DECISION OF MUNICIPAL TAX HEARING OFFICER

Decision Date: October 16, 2006
Decision: MTHO #'s 286 & 294
Taxpayer: ***Taxpayer 1/Taxpayer 2***
Tax Collector: City of Scottsdale
Hearing Date: August 30, 2006

DISCUSSION

Introduction

On November 23, 2005, ***Taxpayer 1/Taxpayer 2*** ("Taxpayer") filed a protest (MTHO # 286) of a tax assessment made to the City of Scottsdale ("City"). After review, the City concluded on December 9, 2005, that the protest (MTHO # 286) was timely and in the proper form. On December 15, 2005, the Municipal Tax Hearing Officer ("Hearing Officer") ordered the City to file a response on or before January 30, 2006. On January 10, 2006, the Taxpayer filed a protest (MTHO # 294) of a tax assessment made by the City After review, the City concluded on January 27, 2006 that the protest was timely and in the proper form. On January 27, 2006, the City indicated the parties were discussing issues and that the Taxpayer wanted to file a supplement to its protest. On January 27 2006, the Hearing Officer ordered the Taxpayer to file any supplement to MTHO # 286 on or before February 28, 2006 and the City to file a response on or before March 31, 2006. On February 3, 2006, the Hearing Officer ordered the City to file a response to MTHO # 294 on or before March 20, 2006. The Taxpayer filed a supplement to its protest on February 27, 2006. On March 20, 2006, the City filed a response to MTHO # 294. On March 21, 2006, the Hearing Officer ordered the Taxpayer to file a reply on MTHO # 294 on or before April 11, 2006. The City filed a response to MTHO # 286 on March 31, 2006. On April 3, 2006, the Hearing Officer ordered the Taxpayer to file a reply on MTHO # 286 on or before April 24, 2006. On April 7, 2006, the Taxpayer requested an extension to file a reply on MTHO # 294. On April 8, 2006, the Hearing Officer granted the Taxpayer an extension until April 25, 2006. On April 12, 2006, the City requested MTHO #'s 286 and 294 be consolidated. On April 17, 2006, a Notice of Tax Hearing ("Notice") scheduled the matter for hearing commencing on June 28, 2006. On April 18, 2006, the Hearing Officer consolidated MTHO #'s 286 and 294. On April 25, 2006, the Taxpayer filed a reply in the consolidated matters. On June 16, 2006, the Taxpayer sent an email requesting an continuance of the hearing. On June 16, 2006, the Hearing Officer granted a continuance of the hearing. A June 30, 2006 Notice rescheduled the hearing for August 30, 2006. Both parties appeared and presented evidence at the August 30, 2006 hearing. On September 1, 2006, the Hearing Officer indicated the record was closed and a written decision would be issued on or before October 16, 2006.

City Position

The City assessed Taxpayer (MTHO # 286) for the period February and March 1999 for taxes in the amount of $491,542.28, interest up through September 2005 in the amount of $94,494.50, and penalties for late filing and late payments totaling $30,373.20. The City waived the penalties and allowed tax credits totaling $108,925.22.

The City noted that ***Company A*** owned the ***Shopping Center*** ("Shopping Center") located at the corner of ***Location 1*** and ***Location 2***. According to the City, ***Company A*** had improvements made at the Shopping Center commencing in September 1998 up through February 12, 1999. On February 12, 1999, ***Company A*** sold the Shopping Center to Taxpayer for $40,933,624. On the same day the Shopping Center was purchased, Taxpayer split off a retail pad which was sold to ***Customer 1***. On March 15, 1999, the Taxpayer sold another retail pad to ***Customer 2***.

The City argued that the ***Company A*** sale to Taxpayer was a speculative builder sale of improved real property for which no tax was paid to the City. Since ***Company A*** failed to pay any tax, the City asserted Taxpayer was responsible for the tax pursuant to City Code Section 595(c) ("Section 595(c)"). Section 595(c) provides as follows:

> "any person who purchases … improved real property or a portion of improved real property for which the Privilege Tax imposed by this Chapter has not been paid shall be responsible for payment of such tax as a speculative builder or owner builder, as provided in Sections 416 and 417."

The City argued there was a tax on the sale of the Shopping Center which was not paid and Taxpayer, as purchaser of the property, was responsible for the tax. According to the City, a native plant permit was issued to ***Company A*** on September 24, 1998. Subsequently, a plant salvage contractor was hired to excavate, box, and remove salvaged trees. The City asserted that as of December 31, 1998, the work of the plant salvage contractor was essentially completed. The City also argued that some preliminary grading and excavation work was performed before the shopping center was sold to Taxpayer. The City opined that the property was improved real property pursuant to City Code Section 416(2)(B) ("Section 416(2)(B) which defines improved real property : "Where improvements have been made to land containing no structure (such as paving or landscaping)". The City asserted that ***Company A*** was a "speculative builder" pursuant to the definition set forth in City Code Section 100 ("Section 100") as follows:

(1) An owner-builder who sells or contracts to sell, at anytime, improved real property (as provided in Section 416) consisting of:

A) Custom, model, or inventory homes, regardless of the stage of completion of such homes; or

B) Improved residential or commercial lots without a structure; or

(2) An owner-builder who sells or contracts to sell improved real property, other than improved real property specified in subsection (1) above:

A) Prior to completion; or

B) Before the expiration of twenty-four (24) months after the improvements of the real property sold are substantially complete.

"Owner-Builder" means an owner or lessor of real property who, by himself or by or through others, constructs or has constructed or reconstructs or has reconstructed any improvements to real property.

The City argued the ***Company A*** sale was not a casual sale and was a business transaction. The City noted that Section 100 defines a "casual activity or sale" as follows:

> "Casual Activity or Sale" means 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 Chapter. However, no sale, rental, license for use, or lease transaction concerning real property nor any activity entered into by a business taxable by this Chapter 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.

In response to the Taxpayer's arguments, the City asserted that many individuals engage in business and are taxed on their business transactions. According to the City, ***Company A*** clearly entered into the $40 million sale and transaction with the object of gain.

The City also argued the Taxpayer was a speculative builder for its February 12, 1999 sale of the ***Customer 1*** and its March 15, 1999 sale of the ***Customer 2***. The City's assessment for these two sales totaled $11,140.00. The City noted that without credit for the successive liability tax, the assessment for the two sales would total $119,099.00. The City asserted Taxpayer had undertaken significant improvements to the two sites that were sold. The City indicated the Taxpayer had contracted with the new owners for both the ***Customer 1***, on February 12, 1999, and the ***Customer 2***, on March 15, 1999, to construct parking lots, street lighting, landscaping, drainage, water, and sewer on the sites following the close of escrow.

The City assessed Taxpayer (MTHO # 294) for the period October 2005 for taxes in the amount of $327,564.13 and penalties totaling $141,909.67. The City subsequently waived the penalties and allowed tax credits totaling $124,836.02. After adjustments for the penalties and tax credits the net amount due totaled $202,728.11. The City noted that Taxpayer recorded a new plat for the Shopping Center on October 28, 2005. With the exception of the previously sold ***Customer 2*** and the ***Customer 1*** and Lots 7 and 9, Taxpayer sold the remaining portion of the Shopping Center on October 31, 2005. According to the City, Taxpayer sold twenty-six lots. The City concluded fourteen of the lots were not taxable because their building completion dates were more than twenty-four months prior to the sale date. The City indicated eight lots were taxable because they had building permit completion dates less than twenty-four months prior to the sale date. The City noted the other four lots had valid open building permits and had been improved at the time of the sale. As a result, the City assessed tax on the sale of twelve (eight plus four) improved lots pursuant to Section 416 as speculative builder sales. The City

allocated the sale price to each lot based on the proportional size of each lot. Similarly, the City allocated deductions and credits using the same methodology.

Taxpayer Position

Taxpayer protested the entire assessment for MTHO # 286. Taxpayer argued that ***Company A*** did not sell "improved real property" to Taxpayer when he sold the Shopping Center. Further, Taxpayer argued that the burden of proof was on the City to prove that ***Company A*** was liable for speculative builder tax on the sale of the Shopping Center. Taxpayer indicated ***Company A*** owned the Shopping Center as an individual and asserted the sale of a piece of land by an individual person does not constitute "engaging or continuing in" a "business" activity as defined in Section 100.Taxpayer also argued the ***Company A*** sale did not constitute engaging in "business" as it was a "casual sale". Taxpayer opined that the phrase "casual sale" set forth in Section 100 only applies to "businesses taxable by this Chapter" because the phrase "entered into by a business taxable by this Chapter shall be treated, or be exempt, as casual" modifies both the phrase "no sale, rental, for use, or lease transaction concerning real property", and the phrase, "nor any activity".
Taxpayer argued that Section 595 does not apply because there was no succession in business or a cessation of business. According to Taxpayer, there was no business to cease and no business for Taxpayer to be successor of. Taxpayer also argued that Section 595 is unconstitutional and that it violated Taxpayer's rights to Due Process and Equal Protection under the Arizona and/or US Constitutions.

Taxpayer protested the entire assessment for MTHO # 294. Taxpayer asserted it was not a "speculative builder" for the transaction in question. Taxpayer argued the City improperly allocated tax credits to each lot based on a square footage basis. According to Taxpayer, the speculative builder tax is a tax based on the privilege of engaging in the business of improving real property. As a result, Taxpayer asserted any credits relating to the business of improving a property should be consumed on a dollar basis regardless of square footage. Taxpayer argued there is no limitation in the City Code stating that credits can only be taken at the time an allocated portion of the property is sold. According to Taxpayer, the only limitation on the timing of the taking of credits is found in City Code Section 417(b)(3)(C) ("Section 417(b)") which provides that no tax credits can be taken until gross income from the improved property is reported. Taxpayer argued as soon as a taxpayer reports sufficient gross income under the speculative builder classification with respect to the property to utilize the credit in full, the credit should be usable in full even if a portion of the property is not yet sold.

ANALYSIS

Our first issue is whether or not there was a succession in and/or cessation in business pursuant to Section 595 when ***Company A*** sold the Shopping Center to Taxpayer. Clearly, an individual (***Company A***) would be a "person" pursuant to Section 100 and subject to tax on taxable transactions under the Code. Next, we must decide if ***Company***

A was in “business” pursuant to the definition set forth in Section 100 as follows; “activities or acts, personal or corporate, engaged in and caused to be engaged in with the object of gain, benefit, or advantage, either direct or indirect, but not casual activities or sales.” We do find that ***Company A*** was involved in an activity or act with the object of gain, benefit, or advantage. We must now decide if the ***Company A*** sale to Taxpayer was a “casual activity or sale” pursuant to Section 100 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 Chapter…”. In this case, the City has argued that ***Company A*** was in the taxable business of being a “speculative builder’ pursuant to Sections 100 and 416.

In order for the speculative builder tax to be imposed there must be a sale of improved real property. The City has relied on the definition of “improved real property” set forth in Section 416(a)(2)(B) as follows: any real property “where improvements have been made to land containing no structure (such as paving or landscaping)…”. The City relied on the fact that ***Company A*** had obtained a native plant permit and that some native plants had been removed from the ground and placed in boxes to be replanted on the land at a later date. While there is no definition in the Code for landscaping, the City concluded permitting and native plant removal would be included under the landscaping umbrella. We must disagree. Since there is no definition of landscaping in the Code, we looked to Webster’s Dictionary to conclude the normal meaning would be some type of improvement such as adding lawns, trees, bushes, etc. In this case, the native plants are simply being stored temporarily until they can be placed back on the land at another location. This is a Governmental requirement in order to protect the native plants. While it may cost considerable money to temporarily store these plants, we do not find it results in any improvements to the real property similar to landscaping. We must conclude that the City’s interpretation of Section 416(a)(2)(B) would result in a “strained construction or implication” in order to tax the sale of the Shopping Center by ***Company A*** to Taxpayer. Accordingly, we conclude that ***Company A*** was not in the taxable business of being a “speculative builder” pursuant to Sections 100 and 416. As a result, the ***Company A*** sale to Taxpayer would be a casual sale and there would be no succession in and/or cessation in business pursuant to Section 595.

The City also assessed the February 12, 1999 sale of the ***Customer 1*** and the March 15, 1999 sale of the ***Customer 2*** as speculative builder sales. The City again relied on Section 416(a)(2)(B) for the definition of a sale of “improved real property”. We conclude that it would have been impossible for Taxpayer to have made any improvements (such as paving or landscaping) to the ***Customer 1*** as it was sold almost simultaneously as the February 12, 1999 sale from ***Company A*** to Taxpayer. As to the March 15, 1999 sale of the ***Customer 2***, there was no evidence presented of any improvements (such as paving or landscaping) being made to the ***Customer 2*** by Taxpayer prior to the sale. At best, there may have been a grading permit issued to Taxpayer. We do not find a grading permit would result in any improvements to the real property similarly to paving. We conclude the City’s interpretation of Section 416(a)(2)(B) would result in a “strained construction or implication” in order to tax the sale of the ***Customer 1*** and the ***Customer 2***.

Lastly, we conclude there was no dispute that Taxpayer's sale of twelve lots on October 31, 2005 were sales of "improved real property" that would be taxable pursuant to Section 416 as speculative builder sales. While Taxpayer protested the entire assessment on the sale of twelve lots on October 31, 2005 as not being "speculative builder" transactions, Taxpayer failed to provide any evidence to refute the City's evidence these were "improved real property". We find the evidence was clear that the twelve lots were improved and either sold "prior to completion" or were "substantially complete before the expiration of twenty-four months". The Taxpayer complained of the City's use of a square footage basis for allocating tax credits. The Taxpayer believed it should be able to use tax credits in full even if a portion of the property was not yet taxable. Section 416(c)(3)(B) provides that no tax credits may be claimed until such time that the gross income against which said credits apply is reported. The City's methodology of applying the tax credit based on square footage of taxable lots sold is reasonable. Under the City's method, if certain lots are not sold or are not taxable when sold, the credits associated with those lots will be lost. The City's method is consistent with Section 416(c)(3)(B) and is fair and just since the tax credits are associated with all the property and not just with the sale of taxable lots. Accordingly, the Taxpayer's protest of MTHO # 294 is denied.

FINDINGS OF FACT

1. On November 23, 2005, Taxpayer filed a protest (MTHO # 286) of a tax assessment made by the City.

2. After review, the City concluded on December 9, 2005, that the protest was timely and in the proper form.

3. On December 15, 2005, the Hearing Officer ordered the City to file a response on or before January 30, 2006.

4. On January 10, 2006, the Taxpayer filed a protest (MTHO # 294) of a second assessment made by the City.

5. After review, the City concluded on January 27, 2006 that the protest was timely and in the proper form.

6. On January 27, 2006, the City indicated the parties were discussing issues and that the Taxpayer wanted to file a supplement to its protest.

7. On January 27, 2006, the Hearing Officer ordered the Taxpayer to file any supplement to MTHO # 286 on or before February 28, 2006 and the City to file a response on or before March 31, 2006.

8. On February 3, 2006, the Hearing Officer ordered the City to file a response to MTHO # 294 on or before March 20, 2006.

9. The Taxpayer filed a supplement to its protest on February 27, 2006.

10. On March 20, 2006, the City files a response to MTHO # 294.

11. On March 21, 2006, the Hearing Officer ordered the Taxpayer to file a reply on MTHO # 294 on or before April 11, 2006.

12. The City filed a response to MTHO # 286 on March 31, 2006.

13. On April 3, 2006, the Hearing Officer ordered the Taxpayer to file a reply on MTHO # 286 on or before April 24, 2006.

14. On April 7, 2006, Taxpayer requested an extension to file a reply on MTHO # 294.

15. On April 8, 2006, the Hearing Officer granted the Taxpayer an extension until April 25, 2006.

16. On April 12, 2006, the City requested MTHO #'s 286 and 294 be consolidated.

17. On April 17, 2006, a Notice scheduled the matter for hearing commencing on June 28, 2006.

18. On April 18, 2006, the Hearing Officer consolidated MTHO #'s 286 and 294.

19. On April 25, 2006, Taxpayer filed a reply in the consolidated matter.

20. On June 16, 2006, Taxpayer sent an email requesting a continuance of the hearing.

21. On June 16, 2006, the Hearing Officer granted a continuance of the hearing.

22. A June 30, 2006 Notice rescheduled the hearing for August 30, 2006.

23. Both parties appeared and presented evidence at the August 30, 2006 hearing.

24. On September 1, 2006, the Hearing Officer indicated the record was closed and a written decision would be issued on or before October 16, 2006.

25. The City assessed Taxpayer (MTHO #286) for the period February and March 1999 for taxes in the amount of $491,542.28, interest up through September 2005 in the amount of $95,494.50, and penalties for late filing and late payments totaling $30,373.20.

26. The City waived the penalties for late filing and late payments and allowed tax

credits totaling $108,925.22.

27. ***Company A*** owned the Shopping Center located as the corner of ***Location 1*** and ***Location 2***.

28. On February 12, 1999, ***Company A*** sold the Shopping Center to Taxpayer for $40,933,624.

29. On the same day the Shopping Center was purchased, Taxpayer split off a retail pad which was sold to ***Customer 1***.

30. On March 15, 1999, Taxpayer sold another retail pad to ***Customer 2***.

31. A native plant permit was issued to ***Company A*** on September 24, 1998.

32. A plant salvage contractor was hired to excavate, box, and remove salvaged trees from the Shopping Center prior to the sale to Taxpayer.

33. The City assessed Taxpayer for the sale of the ***Customer 1*** and the ***Customer 2*** for a total of $11,140.00.

34. Without credit for the successive liability tax, the total assessment on the sale of the ***Customer 1*** and the ***Customer 2*** would have totaled $119,099.00.

35. Taxpayer had contracted with the new owners for both the ***Customer 1***, on February 12, 1999, and the ***Customer 2***, on March 15, 1999 to construct parking lots, street lighting, landscaping, drainage, water, and sewer on the sites following the close of escrow.

36. The City assessed Taxpayer (MTHO #294) for the period October 2005 for taxes in the amount of $327,564.13 and penalties totaling $141,909.67.

37. The City waived the penalties and allowed tax credits totaling $124,836.02.

38. Taxpayer recorded a new plat for the Shopping Center on October 28, 2005.

39. With exception of the previously sold ***Customer 2*** and the ***Customer 1***, Taxpayer sold the remaining portion of the Shopping Center on October 31, 2005.

40. Taxpayer sold twenty-six lots.

41. The City assessed taxes on the sale of twelve of the lots and concluded the other fourteen lots were not taxable because their building completion dates were more than twenty-four months prior to the sale date.

42. Eight lots were taxable because they had building permit completion dates less

than twenty-four months prior to the sale date.

43. The other four lots had valid open building permits and had been improved at the time of the sale.

44. The City allocated tax credits to the taxable lots based on the ratio of each lot's square footage to the square footage of the Shopping Center.

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. ***Company A*** was a "person" pursuant to Section 100.

3. ***Company A*** was involved in an activity or act with the object of gain, benefit, or advantage.

4. There was not sufficient evidence to demonstrate that there was either paving or landscaping or a similar activity on the Shopping Center at the time of the sale to Taxpayer.

5. Permitting and native plant removal as required by Governmental entities does not constitute "improved real property" as set forth in Section 416(a)(2)(B).

6. The City's interpretation of Section 416(a)(2)(B) would result in a "strained construction or implication" in order to tax the sale of the Shopping Center to Taxpayer.

7. The ***Company A*** sale to Taxpayer would be no succession in and/or cessation in business pursuant to Section 595.

8. The issuance of a grading permit would not result in "improved real property" similar to paving as set forth in Section 416(a)(2)(B.

9. The City's interpretation of Section 416(a)(2)(B) would result in a "strained construction or implication" in order to tax the sales of the ***Customer 1*** and the ***Customer 2*** by Taxpayer.

10. Taxpayer's sale of twelve lots on October 31, 2005 was a sale if "improved real property" that was taxable pursuant to Section 416.

11. The City's use of a square footage basis for allocating tax credits was consistent with Section 416©(3)(B) and was fair and just.

12. Taxpayer's protest of MTHO #286 should be granted.

13. Taxpayer's protest of MTHO #294 should be denied.

ORDER

It is therefore ordered that the November 23, 2005 protest by ***Taxpayer 1/Taxpayer 2*** (MTHO #286) of a tax assessment made by the City of Scottsdale is hereby granted, consistent with the Discussion, Findings, and Conclusions, herein.

It is further ordered that the January 10, 2006 protest by ***Taxpayer 1/Taxpayer 2*** (MTHO #294) of a tax assessment made by the City of Scottsdale is hereby denied, consistent with the Discussion, Findings, and Conclusions, herein.

It is further ordered that the City of Scottsdale shall revise their assessment of ***Taxpayer 1/Taxpayer 2*** by removal of all taxes, penalties, and interest on the assessment for the ***Company A***. sale to ***Taxpayer 1/Taxpayer 2*** and removal of all taxes, penalties and interest on the sales by ***Taxpayer 1/Taxpayer 2*** to ***Customer 1*** and ***Customer 2***

It is further ordered that this Decision is effective immediately.

Jerry Rudibaugh
Municipal Tax Hearing Officer