



A TAX CONVERSATION WITH PAT DERDINGER

Patrick Derdinger is a respected Arizona tax authority, and is a partner with the Phoenix office of the Washington-based law firm of Steptoe & Johnson LLP. He received his undergraduate degree from Loyola University of Los Angeles in 1968, his M.B.A. and J.D. degrees from the University of Southern California and his LL.M. degree in taxation from The George Washington University. Mr. Derdinger advises business clients on the state and local tax implications of their transactions and represents them in income, sales, use and property tax matters. His clients include high-technology businesses, electric utilities, telecommunications companies, mines, railroads, manufacturers, retailers, banks, and e-commerce. Mr. Derdinger has been listed in The Best Lawyers in America since 1995. His professional affiliations have included the State Bar of Arizona as chair of the Tax Section, and also of the Tax Law Advisory Commission. He serves as the chair of the Arizona Chamber of Commerce's Tax Policy Committee. In addition to those professional memberships, Mr. Derdinger is a frequent lecturer on state and local tax subjects and has contributed the Arizona chapters to many national tax publications, such as CCH "Business Incentives Guide," ABA Sales and Use Tax Deskbook, ABA Property Tax Procedures Handbook, and "ABA State and Local Tax Lawyer."

Richard Marmor, chair of AZSA's Legal and Legislative Committee, sat down with Pat and put some self-storage related tax questions to him.

AZSA: Some operators still challenge the idea that sales tax applies to fees, e.g. late fees, just as it does to rents. Exactly what law is being applied?

Derdinger: [To make it easier to understand,] I wish I could point to a statutory or regulatory provision that specifies late fees are taxable under the rental of commercial property classification as additional rental income. I also searched the DOR [Department of Revenue] published and private rulings and found none specifically on point. But, knowing the DOR as you and I do, they will undoubtedly consider such late fees as taxable. DOR regulation R15-5-1604, dealing with the determination of gross income under the commercial lease classification, does state that "gross income under the commercial lease classification shall include *all amounts paid to or on behalf of the lessor*, including but not limited to the following..." While the list that follows does not include late fees, the phrase "all amounts paid to the lessor" should be broad enough to cover late fees, since those fees are required by the rental agreement and arise out of the rental transaction.

AZSA: What about tax on auction sales? Is the Department of Revenue within their rights to collect sales tax from us on the auction proceeds?

Derdinger: I take it you are talking about the mini storage owner's or agent's sale of the personal property that was stored by the deadbeat customer. "Sale" is defined pretty broadly [in] ARS § 42-5001, the sales tax statutes, and would include a foreclosure sale by the mini-storage owner. And if you are talking specifically about auction sales, the Sales Tax Regulations provide that sales by auctioneers are taxable, since auctioneers are viewed as being in the business of selling tangible personal property.

AZSA: It's not as if self-storage auctions happen daily. Could it not be argued that our auctions are merely "casual sales" and therefore are not taxable?

Derdinger: While "casual sales" are not subject to the sales tax, a casual sale is an "occasional transaction of an isolated nature made by a person who is not engaged in the business of selling ...the same type or character of property as that which was sold." (Department of Revenue Regulation R15-5-2001.1.) As an example, a garage sale that I put on at my home once every few years would be a casual sale, but if I went to the flea market every week and sold stuff, that would not be a casual transaction. As a further example, the Department considers the sale of off-lease automobiles or repossessed autos by a bank as not being casual, since they are making such sales regularly. I am afraid the Department would view the mini-storage sales similarly and not as casual sales.



AZSA: What tax rate would apply to our auction sales?

Derdenger: I believe that the Department of Revenue and the city where the sale took place would argue that everything that was paid was consideration for the auction sale of the boat or auto, or whatever, and the retail sales tax rate (for the county and the city where the sale took place) would apply to everything, as opposed to the lower commercial lease rate.

AZSA: Technically, the first dollars we receive on any auction sale represent a recovery of our costs of sale. Do we have to charge tax on that portion of the sale, too?

Derdenger: There is no deduction under the retail classification – or the commercial rental classification for that matter – for the costs of the sale. The tax is imposed on “gross receipts.” It doesn’t work like an income tax which is traditionally imposed on net income, after deduction the costs of the business activity.

AZSA: What about the argument that a foreclosure is really a substitute for the rent that was due and therefore should be taxable at the much lower commercial lease rate?

Derdenger: This is a "toughie." I understand the point you are making – by selling the property, you are only trying to recoup the back rent that was not paid by the “deadbeat” tenant, and shouldn’t that be taxed at the commercial rental rate? I am afraid though that the Department of Revenue would view the transaction as a sale and tax it under the higher retail rate since *in form* the transaction is a sale and not a commercial rental.

Bottom line: You are safer collecting the tax on everything at the retail rate (both state and city).

AZSA: OK, but let me try one other angle. When we sell a padlock, we own that padlock; we’re selling *our* property. That’s clearly a retail sale. However, when we auction off a unit, the property being sold belongs to the tenant. All we’re doing is engineering some sale conditions so we can collect our back rent. Doesn’t that suggest that the transaction is not a true sale as far as we’re concerned?

Derdenger: I made the same good argument [in tax court] for one of the state's largest auctioneers . . . but to no avail – the Department of Revenue's position is that an auctioneer is engaged in the business of selling tangible personal property and is taxable even though the auctioneer doesn't have title to the goods, much like a consignee . . . The safest (and most conservative) procedure for you is to treat the auction sales as taxable [as retail], and let the bidders know before the auction that applicable sales tax will be added to their bid amount. And if I were a sales tax knowledgeable auctioneer, I would require such a procedure and I would report and pay it to the State and city directly.

AZSA: So essentially, everything is taxable . . . period. Boy, you can’t win. Thanks, Pat.

Derdenger (jokingly): Isn’t tax fun!