

Court Denies City of Chicago's Tax on Assignments of Mortgages

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In October 2015, we discussed Cook County, Illinois circuit court cases *City of Chicago v. KTCP* and *Halsted West v. City of Chicago*, which held that an assignment of a mortgage is a transfer of a "beneficial interest in real property" and therefore taxable under the City of Chicago's Real Property Transfer Tax Ordinance ("Transfer Tax Ordinance"). On Dec. 22, 2016, the Illinois appellate court overturned the circuit court's ruling in the *Halsted West* case and in similar circuit court case involving another note purchaser, in the consolidated case *City of Chicago v. Elm State Property*.

In each of the underlying cases, a lender sold a secured promissory note to an unrelated third party and concurrently assigned the rights under its mortgage to the note purchaser. Several months after the notes were sold, the new holders of the notes entered into deed in lieu of foreclosure agreements with the respective borrowers. Upon recording the deeds in lieu of foreclosure, the city asserted that the assignments of mortgage preceding the deeds were taxable transfers of "beneficial interests" in real property for value and not exempt under the Transfer Tax Ordinance. The assertion of the tax was in furtherance of the recent policy change within the city's Department of Finance to tax transactions by entities that purchase mortgage-backed debt with a "loan to own" strategy, seeking to tax transactions by non-lenders or, according to the city, those who "take an assignment of a mortgage...for the primary purpose of obtaining title to the property for developing, investing in or using the real property itself."

The note holders in the *underlying* cases appealed the tax to the administrative level and were successful. The city appealed the administrative law judge's decisions to the circuit court which ruled that the term "beneficial interest" in the Transfer Tax Ordinance was ambiguous and held that an assignment of a mortgage is a transfer of a "beneficial interest in real property." The appellate court in *Elm State Property* disagreed with the circuit court and found that: (a) the term "beneficial interest in real property" is not ambiguous; (b) the plain language of "beneficial interest in real property" denotes indicia of ownership in or control of real property; and (c) a mortgage is a lien and not an ownership interest or controlling interest in real property.

The appellate court was not persuaded by the city's argument that the transfers should be taxed because the loans were in default, allowing the lenders to exercise their remedies under the loan documents, such as taking possession of the property and receiving the property's rents. The appellate court held that a mortgagee exercising its remedies under the loan documents does not change the mortgagee's interest in the property to that of taxable ownership or controlling interest in the property. Finally, in further support of its reasoning, the appellate court cited the Illinois Real Estate Transfer Tax Law (RETTL) that grants home rule municipalities such as Chicago the right to tax transfers in real estate. In reviewing the language of the RETTL, the appellate court found that the Illinois legislature intended to grant municipalities the power to tax only the transfers of ownership interests in property, not mortgage or other lien interests.

The *Elm State Property* decision reinforces prior presumptions that assignments of mortgages are not taxable transfers of real property under the Transfer Tax Ordinance. We note, however, that the *Elm State Property* decision did not address the scenario in the *KTCP* case where the transfer of the mortgaged property from the borrower to loan purchaser occurred simultaneously with the loan sale. Accordingly, until the appellate court addresses such scenario, those purchasing loans secured by Chicago real estate should still heed the circuit court's decision in the *KTCP* case and avoid performing a deed in lieu of foreclosure concurrently with the purchase of the loan through a tri-party agreement

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or other arrangement.

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