

DECISION OF MUNICIPAL TAX HEARING OFFICER

Decision Date: December 7, 2007

Decision: MTHO #355

Taxpayer: *ABC Taxpayer*

Tax Collector: City of Scottsdale

Hearing Date: September 13, 2007

DISCUSSION

Introduction

On March 9, 2007, *ABC Taxpayer* (“Taxpayer”) filed a protest of a tax assessment made by the City of Scottsdale (“City”) and a protest to lift the jeopardy assessment made by the City. After review, the City concluded on March 29, 2007 that the protest was timely and in the proper form but the request to lift the jeopardy assessment was not timely. On April 9, 2007, the Municipal Tax Hearing Officer (“Hearing Officer”) ordered the City to file a response to the protest on or before May 24, 2007. On April 9, 2007 the Hearing Officer ordered Taxpayer to file response to the jeopardy timeliness issue on or before April 23, 2007. On April 23, 2007, Taxpayer filed a response to the jeopardy timeliness issue. On April 25, 2007, the Hearing Officer ordered the City to file a reply to the jeopardy timeliness issue on or before May 9, 2007. On May 8, 2007, the City filed a reply to the jeopardy timeliness issue. On May 16, 2007, the Hearing Officer denied Taxpayer’s request to lift the jeopardy assessment.

On May 24, 2007, the City filed a response to the protest. On June 4, 2007, the Hearing Officer ordered Taxpayer to file any reply on or before June 25, 2007. On June 13, 2007, Taxpayer filed a request for an extension to reply. On June 19, 2007, the Hearing Officer granted Taxpayer’s request for an extension until July 3, 2007. On July 6, 2007, a Notice of Tax Hearing (“Notice”) scheduled the matter for hearing commencing on August 14, 2007. On August 13, 2007, Taxpayer requested the hearing be rescheduled. On August 14, 2007, a Notice rescheduled the hearing until September 13, 2007. Both parties appeared and presented evidence at the September 13, 2007 hearing. On September 17, 2007, the Hearing Officer indicated the parties had agreed to the following briefing schedule: Taxpayer would file an opening brief on or before October 12, 2007; the City would file a response brief on or before November 27, 2007; and, Taxpayer would file a reply brief on or before November 27, 2007. On October 12, 2007, Taxpayer filed an opening brief. On November 9, 2007, the City filed a response brief. On November 27, 2007, Taxpayer filed a reply brief.

City Position

The City conducted an audit of Taxpayer for the period September 2003 through

December 2005. The City assessed Taxpayer for additional taxes due in the amount of \$91,100.46, for interest up through December 2006 in the amount of \$24,468.27, and penalties totaling \$30,118.01. The assessment was for understated contracting income pursuant to City Code Section 415 and 416 (“Sections 415 and 416”).

According to the City, Taxpayer purchased vacant land in the City on October 4, 2002. The City indicated Taxpayer subdivided the land and developed the *ABC Subdivision* (“Subdivision”) in the City consisting of thirty-two residential lots. The City noted the “Final Plat for *ABC*” (“Final Plat”) was approved on May 19, 2007. The City indicated that an encroachment permit, #*C12345*, to develop the Subdivision was issued on May 27, 2003 and listed *Construction Contracting Co.* as the contractor. According to the City, *Construction Contracting Co.* stated that no tax had been remitted on the project and *Construction Contracting Co.* provided a copy of an “Arizona Department of Revenue Prime Contractor’s Certificate” (“Certificate”) that Taxpayer had given them.

The City noted that the Certificate listed *ABC Homes* as the Prime Contractor and *Construction Contracting Co.* as the Subcontractor. The City asserted that Taxpayer had sold or transferred an interest in thirty-one of the residential lots in the Subdivision. Prior to the sale of the lots, Taxpayer had infrastructure constructed to each of the lots. In response to Taxpayer’s argument that the sale of the lots were entitled to an exclusion pursuant to City Code Section 416(b)(4) (“Section 416(b)(4)”), the City argued Taxpayer did not satisfy the requirements set forth in Section 416(b)(4). The City noted that Section 416(b)(4) states the following:

Exclusions

A speculative builder may exclude gross income from the sale of partially improved residential real property as defined in (a)(4) above to another speculative builder only if all of the following conditions are satisfied:

- (A) the speculative builder purchasing the partially improved residential real property has a valid City privilege license for construction contracting as a speculative builder; and
- (B) At the time of the transaction, the purchaser provides the seller with a properly completed written declaration that the purchaser assumes liability for and will pay all privilege taxes which would otherwise be due the City at the time of sale of the partially improved residential real property; and
- (C) **The seller also:**
 - (i) Maintains proper records of such transactions in a manner similar to the requirements provided in this chapter relating to sales for resale; and
 - (ii) Retains a copy of the written declaration provided by the buyer for the transaction; and
 - (iii) Is properly licensed with the City as a speculative builder and provides the City with the written declaration attached to the City privilege tax return where he claims the exclusion.

According to the City, Taxpayer did not meet the requirement to be licensed during the audit period. The City also indicated Taxpayer failed to provide any copies of written declarations as required by Section 416(b)(4). The City noted that City Code Section 400 (“Section 400”) provides that the tax is presumed to apply until the contrary is established

by Taxpayer. The City argued that Taxpayer has failed to establish the tax does not apply and has clearly failed to satisfy all the requirements set forth in Section 416(b)(4). The City disputed Taxpayer's allegation that the City makes exceptions to the strict requirements of Section 416(b)(4). Based on all the above, the City requested Taxpayer's protest be denied.

Taxpayer Position

Taxpayer requested the entire assessment be abated. Taxpayer argued that even if it was a speculative builder when it sold lots during the audit period, it was entitled to an exclusion pursuant to Section 416(b)(4). Taxpayer asserted the sale of lots were "the sale of partially improved real property... to another speculative builder." Taxpayer acknowledged that it failed to keep records that conform precisely to the strict requirements of Section 416(b)(4). However, Taxpayer argued that the City makes exceptions to the strict requirements when they are satisfied the person purchasing the partially improved property is a speculative builder.

ANALYSIS

There was no dispute that Taxpayer had "improved property" that was sold and thus taxable pursuant to Section 416. There was also no dispute that the "improved real property" was "partially improved residential real property" pursuant to Section 416(a)(4). "Partially improved residential real property" which is being developed for sale to individual homeowners where construction of residences upon the property was not substantially complete is defined in Section 416(a)(2) as "improved real property". The remaining issue is whether or not Taxpayer is entitled to an exclusion pursuant to Section 416(b)(4) for the sale of "partially improved real property." Section 416(b)(4) provides that the exclusion applies to the sale of "partially improved real property" to another speculative builder only if all of the conditions set forth therein are satisfied. Those conditions required Taxpayer to have a copy of a written declaration from the buyer stating the buyer would assume liability for and pay all City privilege taxes. In this case, Taxpayer failed to provide any such written declaration. Another condition required Taxpayer to be properly licensed with the City as a speculative builder. Taxpayer failed to provide any evidence it was properly licensed with the City as a speculative builder. Based on all the above, we conclude that Taxpayer has failed to meet its burden of proof of demonstrating it met all of the conditions set forth in Section 416(b)(4) for an exclusion.

Even if Taxpayer failed to meet the conditions set forth in Section 416(b)(4), we would still find an exclusion was proper if there was evidence that a subsequent speculative builder actually paid the City tax on the improved property.

In this case, the auditor for the City acknowledged he had obtained information that some subsequent speculative builders had paid the City tax on the improvements and as a result the auditor credited Taxpayer for those sales. While the City provided a tax credit to Taxpayer for those sales, the City did not remove the penalties associated with those

sales. We conclude that once the City determined a subsequent speculative builder was the appropriate taxpayer, then the penalties assessed to Taxpayer for those sales should be removed.

Since Taxpayer failed to timely file reports and failed to timely pay taxes, the City was authorized to assess penalties pursuant to City Code Section 540 (“Section 540”). The only issue is whether or not Taxpayer demonstrated reasonable cause to have the penalties waived. The fact that two of the principals for Taxpayer had been previously audited by the City under Section 416 demonstrates that Taxpayer was aware or should have been aware of the speculative builder tax. Even if Taxpayer believed the sales were not taxable pursuant to Section 416(b)(4), they should have been aware of the requirement to file tax returns with the written declaration attached. As a result, we conclude that Taxpayer has failed to demonstrate reasonable cause to have the failure to timely file return penalties to be waived. The fact that the City determined that at least some of Taxpayer’s sales were to other speculative builders lends credibility to Taxpayer’s assertion that they believed no taxes were to be paid. Accordingly, we find Taxpayer has demonstrated reasonable cause to have the failure to timely pay tax penalties to be waived.

FINDINGS OF FACT

1. On March 9, 2007, Taxpayer filed a protest of a tax assessment made by the City and a protest to lift the jeopardy assessment made by the City.
2. After review, the City concluded on March 29, 2007, that the protest was timely and in the proper form but the request to list the jeopardy assessment was not timely.
3. On April 9, 2007, the Hearing Officer ordered the City to file a response to the protest on or before May 24, 2007.
4. On April 9, 2007, the Hearing Officer ordered Taxpayer to file a response to the jeopardy timeliness issue on or before April 23, 2007.
5. On April 23, 2007, Taxpayer filed a response to the jeopardy timeliness issue.
6. On April 25, 2007, the Hearing Officer ordered the City to file a reply to the jeopardy timeliness issue.
7. On May 8, 2007, the City filed a reply to the jeopardy timeliness issue.
8. On May 16, 2007, the Hearing Officer denied Taxpayer’s request to lift the jeopardy assessment.
9. On May 24, 2007, the City filed a response to the protest.

10. On June 4, 2007, the Hearing Officer ordered Taxpayer to file any reply on or before June 25, 2007.
11. On June 13, 2007, Taxpayer filed a request for an extension to file a reply.
12. On June 19, 2007, the Hearing Officer granted Taxpayer's request for an extension until July 3, 2007.
13. On July 6, 2007, a Notice scheduled the matter for hearing commencing on August 14, 2007.
14. On August 13, 2007, Taxpayer filed a request to reschedule the hearing.
15. On August 14, 2007, a Notice rescheduled the hearing for September 13, 2007.
16. Both parties appeared and presented evidence at the September 13, 2007 hearing.
17. On September 17, 2007 the Hearing Officer indicated the parties had agreed to the following briefing schedule: Taxpayer would file an opening brief on or before October 12, 2007; the City would file a response brief on or before November 12, 2007; and, Taxpayer would file a reply brief on or before November 27, 2007.
18. On October 12, 2007, Taxpayer filed an opening brief.
19. On November 9, 2007, the City filed a response brief.
20. On November 27, 2007, Taxpayer filed a reply brief.
21. The City conducted an audit of Taxpayer for the period September 2003 through December 2005.
22. The City assessed Taxpayer for additional taxes due in the amount of \$91,100.46, for interest up through December 2006 in amount of \$24,468.27, and penalties totaling \$30,118.01.
23. Taxpayer purchased vacant land in the City on October 4, 2002.
24. Taxpayer developed the Subdivision in the City consisting of thirty-two residential lots.
25. The Final Plat was approved on May 19, 2007.
26. An encroachment permit, #*C12345*, to develop the Subdivision was issued on May 27, 2003 and listed *Construction Contracting Co.* as the contractor.
27. *Construction Contracting Co.* provided a copy of a Certificate that Taxpayer had

given them.

28. The Certificate listed *ABC Homes* as the Prime Contractor and *Construction Contracting Co.* as the Subcontractor.
29. During the audit period, Taxpayer sold or transferred an interest in thirty-one of the residential lots in the Subdivision.
30. Prior to the sale of the lots, Taxpayer had infrastructure constructed to each of the lots.
31. Taxpayer was not licensed during the audit period.
32. Taxpayer failed to provide any written declarations from the buyers of the lots.
33. Two of the principals for Taxpayer had been previously audited by the City under Section 416.
34. The City determined that some of Taxpayer's sales were to other speculative builders.
35. The City provided tax credits to Taxpayer when the City had sufficient documentation to demonstrate a subsequent speculative builder paid City taxes on the improved property.

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. During the audit period, Taxpayer sold "improved real property" pursuant to Section 416.
3. The "improved real property" was being developed for sale to individual homeowners where construction on the property was not substantially complete.
4. The "improved real property" was "partially improved real property" pursuant to Section 416(a)(4).
5. Taxpayer failed to meet its burden of proof of demonstrating it met the conditions set forth in Section 416(b)(4) for an exclusion.
6. The City allowed tax credits to Taxpayer when the City had sufficient information to conclude a subsequent speculative builder paid City tax on the improved property.

7. All penalties assessed Taxpayer on sales that the City determined City taxes were paid by subsequent speculative builders should be waived.
8. The City was authorized pursuant to Section 540 to assess penalties for failure to timely file tax returns and failure to timely pay taxes.
9. Taxpayer failed to demonstrate reasonable cause for failing to file tax returns.
10. Taxpayer demonstrated reasonable cause for failure to timely pay taxes.
11. Taxpayer's protest should be partly granted and partly denied, consistent with the Discussion, Findings, and Conclusions, herein.

ORDER

It is therefore ordered that the March 9, 2007 protest of *ABC Taxpayer* of a tax assessment made by the City of Scottsdale is hereby partly granted and partly denied, consistent with the Discussion, Findings, and Conclusions, herein.

It is further ordered that the City of Scottsdale shall waive all penalties assessed on sales for which the City granted tax credit for City taxes paid by subsequent speculative builders.

It is further ordered that the City of Scottsdale shall waive all penalties assessed for failure to timely pay taxes.

It is further ordered that this Decision is effective immediately.

Jerry Rudibaugh
Municipal Tax Hearing Officer