

## DECISION OF MUNICIPAL TAX HEARING OFFICER

Decision Date: December 31, 2007

Decision: MTHO #384

Taxpayer: *ABC Taxpayer*

Tax Collector: City of Tucson

Hearing Date: November 20, 2007

### DISCUSSION

#### Introduction

On September 12, 2007, *ABC Taxpayer* (“Taxpayer”) filed a protest of a tax assessment made by the City of Tucson (“City”). After review, the City concluded on September 19, 2007 that the protest was timely and in the proper form. On September 24, 2007, the Municipal Tax Hearing Officer (“Hearing Officer”) ordered the City to file any response to the protest on or before November 8, 2007. On October 3, 2007, the City filed a response to the protest. On October 5, 2007, the Hearing Officer ordered Taxpayer to file any reply on or before October 26, 2007. On October 15, 2007, a Notice of Tax Hearing (“Notice”) scheduled the matter for hearing commencing on November 20, 2007. Both parties appeared at the October 24, 2007 hearing and presented evidence. On November 23, 2007, the Hearing Officer indicated the record was closed and a written decision would be issued on or before January 4, 2008.

#### City Position

The City conducted an audit of Taxpayer for the period March 2003 through February 2007. The City concluded that Taxpayer had underreported contracting income and use tax. The City assessed additional taxes due in the amount of \$3,195.22, penalties in the amount of \$640.22, and interest up through June 2007 in the amount of \$503.13. Subsequently, the City waived the penalties.

The City noted that Taxpayer was the original contractor who built the *Tucson Apartment Complex* (“Apartments”). According to the City, *Apartment Owner* owns the Apartments and Taxpayer provided the property management for the Apartments and billed *Apartment Owner* for the services. The City also noted that the officers of Taxpayer were members of *Apartment Owner*. The City asserted that Taxpayer was a separate legal entity that provided the personnel used in building maintenance, repairs, cleaning, landscaping, and property management. The City indicated City Code Section 19-100 (“Section 100”) defines a construction contractor as a person who alters or repairs real property. The City argued that Taxpayer had taxable contracting income for the services provided to *Apartment Owner*.

The City disagreed with Taxpayer's dispute of the inclusion of \$43,195 in City building permit fees, \$49,600 in Pima County ("County") sewer connection fees, and \$38,416 paid to the City of Tucson Water ("Tucson Water"). The City argued that City Code Section 19-415 ("Section 415") does not specify a deduction from contracting income or allow for the exclusion of building permit fees, sewer connection fees, or water meter purchases incurred during the construction of real property. The City asserted these items are expenses of doing business and are included in taxable contracting income. The City noted that City Code Section 19-200(c) ("Section 200") states "No deduction or exclusion is allowed from gross income on account of the cost of the property sold, the time value of money, expense of any kind or nature, losses, materials used, labor or service performed, interest paid, or credits granted." The City acknowledged that Section 415(a)(1) allows for the exclusion of ground water devices from construction contracting activity. However, the City asserted that A.R.S. Section 45-604 ("Section 604") provides that sewer connection fees do not fit the description of such devices. After review of Taxpayer's documentation included with its protest, the City concurred that \$17,171.00 of the management services fees provided for *Apartment Owner* were non-taxable fees for services.

### **Taxpayer Position**

Taxpayer argued corrections needed to be made to the audit results which would reduce the tax due to \$1,164.57 plus interest. Taxpayer indicated it was not protesting the use tax portion of the audit but was protesting the contracting tax assessment. Taxpayer protested billings for the months of 10/04, 1/05, 2/05, and 4/05 for property management services of an apartment complex that Taxpayer provided for *Apartment Owner*. Taxpayer asserted the billings were for a variety of services including building maintenance, cleaning, landscaping, miscellaneous items, and management fees. According to Taxpayer, these billing amounts totaled \$27,977.93.

Taxpayer also protested the taxation of various items paid by Taxpayer during the construction of the *123 Apartment Complex* during the period 6/05 through 9/05. Taxpayer disputed the inclusion of \$43,195.00 in City building permit fees ("City Fees") as part of the assessment, the inclusion of \$49,600.00 in County sewer connection fees ("County Fees"), and \$38,416.00 paid to the City of Tucson Water ("Tucson Water") for water meters. Taxpayer asserted the sewer connection fees represented exempt income from a groundwater-measuring device. According to Taxpayer, the disputed fees were separately stated on the books and records and should be exempted from taxes. Taxpayer argued a payment of \$1,700.00 to *Developer* should be excluded as the payment was a reimbursement to *Developer* for payment of an environmental assessment.

### **ANALYSIS**

There was no dispute that Taxpayer had contracting income during the audit period. There was also no dispute that Taxpayer owed use tax for the audit period in the amount of \$556.08. Pursuant to City Code Section 100 ("Section 100"), Taxpayer and *Apartment*

*Owner* were separate persons. City Code Section 360 (“Section 360”) provides that all deductions, exclusions, and exemptions are conditional upon adequate proof and documentation being provided by part of its protest, Taxpayer did provide documentation to support some of the billings to *Apartment Owner* were for nontaxable services. We conclude from our review of Taxpayer’s documentation that some of the billings (framing, drywall, finish carpentry, etc.) were for contracting work. We conclude that the City’s determination that \$17,171.00 of the billings were for nontaxable services to be reasonable and should be removed from the assessment.

We also find that Taxpayer provided sufficient evidence to demonstrate the amount of \$1700.00 paid to *Developer* was for a nontaxable reimbursement for environmental fees paid by *Developer*. That amount should be removed from the assessment. The remaining disputed items were for fees paid to the City for building permits, fees paid to Tucson Water for water meters, and fees paid to the County for sewer connection fees. Taxpayer had argued the sewer connection fees and water meter fees should be excluded as exempt income from a groundwater-measuring device. Section 415 provides for an exclusion for groundwater measuring devices required by Section 604. It is clear from Section 604 that the exclusion is for devices that measure water being withdrawn from the ground. Neither of the disputed items would fit that description. As a result, we conclude Taxpayer has failed to meet its burden of proof of demonstrating those fees should be excluded.

As to the City building fees, we find that Taxpayer has provided documentation that these fees were separately stated in their books and records. We conclude that these fees were part of the preliminary design phase and not part of the contracting construction. Accordingly, we conclude the building permit fees should be removed from the assessment.

### **FINDINGS OF FACT**

1. On September 12, 2007, Taxpayer filed a protest of a tax assessment made by the City.
2. After review, the City concluded on September 19, 2007, that the protest was timely and in the proper form.
3. On September 24, 2007, the Hearing Officer ordered the City to file a response to the protest on or before November 8, 2007.
4. The City filed a response to the protest on October 3, 2007.
5. On October 5, 2007, the Hearing Officer ordered Taxpayer to file any reply on or before October 26, 2007.
6. On October 15, 2007, a Notice scheduled the matter for hearing commencing on November 20, 2007.

7. Both parties appeared at the November 20, 2007 hearing and presented evidence.
8. On November 23, 2007, the Hearing Officer indicated the record was closed and a written decision would be issued on or before January 4, 2008.
9. The City conducted an audit of Taxpayer for the period March 2003 through February 2007.
10. The City assessed Taxpayer for additional taxes in the amount of \$3,195.22, penalties in the amount of \$640.22, and interest up through June 2007 in the amount of \$503.13.
11. Subsequently, the City waived the penalties.
12. Taxpayer was the original contractor who built the Apartments.
13. *Apartment Owner* owns the Apartments.
14. During the audit period, Taxpayer performed property management of the Apartments and billed *Apartment Owner* for the services.
15. The officers for Taxpayer were members of *Apartment Owner*.
16. As part of its protest, Taxpayer provided documentation to support its claim that some of the billings for *Apartment Owner* were for nontaxable services.
17. After review of the additional documentation, the City concluded that \$17,171.00 of the billings for *Apartment Owner* were for nontaxable services.
18. During the audit period, Taxpayer reimbursed *Developer* for \$1,700.00 for the cost of an environmental assessment.

### 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 underreported contracting income and use tax.
3. Taxpayer and *Apartment Owner* were separate persons pursuant to Section 100.

4. Taxpayer had the burden of proof pursuant to Section 360 to demonstrate it was entitled to claimed deductions, exclusions, and exemptions.
5. Taxpayer provided documentation to demonstrate that \$17,100.00 of the billings to *Apartment Owner* were for nontaxable services.
6. Taxpayer provided documentation to demonstrate the \$1,700.00 paid to *Developer* was for a nontaxable reimbursement for environmental fees paid by *Developer*.
7. Section 415 provides for an exclusion for groundwater measuring devices pursuant to Sections 415 and 604.
8. Taxpayer failed to meet its burden of proof of demonstrating fees for water meters and sewer connection fees were groundwater measuring devices pursuant to Sections 415 and 604.
9. Taxpayer provided documentation to demonstrate the City building fees were separately maintained on the books and records and were part of the preliminary design phase and not part of the contracting income.
10. Consistent with the Discussion, Findings, and Conclusions herein, Taxpayer's protest should be partly granted and partly denied.

### **ORDER**

It is therefore ordered that the September 12, 2007 protest by *ABC Taxpayer* of a tax assessment made by the City of Tucson is hereby partly granted and partly denied, consistent with the Discussion, Findings, and Conclusions, herein.

It is further ordered that the City of Tucson shall remove \$17,710.00 of the billings to *Apartment Owner* from the assessment.

It is further ordered that the City of Tucson shall remove the amount of \$1700.00 paid to *Developer* from the assessment.

It is further ordered that the City of Tucson shall remove \$43,195.00 in City building permit fees from the assessment.

It is further ordered that this Decision is effective immediately.

Jerry Rudibaugh  
Municipal Tax Hearing Officer