

## DECISION OF MUNICIPAL TAX HEARING OFFICER

January 17, 2012

### *Taxpayer's Representative's Name*

*Taxpayer*  
License Nos. *ABCDE and 12345*  
MTHO #659 & 660

Dear *Taxpayer's Representative*:

We have reviewed the evidence and arguments presented by *Taxpayer* and the City of Chandler (Tax Collector or City) at the hearing on December 7, 2011. The review period covered was March 2007 through December 2010. Taxpayer's protest, Tax Collector's response, and our findings and ruling follow.

### Taxpayer's Protest

Taxpayer held deeds of trust on two properties in the City securing loans for the purchase of the properties by the owners. The owners of the properties (the debtors on the deeds of trust) leased the properties to tenants. The owners/debtors failed to pay privilege taxes to the City on their leasing activity and also defaulted on their payments to the lender. Taxpayer, as the assignee of the loan and loan documents, foreclosed on the properties and acquired the properties at the trustee's sale through a credit bid. The City assessed Taxpayer for delinquent privilege taxes due from the owners under Chandler Tax Code (CTC) § 62-595 as the owners' successor. Taxpayer was not a successor to the owners and did not pay purchase money from which taxes could be withheld. Taxpayer is not liable for the owners' delinquent taxes under the City's successor liability statute.

### Tax Collector's Response

Taxpayer was the mortgage holder on the properties in question and acquired title to the properties from the predecessor through a credit bid at a trustee's sale. Upon acquisition Taxpayer became the landlord on the properties responsible for payment of taxes on lease receipts generated from the tenants. By acquiring the properties at the trustee's sales, Taxpayer was the purchaser of the properties and could withhold "purchase money" to satisfy the unpaid tax liability by adjustment of the underlying mortgage debt. Taxpayer is therefore a successor to its predecessors and is liable for all tax, penalty, interest and fees assessed.

### Discussion

Taxpayer held deeds of trust on two properties in the City securing loans for the purchase of the properties by the owners. The owners leased the properties to tenants. The owners failed to pay privilege taxes to the City on their leasing activity. Because the owners failed to pay privilege taxes to the City on their leasing activity, the Tax Collector issued jeopardy assessments to the owners for the delinquent taxes. The assessments became final and were not paid.

The owners also defaulted on their payments to the lender. Taxpayer, as the assignee of the loan and loan documents, foreclosed on the properties. The properties were sold at a trustee's sale under the deeds of trust and Taxpayer acquired the properties through a credit bid. Taxpayer sold the properties to unrelated third parties in July 2011.

Because the prior owners had not paid the assessments, the Tax Collector assessed Taxpayer for the owners' unpaid privilege taxes under CTC § 62-595(d) as the owners' successor. The question presented is whether Taxpayer became liable for the prior owners' privilege taxes by virtue of acquiring the property through a credit bid at the trustee's sale?

A similar question was addressed by the Arizona Supreme Court in *In re McKeever*, 169 Ariz. 312, 819 P.2d 482 (1991). McKeever had repossessed leased business premises for the tenants' failure to pay rent and also took possession of the assets that they had sold to the tenants. The tenants had also failed to pay City of Prescott privilege taxes. The city argued that McKeever were liable for the tenants' unpaid privilege taxes as successors because they had repossessed the premises and took possession of the assets of the tenants' business.

The Arizona Supreme Court held that to have successor liability under section 595(d)(2) of the Model City Tax Code, one must be a purchaser of a business or stock of goods. Where there is a simple repossession of a business with nothing more, there is no source from which to withhold purchase money. A person acquiring property cannot withhold purchase money unless the transaction generates purchase consideration such that the purchaser is in a position to account for his predecessor's tax liability. The Court further held that McKeever were also entitled to take possession of the fixtures, equipment and inventory pursuant to their rights under the security agreement without successor liability attaching because no purchase consideration was generated.

Similarly here, Taxpayer's foreclosure of its deeds of trust and acquiring the property through a credit bid did not generate purchase money to be applied to the prior owners' tax liability. No purchase money was being paid to the owners from which monies could be withheld.

The Tax Collector argued that this case is different from *McKeever* because this case involves the foreclosure of a deed of trust and the sale of the properties to Taxpayer and not a repossession of leased property by the lessor. The lessor already had title to the property before the repossession. We do not believe that is a legally meaningful distinction. First, *McKeever* involved not only the repossession of a leasehold interest pursuant to a landlord's lien, but also the possession of the tenants' fixtures, equipment and inventory under a security agreement. The Court held that neither event gave rise to successor liability.

Second, no cases have been cited and we have found no authority that would support such distinction. Both cases cited in *McKeever* and subsequent cases citing *McKeever* involved the foreclosure of liens and security interests. For example, *State v. Standard Oil Co.*, 39 Ohio St.2d 41, 313 N.E.2d 838 (1974)(cited in *McKeever*) stated that foreclosure of defaulting debtor's property by a creditor holding a perfected security interest in such property was not a "sale" within the meaning of successor liability statute. Similarly, *Lks Pizza, Inc. v. Com. ex rel. Rudolph*, 169 S.W.3d 46 (KY 2005)(citing *McKeever*) held that if a secured creditor acquires assets as a result of a foreclosure in which no consideration changes hands, that creditor does not thereby become liable for the debtor's unpaid sales taxes and *Lloyds Bank PLC v. State*, 109 Nev. 1111, 864 P.2d 298 (1993)(also citing *McKeever*) held that a secured creditor who acquires title to collateral by credit bidding at a foreclosure sale is not a "purchaser" under the successor liability statute. When there is

no fund available from which a successor can withhold the amount of the tax debt, the obligation to withhold does not arise. *Northern Lights Inn v. Employment Sec. Div.*, 695 P.2d 723 (Alaska 1985).

The Tax Collector also argued that Taxpayer assumed the responsibilities of the prior landlord and had the right to collect rents, current and any past due, do required maintenance and undertake other obligations of a landlord. These, however, were activities undertaken after the foreclosure. While these may be considerations in determining whether Taxpayer was liable for privilege taxes during the post foreclosure periods, that question is not before us now. As the Court stated in *McKeever*, successor liability is measured by the mechanism used to acquire the property.

Finally, our conclusion is supported by the language of CTC § 62-595(c), which states:

(c) Any person who purchases, *or who acquires by foreclosure*, by sale under trust deed or warranty deed in lieu of foreclosure, or by any other method, improved real property or a portion of improved real property for which the Privilege Tax imposed by this Chapter has not been paid shall be responsible for payment of such tax as a speculative builder or owner builder, as provided in Sections 416 and 417. (Emphasis added)

As the Court in *McKeever* noted, subsection (c) is the only subsection that refers to acquisition by foreclosure. Subsection (c) is limited to speculative builder situations. If the general provisions of section 595 applied to acquisition by foreclosure, it would not have been necessary to specifically add acquisition by foreclosure to subsection (c).

Based on all the above, we conclude Taxpayer's protests should be granted. The City's successor liability assessments against Taxpayer must be vacated.

#### Findings of Fact

1. ***Big Farm Partnership, Ltd.*** and ***Big Time Investments, LLC*** (Owners) owned two commercial properties in the City.
2. Owners purchased the properties with proceeds from a loan from ***Highly Reputable National Bank Association***.
3. The loan was secured by deeds of trust on the properties, assignment of leases and rents, security agreements and fixture filing (Loan Documents).
4. The Loan Documents were assigned to ***Great State Banking NA*** as Trustee for the Registered Holders of ***Top Notch Securities Corp., Commercial Mortgage Pass-Through Certificates, Series ABC-123 (Trustee)***.
5. The Owners leased the properties to tenants but failed to pay privilege taxes to the City on their commercial leasing activity.
6. The Tax Collector issued assessments to the Owners for the period March 2007 through December 2010 for privilege taxes due on the leases of the two properties in the total amount of \$46,607.63, consisting of privilege tax, penalties, interest and license fees.
7. The Owners failed to pay the assessments.
8. The Owners also defaulted on the loan.
9. The Trustee commenced steps to foreclose on the deeds of trust securing the loan.

10. As a part of the foreclosure process the Trustee assigned the Loan and the Loan Documents to Taxpayer.
11. The Trustee was the sole member of Taxpayer.
12. The Trustee held a trustee's sale on February 4, 2011.
13. Taxpayer, as the beneficiary of the deeds of trust, acquired the properties through a credit bid.
14. There were no surplus proceeds generated at the sale.
15. Taxpayer thereafter sold the properties to an unrelated third party on July 12, 2011.
16. During the period February 4, 2011 to July 12, 2011 Taxpayer maintained the commercial leases of the properties.
17. The Tax Collector issued two assessments to Taxpayer as successor to the Owners for the Owners' failure to pay the assessments previously issued to them.
18. Taxpayer timely protested the assessments contending that it was not a successor to the Owners and was therefore not liable for privilege taxes owed by the Owners.
19. The Tax Collector also issued two assessments to Taxpayer for privilege taxes due for the period January 2011 through June 2011, during which period Taxpayer held the properties and maintained the commercial leases on the properties.
20. The Tax Collector accepted Taxpayer's protests as protests of all amounts assessed.
21. At the hearing in this matter the parties agreed that this case only involves the successor liability assessments. The assessments to Taxpayer for the period January 2011 through June 2011 are not before the Hearing Officer at this time.

#### Conclusions of Law

1. CTC § 62-445 imposes the city privilege tax on the business activity of renting, leasing or licensing for use real property located in the city.
2. Owners owed privilege taxes on the lease of their properties in the City.
3. Taxpayer held deeds of trust on Owners' properties to secure loans made to Owners.
4. Owners defaulted on their loan payments.
5. Taxpayer foreclosed on the deeds of trust and the properties were sold by the Trustee at a trustee's auction.
6. Taxpayer acquired the properties through a credit bid at the auction.
7. CTC § 62-595(d) requires a person's successors or assignees to withhold from the purchase money an amount sufficient to cover the taxes required to be paid, and interest or penalties due and payable, until the former owner produces a receipt from the Tax Collector showing that all City tax has been paid or a certificate stating that no amount is due as then shown by the records of the Tax Collector.
8. CTC § 62-595(d)(2) provides that if the purchaser of a business or stock of goods fails to obtain a certificate as provided by this Section, he is personally liable for payment of the

amount of taxes required to be paid by the former owner on account of the business so purchased, with interest and penalties accrued by the former owner or assignees.

9. To have successor liability under CTC § 62-595(d)(2), one must be a purchaser of a business or stock of goods. *In re McKeever, supra.*
10. A person acquiring property cannot withhold purchase money unless the transaction generates purchase consideration such that the purchaser is in a position to account for his predecessor's tax liability. *In re McKeever, supra.*
11. Where there is a simple repossession of a business with nothing more, there is no source from which to withhold purchase money. *In re McKeever, supra.*
12. The fact that the repossessed property was subsequently sold to satisfy the lien is not relevant. Successor liability is measured by the mechanism used to acquire the property, not by the fact that it is subsequently sold. *In re McKeever, supra.*
13. Taxpayer's foreclosures of its deeds of trust were legal remedies and not the purchase of a business or stock of goods under CTC § 62-595(d).
14. Taxpayer is not liable under CTC § 62-595(d) for the Owners' privilege tax liabilities.
15. Taxpayer's protest should be granted.

#### Ruling

Taxpayer's protest of the City's Notices of Successor Liability Assessments issued May 18, 2011 is granted.

The Tax Collector is directed to abate the successor liability assessments and to remove all taxes assessed on Taxpayer for privilege taxes due for the period March 2007 through December 2010.

The parties have timely rights of appeal to the Arizona Tax Court pursuant to Model City Tax Code Section -575.

Sincerely,

Hearing Officer

HO/7100.doc/10/03

c: ***Tax Audit Supervisor***  
Municipal Tax Hearing Office