DECISION OF MUNICIPAL TAX HEARING OFFICER

Decision Date: October 4, 2004
Decision: MTHO #188
Tax Collector: City of Tucson
Hearing Date: August 20, 2004

DISCUSSION

Introduction

On May 14, 2004, ***Taxpayer*** ("Taxpayer") filed a protest of a tax assessment made by the City of Tucson ("City"). After review, on May 27, 2004, the City concluded the protest was timely and in the proper form. On June 1, 2004, the Municipal Tax Hearing Officer ("Hearing Officer") ordered the City to file a response to the protest on or before July 16, 2004. On June 4, 2004, the City filed a response. On June 25, 2004, the Hearing Officer ordered the Taxpayer to file any reply to the City on or before July 16, 2004. On July 2, 2004, a Notice of Tax Hearing ("Notice") was issued setting the matter for hearing commencing on August 20, 2004. On July 9, 2004, the Taxpayer filed a reply. Both parties appeared and presented evidence at the August 20, 2004 hearing. On August 21, 2004, the Hearing Officer indicated the record was closed and a written decision would be issued on or before October 5, 2004.

The issues in this case concern a parcel of property located in the City on the southeast corner of _____. In 1991, ***Mr. and Mrs. S*** purchased the property for $490,000. Two years later ***Mrs. S*** and the Estate of ***Mr. S*** conveyed the property to ***Property***, LLC for $490,000. Mr. ***S's*** son, ***Mr. SS***, was a principal in ***Property***, LLC ("***Property***").

In 1998, ***Mr. SS*** approached ***Mr. K***, a Tucson area developer, about developing the property. Eventually, ***Mr. SS*** and ***Mr. K*** agreed to develop the property and lease it to a national retailer. The owner of the property, ***Property*** and ***Mr. K***'s company, ***ABC***, LLC, formed ***Taxpayer*** ("Taxpayer") effective October 30, 1998. Pursuant to the Taxpayer operating agreement, ***Property*** contributed the property, and ***ABC***, LLC, contributed the capital to develop the property. The property was valued at $2,300,000 at the time ***Property*** conveyed it to the Taxpayer. The $2,300,000 valuation of the property became the amount of ***Property***'s capital account in Taxpayer. Pursuant to the operating agreement, as amended, Taxpayer was required to distribute the first $1,150,000 received to ***Property***. After Taxpayer received a construction loan, it paid ***Property*** $875,000 towards the amount owed to it. ***Property*** conveyed the property to Taxpayer on May 11, 2000.

On May 17, 2000, Taxpayer divided the property into three separate parcels. The three parcels and the businesses that currently occupy them are as follows:

Parcel	Parcel Tax ID #	Street Address	Tenant Name	Parcel Size
Parcel A	***123456A***	_____	***Tenant A***	78,998 ft^2
Parcel B	***123456B***	_____	***Tenant B***	35,165 ft^2
Parcel C	***123456C***	_____	vacant	45,970 ft^2

Taxpayer demolished the existing buildings, leveled the site, and then constructed a building and parking on Parcel B to lease to ***Tenant B*** and constructed another building and parking lot on Parcel A to lease to ***Tenant A***. Parcel C is unimproved. Demolition began on May 17, 2000. Construction of the buildings, except for the tenants' interior improvements, was completed on or about December 7, 2000. The interior finishes were completed on January 15, 2001. The City issued a certificate of occupancy for Parcel A on February 26, 2001 and a certificate of occupancy for Parcel B on February 22, 2001.

Taxpayer leased Parcel A to ***Tenant A***, Inc. and Parcel B to ***Tenant B***. The leases had an initial term of 20 years, with the right to renew for three 5-year terms.

Taxpayer applied for a business privilege license from the City on April 20, 2001 to engage in the business of commercial leasing. The City issued it a business privilege license (#***XXXXXXX***). As a business engaged in commercial leasing, Taxpayer was subject to the two-percent business privilege tax levied on the rental income earned each month. The net amount of income received was $49,222.92 per month, and the tax due on that amount of $984.46. Taxpayer paid the City business privilege tax on May 24, 2001 in the amount of $984.46, and each month thereafter until January 27, 2003.

Taxpayer sold Parcel A to ***Buyer A*** on December 10, 2002 for $3,550,000 and sold Parcel B to ***Buyer B*** on December 9, 2002 for $1,285,000.

Subsequently, the City assessed the Taxpayer as a speculative builder with taxes due in the amount of $21,460.30, penalties due in the amount of $8,938.51, and interest due up through March 31, 2004 in the amount of $4,246.62.

City Position

The City asserted the Taxpayer meets the "speculative builder" definition of City Code Section 19-100 ("Section 100"). The "speculative builder" definition includes an owner-builder who sells improved real property "Before the expiration of twenty-four (24) months after the improvements of the real property sold are substantially complete." According to the City, the certificates of occupancy were issued in February 2001 and the sales occurred in December 2002. As a result, the City argued the sales were taxable as speculative business sales pursuant to City Code Section 19-416 ("Section 416"). The City did allow a land deduction based on the original purchase price of $490,000. Based on the above, the City requested its assessment to be upheld.

Taxpayer Position

The Taxpayer argued they did not sell the property within 24 months of substantial completion and as a result the Taxpayer was not a speculative builder. The Taxpayer indicated the term "substantial complete" is defined in City Code Section 19-100 ("Section 100") as follows:

"(1) ha[ving] passed final inspection or its equivalent; or (2) [having] certificate of occupancy or its equivalent … issued; or (3) is ready for immediate occupancy or use."

The Taxpayer acknowledged that a certificate of occupancy was issued on February 26, 2001 and February 22, 2001 for Parcels A and B, respectively. The Taxpayer argued that the property was ready for "use" on December 7, 2000 when construction of the building was complete other than the lessees' interior finishes. The Taxpayer noted that the December 7, 2000 date would be more than 24 months before the sale and thus there would be no speculative builder sale. The Taxpayer argued that tax statutes are to be construed in favor of the taxpayer and since date of "use" is more favorable under Section 100 to the Taxpayer that is the date that must be used.

The Taxpayer argued that by the City imposing the speculative builder tax on the Taxpayer at the same time the Taxpayer was in the business of commercial leasing constitutes double taxation. According to the Taxpayer, double taxation occurs when the same property or person is taxed twice for the same purpose for the same tax period by the same taxing authority. The Taxpayer asserted that in order to avoid the presumption against double taxation, the commercial lease classification and the speculative builder classification should be construed so they are mutually exclusive. The Taxpayer argued that the only way to reconcile the speculative builder classification with the commercial lease classification is to find that owners that construct a new building to fulfill a lease agreement are not speculative builders. The taxpayer further argued that since the Taxpayer was in the business of commercial leasing, the sale of the two parcels in December of 2002 was a "casual" sale and thus not taxable. Section 100 defines "casual sale" as follows:

> "a transaction of an isolated nature made by a person who neither represents himself to be nor is engaged in a business subject to a tax imposed by this article. However, no sale, rental, license for use, or lease transaction concerning real property nor any activity entered into by a business taxable by this article shall be treated, or be exempt, as casual. This definition shall include sales of used capital assets, provided that the volume and frequency of such sales do not indicate that the seller regularly engages in selling such property."

According to the Taxpayer, the sales were "transactions of an isolated nature made by a person who neither represents himself to be nor is engaged in the business of being a speculative builder." As a result, the Taxpayer argued the sales were "casual sales" and not subject to the speculative builder tax.

Even if the Hearing Officer should find the Taxpayer was a speculative builder, the Taxpayer argued the tax assessed was excessive because the City failed to subtract the proper land cost

from the sales price. The Taxpayer asserts it was the seller of the two properties. As a result, the Taxpayer argued the "original purchase price of the land" is the $2,300,000 cost that Taxpayer incurred in obtaining the property from ***Property*** on May 11, 2000. According to the Taxpayer, the City erroneously used ***Property*** as the seller and the original purchase price of the land of $490,000 that occurred in 1993. The Taxpayer argued that if the land did not really belong to the Taxpayer, the Taxpayer could not be an "owner builder" and therefore cannot be a "speculative builder".

According to the Taxpayer, City Code Section 19-578 (a) allows a taxpayer who is a prevailing party to be reimbursed for its costs and attorney's fees incurred in the administration proceeding. The Taxpayer argued that if the Hearing Officer should find in favor of the Taxpayer on either issue, the Taxpayer would be a prevailing party and would be entitled to attorney's fees.

ANALYSIS

The Taxpayer entered into agreements with both ***Tenant B*** and ***Tenant A*** to construct shell buildings with tenant improvements. It is clear that the construction on neither Parcel A or Parcel B was substantially complete on December 7, 2000 as argued by the Taxpayer. There wasn't even electricity or water available until February of 2001. As a result, we find the City's use of the certificate of occupancy dates to be a reasonable estimation of the dates for substantial completion. Based on those dates, Parcels A and B were both sold within 24 months of the improvements of the real property being substantially complete. Accordingly, the sales would be taxable as speculative builder sales. We must disagree with the Taxpayer's argument that being in the business of commercial leasing and paying transaction privilege tax on the leasing income would result in the speculative builder tax being double taxation. The commercial leasing tax was for the activity from May 24, 2001 until the properties were sold. The speculative builder tax was assessed for the activity that occurred on the date of the sale. The period of assessment was different and there were two different taxable activities and no double taxation.

We must also conclude that the sales of Parcels A and B were not "casual sales" pursuant to Section 100. That definition specifies that no sale concerning real property shall be treated as casual.

We concur with the Taxpayer that the City utilized the wrong "original purchase price of the land" for this Taxpayer. ***Property*** conveyed the property to the Taxpayer on May 11, 2000. That would be the date to ascertain the "original purchase price of the land" and the value at that time as a result of a negotiated price by two equal parties was $2,300,000. As a result, the speculative builder tax will need to be recalculated using $2,300,000 for the price of land and not $490,000. Since the purchase price of $2,300,000 was for the two parcels sold as well as a third parcel, the total cost must be allocated to all three parcels. Further, we find the City's method of utilizing the square footage to allocate the cost to each parcel to be reasonable. While the Taxpayer provided testimony that some of the parcels may have been more valuable, there was no supporting study or appraisal provided. Accordingly, we will approve the City's methodology and allocate $1,134,653 of original land cost to Parcel A and $505,077 of original land cost to Parcel B. The remaining cost would be allocated to the unsold Parcel C.

While the Taxpayer has argued for costs and attorney fees pursuant to Section 578 (a), we find that request should be made to the City's Taxpayer Problem Resolution Officer. We do find, however, that the City has prevailed on the most significant issue in this case regarding whether or not there was a speculative builder sale.

FINDINGS OF FACT

1. On May 14, 2004, the Taxpayer filed a protest of a tax assessment made by the City.

2. After review, on May 27, 2004, the City concluded that the protest was timely and in proper form.

3. On June 1, 2004, the Hearing Officer ordered the City to file a response to the protest on or before July 16, 2004.

4. On June 4, 2004, the City filed a response.

5. On June 25, 2004, the Hearing Officer ordered the Taxpayer to file a reply to the City on or before July 16, 2004.

6. On July 2, 2004, a Notice was issued setting the matter for hearing commencing on August 20, 2004.

7. On July 9, 2004, the Taxpayer filed a reply.

8. Both parties appeared and presented evidence at the August 20, 2004 hearing.

9. On August 21, 2004, the Hearing Officer indicated the record was closed and a written decision would be issued on or before October 5, 2004.

10. In 1991, ***Mr. and Mrs. S*** purchased a parcel of property located in the City on the southeast corner of _____ for $490,000.

11. In 1993, the parcel was conveyed to ***Property*** for $490,000.

12. ***Mr. S***'s son, ***Mr. SS*** was a principal in ***Property***.

13. In 1998, ***Mr. SS*** approached ***Mr. K***, a Tucson area developer, about developing the property.

14. ***Property*** and ***Mr. K***'s company, ***ABC*** LLC formed Taxpayer.

15. Pursuant to the Taxpayer operating agreement, ***Property*** contributed the property, and ***ABC***, LLC contributed the capital to develop the property.

16. The property was valued at $2,300,000 at the time ***Property*** conveyed it to the Taxpayer

17. The $2,300,000 valuation of the property became the amount of ***Property***'s capital account in Taxpayer.

18. ***Property*** conveyed the property to Taxpayer on May 11, 2000.

19. On May 17, 2000, Taxpayer divided the property into three separate parcels: Parcel A, 78,998 sq. ft.; Parcel B, 35,165 sq. ft.; and, Parcel C, 45,970 sq. ft.

20. The Taxpayer constructed a building and parking on Parcel A and leased to ***Tenant A***.

21. The Taxpayer constructed a building and parking on Parcel B and leased to ***Tenant B***.

22. Constructions of the buildings, except for the tenants' interior improvements were completed on or about December 7, 2000.

23. There was no electricity or water available to Parcels A and B until February 2001.

24. The City issued a certificate of occupancy for Parcel A on February 26, 2001 and a certificate of occupancy for Parcel B on February 22, 2001.

25. Taxpayer leased Parcel A to ***Tenant A***, and Parcel B to ***Tenant B*** for terms of 20 years, with the right to renew for three 5-year terms.

26. Taxpayer applied for a City privilege license to engage in the business of commercial leasing.

27. Commencing on May 24, 2001, the Taxpayer paid the City a monthly privilege tax on commercial leasing until January 27, 2003.

28. Taxpayer sold Parcel A to ***Buyer A*** on December10, 2002 for $3,550,000 and sold Parcel B to ***Buyer B*** on December 9, 2002 for $1,285,000.

29. The City assessed the Taxpayer as a speculative builder for the sale of Parcels A and B with taxes due in the amount of $21,460.30, penalties due in the amount of $8,938.51, and interest due up through March 31, 2004 in the amount of $4,246.62.

30. The Taxpayer entered into lease agreements with ***Tenant A*** and ***Tenant B*** that required the Taxpayer to construct shell building plus tenant improvements.

31. The ***Tenant B*** and ***Tenant A*** buildings had electricity available on February 1, 2001 and February 14, 2001, respectively.

32. The ***Tenant B*** and ***Tenant A*** buildings had plumbing available on February 8, 2001 and January 31, 2001, respectively.

33. The original land cost for Parcel A was $1,134,653.

34. The original land cost for Parcel B was $505,077.

CONCLUSIONS OF LAW

1. Pursuant to ARS Section 42-6056, the Municipal Tax Hearing Officer is to hear all reviews of petitions for hearing or redetermination under the Model City Tax Code.

2. The Taxpayer sold improved Parcels A and B within 24 months of the improvements to the real property being substantially complete.

3. The sales by Taxpayer of improved Parcels A and B were subject to the speculative builder tax pursuant to Section 416.

4. The speculative builder tax on the sale of Parcels A and B did not result in double taxation.

5. The sales of improved Parcels A and B were not casual sales pursuant to Section 100.

6. The original purchase price of the land for Parcels A and B for the Taxpayer would have been the value as of May 11, 2000.

7. The City's methodology of allocating land cost based on the square footage of each parcel was reasonable.

8. The City prevailed on the most significant issue presented in this matter, which was whether or not there was a speculative builder sale.

9. The Taxpayer's protest should be granted, in part, and denied, in part, consistent with the Discussion, Finding, and Conclusion, herein.

ORDER

It is therefore ordered that the May 14, 2004 protest filed by ***Taxpayer*** of a tax assessment made by the City of Tucson is hereby denied, in part, and granted, in part, consistent with the Discussion, Findings, and Conclusions, herein.

It is further ordered that the City of Tucson shall revise the assessment to reflect the revised cost of land determined herein.

It is further ordered that this Decision is effective immediately.

Jerry Rudibaugh
Municipal Tax Hearing Officer