



STATE BOARD OF EQUALIZATION

June 27, 1967

To: San Jose - Auditing
From: Tax Counsel (EDM)

We regret our delay in reply to your memoranda of April 3 and June 15, in which you ask our opinion with respect to the application of the tax to the following sales transaction and security arrangements.

In November of 1963, "A", owners of a restaurant business and equipment therein, sold the business and equipment to "B" pursuant to a purchase money chattel mortgage. The original sales price was \$100,000. The equipment assets declared value was \$32,000. There is a valuable lease involved and improvements. The down payment was \$15,000 with payments of \$750 per month. "B" paid about \$44,000 before he defaulted. With interest, the balance is about \$78,000. "A" (the secured party) repossessed the property under the purchase money chattel mortgage on "B"'s default. "A"'s action was taken pursuant to an agreement with "B" entered into on March 1, 1967, whereby "A" proposed to retain the collateral (property) covered by said chattel mortgage, in full satisfaction of the mortgagor debtor's ("B") obligation.

Where a purchaser-mortgagor is in default and the seller-mortgagee reacquires the property by agreement pursuant to a purchase money mortgage and the only consideration received by the mortgagor from the mortgagee is a cancellation of the unpaid balance of the mortgage note, it has been our position that the reacquisition does not constitute a taxable sale.

On the other hand, where a purchasing-mortgagor under a nonpurchase money mortgage defaults in payment and, by agreement in lieu of foreclosure, transfers his beneficial interest and title in the mortgaged property to the seller-mortgagee in exchange for a cancellation of the mortgagor's obligation under the chattel mortgage, we believe that the reacquisition by the seller-mortgagee constitutes a taxable sale under Section 6006(a) in that it entails a transfer of title of tangible personal property for a consideration.

Inasmuch as the subject sales transaction and security arrangement appears to fall within the purchase money mortgage category, we are of the opinion that "A"'s reacquisition of the restaurant equipment does not constitute a taxable sale. This conclusion is attributable to the fact that when "B" defaulted on its "purchase money mortgage" and "A" reacquired the property in full satisfaction of "B"'s mortgage obligation, it could not be said that "B" entered into an entirely separate transaction whereby he transferred title in tangible personal property to "A" •

For your further information, with respect to this matter, we are enclosing a letter relating to a similar problem from the Attorney General's office to this Board dated April 28, 1952.

EDM:mm [lb]