re Am. Int’l Airways, Inc.*, 80 B.R. 102, 103 (Bankr. E.D. Pa. 1987) (excise and withholding taxes are “trust fund” taxes). Because the Transportation Taxes are not property of the Debtor’s estates, these funds are not available for the satisfaction of creditors’ claims.

B. Payment of Transportation Taxes Only Affects Timing of Payment

14. Section 507(a)(8) of the Bankruptcy Code provides priority status to certain taxes measured by income or gross receipts, excise taxes, and other types of taxes. These include required to be collected or withheld and for which a debtor is liable in whatever capacity. *See* 11 U.S.C. § 507(a)(8)(C).

15. The Debtors submit that Transportation Taxes are afforded priority status under section 507(a)(8) of the Bankruptcy Code and, therefore, must be paid in accordance with section 1129(a)(9) of the Bankruptcy Code before any general unsecured obligations of the Debtors may be satisfied. The Debtors believe that sufficient funds exist to pay all prepetition Taxes and Assessments in full under any plan of reorganization that may ultimately be proposed and confirmed by this Court. Accordingly, the Debtors submit that the proposed relief will only affect the timing of the payment of the Transportation Taxes and will not prejudice the rights of any general unsecured creditor or any other party in interest.

C. Failure to Pay Transportation Taxes May Affect Debtors’ Officers and Directors

16. Failure to pay Transportation Taxes may prompt the Internal Revenue Service to seek to collect such taxes from any of the Debtors’ responsible officers or directors. *See* I.R.C. § 6672 (imposing personal liability in connection with non-payment of “trust fund” taxes). Accordingly, to the extent that Transportation Taxes remain unpaid by the Debtors, the

Debtors' officers and directors may be subject to lawsuits or criminal prosecution during the pendency of these chapter 11 cases. The threat of a lawsuit, criminal prosecution, or any ensuing liability would distract the Debtors' officers and directors from devoting their full attention the Debtors' businesses. The dedicated and active participation of the Debtors' directors, officers, and other employees is not only integral to the Debtors' continued and uninterrupted operations, but also essential to the orderly administration of these chapter 11 cases. Based on the foregoing Debtors submit that the proposed relief is in the best interest of the Debtors and their estates.

D. The Delaware Secretary of State May Attempt to Prevent the Debtors from Conducting Business in Delaware for Failure to Pay Franchise Taxes

17. As noted above, the Debtors are required to pay Franchise Taxes to the Delaware Secretary of State. Notwithstanding the prohibition against discrimination contained in section 525 of the Bankruptcy Code, if the Debtors do not pay outstanding Franchise Taxes, the State of Delaware may seek to prevent the Debtors from conducting business in Delaware, which would cause a disruption in the Debtors' operations. Moreover, failure to pay Franchise Taxes may impact the Debtors' ability to obtain certifications of good standing, which may affect the Debtors' abilities to enter into certain business transactions.

E. The Court Has Authority Pursuant to Sections 105(a) and 363(b) to Grant the Relief

18. Section 363(b)(1) of the Bankruptcy Code provides that "[t]he trustee, after notice and a hearing, may use, sell, or lease, other than in the ordinary course of business, property of the estate." 11 U.S.C. § 363(b)(1). Pursuant to section 105(a) of the Bankruptcy Code, "[t]he court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of the Bankruptcy Code." 11 U.S.C. § 105(a). The Debtors submit that the relief requested herein is necessary and appropriate to carry out the provisions of the Bankruptcy Code.

19. The ability to pay Taxes and Assessments is critical to the Debtors' continued and uninterrupted operations. As noted above, nonpayment of these obligations may cause the Taxing Authorities to take precipitous action, including, without limitation, preventing the Debtors from conducting business in the applicable jurisdictions and subjecting the Debtors' officers and directors to civil and/or criminal liability, all of which would disrupt the Debtors' day-to-day operations and could potentially impose significant costs on the Debtors' estates and their creditors. Moreover, as explained above, the failure to pay outstanding Franchise Taxes may impact the Debtors' businesses and business relationships. Accordingly, the Debtors submit that the proposed relief is in the best interest of the Debtors and their estates.

Reservation of Rights

20. Nothing contained herein is intended to be or shall be construed as (a) an admission as to the validity of any claim against the Debtors, (b) a waiver of the Debtors' or any appropriate party in interest's rights to dispute any claim, or (c) an approval or assumption of any agreement, contract, program, policy, or lease under section 365 of the Bankruptcy Code. Likewise, if the Court grants the relief sought herein, any payment made pursuant to the Court's order is not intended to be and should not be construed as an admission to the validity of any claim or a waiver of the Debtors' rights to dispute such claim subsequently.

The Debtors Satisfy Bankruptcy Rule 6003(b)

21. Bankruptcy Rule 6003(b) provides that, to the extent relief is necessary to avoid immediate and irreparable harm, a bankruptcy court may approve a motion to "pay all or part of a claim that arose before the filing of the petition" prior to twenty-one (21) days after the Petition Date. FED. R. BANKR. P. 6003(b). As described above, the failure to pay the Taxes and Assessments may cause the Taxing Authorities to take precipitous action, including, without limitation, subjecting the Debtors' officers and directors to civil and/or criminal liability, which

would cause significant disruption to the Debtors' day-to-day operations. The Debtors believe that the relief requested herein is necessary to avoid immediate and irreparable harm to their estates. Accordingly, the Debtors submit that Bankruptcy Rule 6003(b) has been satisfied.

Waiver of Bankruptcy Rules 6004(a) and (h)

22. To implement the foregoing successfully, the Debtors seek a waiver of the notice requirements under Bankruptcy Rule 6004(a) and the fourteen (14) day stay of an order authorizing the use, sale, or lease of property under Bankruptcy Rule 6004(h).

Notice

23. No trustee, examiner, or Creditors' Committee has been appointed in these chapter 11 cases. Notice of this Motion has been provided to (a) the Office of the United States Trustee for the District of Delaware; (b) the Debtors' thirty (30) largest unsecured creditors on a consolidated basis; (c) the Securities and Exchange Commission; (d) the Internal Revenue Service; (e) the United States Attorney's Office of the District of Delaware; (f) the United States Transportation Command; (g) the Defense Logistics Agency - Energy; (h) Canadian Imperial Bank of Commerce, New York Agency ("CIBC"); (i) counsel to CIBC; (j) Oak Hill Capital Management ("Oak Hill"); (k) counsel to Oak Hill; (l) all lessors under aircraft operating leases with Southern Air; and (m) any other party directly affected by this Motion. The Debtors respectfully submit that such notice is sufficient under the circumstances.

No Previous Request

24. No previous request for the relief sought herein has been made to this or any other Court.

WHEREFORE the Debtors respectfully request entry of the Proposed Order granting the relief requested herein and such other and further relief as the Court may deem just and appropriate.

Dated: September 28, 2012
Wilmington, Delaware

/s/ M. Blake Cleary
M. Blake Cleary (No. 3614)
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*Proposed Attorneys for the
Debtors and Debtors in Possession*

Exhibit A

Taxes and Assessments

Taxing Authority	Taxing Authority Address	Description of Tax
United States Treasury	Department of Treasury Internal Revenue Service Center Cincinnati, OH 45999-0009	Transportation Tax
Delaware Secretary of State	Delaware Division of Corporation PO Box 898 Dover, Delaware 19903	Franchise Tax

Exhibit B
Proposed Order

**UNITED STATES BANKRUPTCY COURT
DISTRICT OF DELAWARE**

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: **Chapter 11**
: **Case No. 12-12690 ()**
: **Jointly Administered**
: **Re: Docket No.**
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**ORDER AUTHORIZING THE PAYMENT
OF PREPETITION TAXES AND ASSESSMENTS PURSUANT
TO SECTIONS 105(a) 363(b), 507(a), AND 541 OF THE BANKRUPTCY CODE**

Upon the motion, dated September 28, 2012 (the “Motion”),² of Southern Air Holdings, Inc. and its affiliated debtors, as debtors and debtors in possession (collectively, the “Debtors”), for authority to pay, in their sole discretion, Taxes and Assessments, including any Taxes and Assessments subsequently determined upon audit, or otherwise, to be owed, that have arisen prior to the Petition Date pursuant to sections 105(a), 363(b), 507(a)(8), and 541 of the Bankruptcy Code, as more fully set forth in the Motion; and upon consideration of the *Declaration of Daniel J. McHugh in Support of the Debtors’ Chapter 11 Petitions and First Day Relief*, and the Court having jurisdiction to consider the Motion and the relief requested therein pursuant to 28 U.S.C. §§ 157 and 1334, and the *Amended Standing Order of Reference from the United States District Court for the District of Delaware*, dated as of February 29, 2012; and

¹ The Debtors in these cases, along with the last four digits of each Debtor’s federal tax identification number, are: (i) Southern Air Holdings, Inc., 6605; (ii) Cargo 360, Inc., 4233; (iii) Southern Air Inc., 2187; (iv) Air Mobility Inc., 3824; (v) 21110 LLC, 3761; (vi) 21111 LLC, 8100; (vii) 21221 LLC, 1567; (viii) 21550 LLC, 8103; (ix) 21576 LLC, 6341; (x) 21590 LLC, 8105; (xi) 21787 LLC, 0617; (xii) 21832 LLC, 7893; (xiii) 23138 LLC, 7192; (xiv) 24067 LLC, 6360; (xv) 46914 LLC, 0322; (xvi) Aircraft 21255, LLC, 5500; (xvii) Aircraft 21380, LLC, 1753; and (xviii) CF6-50, LLC, 9733. The address for all Debtors is 117 Glover Avenue, Norwalk, Connecticut 06850.

² All capitalized terms not otherwise defined herein shall have the meanings ascribed to them in the Motion.

consideration of the Motion and the requested relief being a core proceeding pursuant to 28 U.S.C. § 157(b); and venue being proper before this Court pursuant to 28 U.S.C. §§ 1408 and 1409; and due and proper notice of the Motion having been provided to the parties listed therein, and it appearing that no other or further notice need be provided; and the Court having reviewed the Motion; and the Court having determined that the legal and factual bases set forth in the Motion establish just cause for the relief granted herein; and it appearing that the relief requested in the Motion is in the best interests of the Debtors and their respective estates and creditors; and upon all of the proceedings had before the Court and after due deliberation and sufficient cause appearing therefor,

IT IS HEREBY ORDERED THAT:

1. The Motion is GRANTED.
2. The Debtors are authorized, but not directed, to the extent consistent with the terms and conditions of the DIP Credit Agreement,³ pursuant to sections 105(a), 363(b), 507(a), and 541 of the Bankruptcy Code, to pay, in their sole discretion, the Taxes and Assessments; *provided, however*, that payments on account of the Taxes and Assessments shall not exceed \$221,000.
3. Nothing contained in this Order or in the Motion is intended to be or shall be construed as (a) an admission as to the validity of any claim against the Debtors, (b) a waiver of the Debtors' or any appropriate party in interest's rights to dispute any claim, or (c) an approval or assumption of any agreement, contract, program, policy, or lease under section 365 of the Bankruptcy Code. Likewise any payment made pursuant to this Order is not intended to

³ The DIP Credit Agreement shall mean that certain Senior Secured Super-Priority Debtor-in-Possession Credit Agreement, by and among Cargo 360, CIBC, and various financial institutions and other persons from time to time parties thereto, dated as of September 28, 2012.

be and shall not be construed as an admission to the validity of any claim or a waiver of the Debtors' rights to dispute such claim subsequently.

4. The requirements of Bankruptcy Rule 6003(b) have been satisfied.

5. The requirements of Bankruptcy Rule 6004(a) are waived.

6. Notwithstanding any applicability of Bankruptcy Rule 6004(h), the terms and conditions of this Order shall be immediately effective and enforceable upon its entry.

7. The Debtors are authorized to take all steps necessary to carry out this Order.

8. This Court shall retain jurisdiction to hear and determine all matters arising from or related to the implementation, interpretation and/or enforcement of this Order.

Dated: _____, 2012
Wilmington, Delaware

UNITED STATES BANKRUPTCY JUDGE