

**IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE**

In re:

SGR WINDDOWN, INC., *et al.*

Reorganized Debtors.¹

Chapter 11

Case No. 19-11973 (MFW)
(Jointly Administered)

Hrg Date: December 3, 2020 at 10:30 a.m.
Re: D.I. 710, 724, 743 and 752

**DEBTORS' REPLY IN SUPPORT OF OBJECTION TO CLAIM
NUMBER 205 OF THE NEW YORK CITY DEPARTMENT OF FINANCE**

SGR Winddown, Inc., a Delaware corporation, and its affiliated debtors and debtors in possession (collectively, the “Debtors”), by and through their counsel, hereby submit this Reply to the *New York City Department of Finance’s Memorandum Of Law in Opposition to Debtors’ Memorandum Of Law and Second Omnibus Objection to DOF Claim No. 205* [Dkt. No. 752] (the “Opposition”) and with reference to the *Response of The New York City Department of Finance to Debtors’ Second Omnibus Objection to Claim No. 205* [Dkt. No. 724] and the *Debtors’ Memorandum in Support of Objection to Claim Number 205 of the New York City Department of Finance* [Dkt. No. 743] (the “Debtor’s Brief”).

THE CITY’S POSITION IS THE PROVERBIAL SLIPPERY SLOPE

1. The City acknowledges that leases are a form of personal property. Opp. at ¶ 9. The crux of the City’s argument is that the CRT is not a tax on personal property because it applies only to leases that are used for commercial purposes. Opp. at ¶ 15 (arguing that the CRT is not a property tax because of “the key distinction . . . between residential and commercial leaseholds”). According to the City, the transaction giving rise to the CRT is “the Debtors’ entry into a commercial lease with the intent of using such ‘taxable premises’ for commercial purposes.” Opp. at ¶ 26. Under

¹ The Reorganized Debtors in these chapter 11 cases, along with the last four digits of each Debtor's federal tax identification number or Canadian Revenue Agency, as applicable are (1) SGR Winddown, Inc. (4356), (2) SGR Winddown International, LLC (1254) and (3) SGR Canada Winddown Legacy, Ltd. (4480). The location of the Reorganized Debtors' corporate headquarters is 4712 Admiralty Way #552, Marina Del Rey, CA 90292.

this view, the CRT attaches when a commercial lease is signed (i.e., the personal property rights under a lease are granted to the taxpayer), creating an excise tax under section 507(a)(8)(E) because it arises from the “transaction” of signing the lease (as opposed to owning the lease). In this way, according to the City, a personal property tax can be transformed to an excise tax if it is limited to only a subset of property owners or only to a specific geographic region. The City cites to no case law or other support for this kind of rationale, nor does there appear to be any. And for good reason: if the City’s argument holds, *virtually any property tax could be characterized as an excise tax*. The exception will have swallowed the rule.

2. In actuality, and as the Court in *Ampco Printing-Advertisers’ Offset Corp. v. City of New York*, 14 N.Y.2d 11 (1964)² already held, the CRT is a form of tangible personal property tax. These personal property taxes are common throughout the United States, and (as with the CRT) in most instances they are limited to personal property that is used for commercial purposes. *E.g.*, Joyce Errecart, Ed Gerrish, and Scott Drenkard, *States Moving Away from Taxes on Tangible Personal Property*, Tax Foundation Background Paper No. 63 (Oct. 2012)³ (“All states except Oklahoma have exempted from their TTP tax goods that are not used for the production of income, such as household items like furniture and jewelry. . . . While the tax is often labeled a tax on personal property to distinguish it from taxes on real property, because most states have exempted personal property used for personal reasons, most citizens are not aware that the tax on personal property exists.”).

3. Personal property taxes are traditionally acknowledged to be property taxes for purposes of section 507(a)(8)(B). *E.g.*, *In re Precision Concepts, Inc.*, 305 B.R. 438 (Bankr.

² The City relies heavily on *Ampco* but failed in its Opposition to recognize *Ampco*’s primary holding that the CRT is a form of tangible personal property taxation.

³ Available at <https://files.taxfoundation.org/legacy/docs/bp63.pdf>.

M.D.N.C. 2004) (taxes on equipment and machinery used for commercial purposes treated as property taxes under section 507(a)(8)(B)); accord *In re Wang Zi Cashmere Products, Inc.*, 202 B.R. 228 (Bankr. D. Md. 1996); *In re Probulk Inc.*, 2010 WL 5376284 (Bankr. S.D.N.Y. Dec. 23, 2010). The City does not cite to any cases treating personal property taxes under section 507(a)(8)(E), nor do any appear to exist. The City's position, however, would change that. Just as the CRT could be transformed into a tax on the "transaction" of "enter[ing] into a commercial lease with the intent of using such 'taxable premises' for commercial purposes," Opp. at ¶ 26, now tangible personal property taxes would be transformed into an excise tax on the "transaction" of purchasing equipment or other personal property for commercial purposes. Overnight, the priority treatment of these taxes would triple, causing material hardship for future debtors.

4. As the Sixth Circuit Court of Appeals warned in *In re Mansfield Tire & Rubber Co.*, 942 F.2d 1055, 1060 (6th Cir. 1991), bankruptcy courts must be wary of how state and local governments characterize their taxes in order to avoid them from "promot[ing] their own claims within the federal priority scheme." That warning must weigh heavily in this case, where a decision in favor of the City could have dramatic unintended consequences. Below is a list of just a few of the ways that traditional property taxes could now be treated as excise taxes under section 507(a)(8)(E):

- A tax on real property in areas zoned for commercial use would now be an excise tax, because the tax only applies to property that can be used for commercial use and in specific geographic reasons;
- A tax on real property that is used only for residential purposes would now be an excise tax, because the tax only applies to property used for a specific purpose (non-commercial);
- A tax on livestock raised for sale would now be an excise tax because the tax only applies to personal property used for commercial purposes; and
- A tax on inventory would now be an excise tax because inventory, by definition, is used only for commercial purposes.

Accordingly, the City would transmogrify almost any tax obligation into an excise tax, thereby elevating the priority of its claims (and other similarly situated taxing entities) above the priority intended by Congress to the detriment of other creditors.

5. In their Brief, the Debtors discussed the negative policy implications and unintended consequences from accepting the CRT's position. Notably, the City *did not address* these arguments or clarify why they are unfounded, saying only that "the Debtors are confusing an activity i.e., operating a business, with property ownership." Opp. at ¶ 16. The City's silence on this point is deafening.

ADMINISTRATIVE EXPENSES MUST BE CONSTRUED NARROWLY

6. Where there is doubt about interpreting administrative expenses, a court should ere on the side of promoting equal treatment and distributions in a bankruptcy case. As this Court has said, "priority claims are narrowly construed" and "[c]laimants who seek payment ahead of other unsecured claims bear the burden of establishing that their claim qualifies for priority status." *In re Unidigital, Inc.*, 262 B.R. 283, 288 (Bankr. D. Del. 2001). *See also In re Montaldo Corp.*, 207 B.R. 112, 114 (Bankr. M.D.N.C. 1997) ("There is a presumption favoring an equal distribution of a bankrupt debtor's limited resources. Consequently, the canon of construction to be followed in construing a statutory priority is that a priority should be narrowly construed."). Similarly, as the District Court stated in *Continental Airlines*:

Equality of distribution among claimants is a central policy of the Bankruptcy Code. Priority should not be afforded unless it is founded on a clear statutory purpose. If a claim does not comport with the language and underlying purpose of § 503 the claim must fail. ***In other words, if one claimant is to be preferred over others, the purpose should be clear from the statute.***

Since the presumption in bankruptcy cases is that the debtor's limited resources will be equally distributed among his creditors, statutory priorities are narrowly construed. Any preference for claims not intended by Congress to have priority would dilute the value of the intended priority and thus frustrate the intent of

Congress.

In re Continental Airlines, Inc., 148 B.R. 207, 211 (D. Del. 1992) (internal citations and quotations omitted; emphasis added).

7. The City has not provided – and cannot provide – this Court with any credible justification for treating the CRT as an excise tax under section 507(a)(8)(E). Indeed, as discussed in the Debtor’s Brief and this Reply, the better reading, particularly in light of the mandate that priority claims are to be narrowly construed, is that the CRT is a personal property tax under section 507(a)(8)(B). That reading preserves the status quo for treating personal property taxes under the priority scheme and honors the interpretive guidance for applying skepticism towards governmental attempts to prefer their recoveries over other creditors.

8. The Debtors respectfully request that their objection to the City’s claims in these cases should be sustained, as set forth more fully in the Debtor’s Brief.

Dated: November 30, 2020

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