DECISION OF MUNICIPAL TAX HEARING OFFICER

Decision Date: February 17, 2009
Decision: MTHO # 444
Taxpayer:
Tax Collector: Town of Buckeye
Hearing Date: October 9, 2008

DISCUSSION

Introduction

On May 21, 2008, ***Taxpayer*** filed a protest of a tax assessment made by the Town of Buckeye ("Town"). After review, the Town concluded on May 28, 2008 that the protest was timely and in the proper form. On May 30, 2008, the Municipal Tax Hearing Officer ("Hearing Officer") ordered the Town to file any response on or before July 15, 2008. On June 6, 2008, the Town sent an email requesting an extension for the response. On June 7, 2008, the Hearing Officer granted the Town an extension until July 31, 2008. On July 25, 2008, Taxpayer filed an Amendment and Supplemental Protest. On July 31, 2008, the Hearing Officer extended the Town's deadline until August 15, 2008. On July 31, 2008, the Town filed a response to the protest. On August 18, 2008, the Hearing Officer ordered Taxpayer to file any reply on or before September 8, 2008. On September 8, 2008, Taxpayer filed a reply. On September 8, 2008, a Notice of Tax Hearing ("Notice") scheduled the matter for hearing commencing on October 9, 2008.

Both parties appeared and presented evidence at the October 9, 2008 hearing. On October 13, 2008, the Hearing Officer indicated that the parties had agreed to the following schedule: the Town would file any comments/disagreements with Taxpayer Hearing Exhibit Nos. 4 through 8 ("Exhibit Nos. 4-8") on or before November 6, 2008; and, Taxpayer would file any reply on or before November 20, 2008. On November 3, 3008, the Town requested Taxpayer be ordered to provide certain documents. On November 8, 2008, the Hearing Officer ordered Taxpayer to provide the requested documents on or before November 28, 2008. On November 8, 2008, the Hearing Officer extended the Town's deadline for filing comments/recommendations until December 12, 2008 and Taxpayer's reply deadline until December 29, 2008. On December 8, 2008, the Town filed comments/recommendations. On December 11, 2008, Taxpayer requested an extension for its reply. On December 13, 2008, the Hearing Officer extended Taxpayer's reply deadline until January 9, 2009. On January 9, 2009, Taxpayer filed a reply. On January 14, 2009, the Hearing Officer indicated that the record was closed and a written decision would be issued on or before March 2, 2009.

Town Position

The Town conducted an audit of Taxpayer for the period November 2005 through January 2008. The Town assessed Taxpayer for additional taxes in the amount of $272,499.97, interest up through April 2008 in the amount of $34,276.77, and penalties totaling $67,316.69. According to the Town, Taxpayer acted as the prime contractor for ***Home Corporation*** on the ***FC*** master planned community in the Town known as ***Fun City***. The Town asserted that Taxpayer constructed the community amenities comprised of a golf course, golf maintenance facility, pro shop and restaurant (Collectively, the "Golf Course") which are commercially operated and open to the general public. The Town indicated title to the Golf Course is currently held in part by ***Home Corporation*** and in part by the ***Fun City Association, Inc. ("Association").*** According to the Town, title to the remaining portions of the Golf Course would be turned over to the Association on a scheduled basis from March 30, 2007 through January 1, 2015.

The Town argued that Taxpayer does not qualify as a subcontractor pursuant to Town Code Section 18-415 (c) ("Section 415(c)") and therefore is a construction contractor. The Town noted Section 415(c) defines subcontractor as follows:

> "Subcontractor" means a construction contractor performing work for either:
>
> (1) a construction contractor who has provided the subcontractor with a written declaration that he is liable for the tax for the project and has provided the subcontractor his City Privilege License number.
>
> (2) an owner-builder who has provided the subcontractor with a written declaration that:
>
> (A) the owner-builder is improving the property for sale; and
>
> (B) the owner-builder is liable for the tax for such construction contracting activity; and
>
> (C) the owner-builder has provided the contractor his city Privilege License number.

The Town indicated that ***Home Corporation*** had provided the Town an Arizona Form 5005 ("Form 5005") on which ***Home Corporation*** is listed as the "prime contractor" and Taxpayer as the "subcontractor." The Town acknowledged that if the Form 5005 was properly completed, it satisfies the requirements of Section 415(c)(1). The Town asserted that the Form 5005 was invalid resulting in Taxpayer being a construction contractor liable for the tax. The Town noted "prime contractor" is defined as follows in ARS Section 42-5075(N)(8) ("Section 5075"):

"Prime contractor" means a contractor who supervises, performs or coordinates the modification of any building, highway, road, railroad, excavation, manufactured building or other structure, project development or improvement including the contracting, if any, with any subcontractors or specialty contractors and who is responsible for the completion of the contract. Except as provided in subsection E and M of this section, a person who owns real property who engages one or more contractors to modify that real property, who engages one or more contractors to modify that real property is not a prime contractor within the meaning of this paragraph regardless of the existence of a contract for sale or the subsequent sale of that real property.

The Town argued that a contractor must supervise, perform or coordinate the construction in order to qualify as a "prime contractor" pursuant to Section 5075.

According to the Town, Taxpayer has both a residential and commercial construction license with the Arizona Registrar of Contractors ("ROC") while ***Home Corporation*** has only a residential construction license. The Town noted that ARS Section 32-1101(2) defines "commercial contractors" as individuals or entities, which supervise construction projects "except within residential property lines." The Town asserted that construction of the Golf Course is not within residential property lines and thus must be considered commercial construction projects. The Town indicated that since ***Home Corporation*** did not have a commercial construction license, ***Home Corporation*** lacked authority to supervise, perform, or coordinate the construction of the Golf Course. As a result, the Town argued ***Home Corporation*** could not certify to Taxpayer that ***Home Corporation*** was the prime contractor. According to the Town, they have made available to the general public an Owner-Builder Written Declaration ("Declaration"). The Town indicated Taxpayer has not provided the Town with a Declaration.

The Town asserted that Taxpayer and ***Home Corporation*** have adopted inconsistent positions for state and county tax purposes versus the Town privilege tax. According to the Town, Taxpayer acknowledges in its petition that it acts as a prime contractor for the state and county purposes while it acts as a subcontractor for purposes of the Town privilege tax. The Town argued that Taxpayer should not have the benefit of taking diametrically opposed positions in order to escape taxation. While Taxpayer indicated it has contracted with ***Home Corporation*** to be responsible for only the state transaction tax and the county excise tax, the Town asserted that Taxpayer and ***Home Corporation*** cannot shift the tax obligation owing to the Town.

The Town argued that Taxpayer's reliance on an October 11, 1996 letter by the chairman of the Unified Audit Committee ("UAC") to Taxpayer's representative and the UAC's 1997 guidelines for processing offsite contractor refund claims is unfounded. According to the Town, the use of the Golf Course is not built into the cost paid by a homeowner as an offsite improvement or a common area and would escape taxation altogether. The Town indicated the Declaration of Covenants, Conditions, and Restrictions for ***Fun City*** which set forth the restrictions by which an owner may use the Golf Course, demonstrate that a buyer of a home from ***Home Corporation*** does not have the benefit of the use of the Golf Course. The Town asserted that unlike other offsite construction that is included with the purchase price of a home and which a homebuyer can immediately enjoy (such as roads, utilities, and landscaping), a buyer of a home from ***Home Corporation*** is not entitled to use the Golf Course unless the homebuyer pays additional membership fees. As a result, the Town concluded that the Golf Course is not a true "common area" appropriate for inclusion in the sales price by the speculative builder. The Town noted that for purposed of valuing property for assessing community property taxes ARS Section 42-13402(B) ("Section 13402") defines common areas to not include golf courses.

According to the Town, Section 1.51 of the CC&Rs defines a Private Amenity to include golf courses and supporting facilities and improvements which are owned and operated by persons other than the Association. The Town noted that Section 16.1 of the CC&Rs provides that the purchase of a home from ***Home Corporation*** does not entitle a

homeowner to use of such a golf course and related amenities.

The Town argued that the UAC's 1996 letter to ***DLW*** does not apply to Taxpayer or ***Home Corporation***. According to the Town, ***DLW***, ***Home Corporation***, and Taxpayer are separate and distinct entities. The Town noted that the second full paragraph on page three of the letter states, "This analysis applies only to the facts and issues contained in your letter dated September 18, 1996." The Town indicated the ruling assured that "Homebuilder A" as a speculative builder would complete the documentation required by Section 415 with respect to each of the contractors. In this case, there is no evidence that Taxpayer completed a Declaration to satisfy Section 415.

The Town asserted that the 1997 UAC guideline is not applicable to this situation. According to the Town, the guideline was issued to clarify the required documentation that was necessary for cities to process refund/credit requests by speculative builders. The Town argued that the guidelines did not establish any policies or procedures with respect to the tax treatment of offsite construction. The Town indicated that the guideline does not address amenities, such as a golf course.

The Town disputed Taxpayer's assertion that it had reasonable cause under Town Code Section 8-540 ("Section 540") for relying on UAC's 1996 letter and the 1997 UAC guidelines. The Town argued Taxpayer could not have relied on the 1996 letter because Taxpayer knew the letter was issued to another taxpayer. The Town also argued Taxpayer could not have relied on the UAC 1997 guideline because ***Home Corporation*** never completed a Declaration.

The Town opposed the admission of Taxpayer Exhibit Nos. 4-8. According to the Town, Taxpayer failed to provide foundation and the Exhibits lacked probative value. In the Town's post-hearing response, the Town agreed to the admission of Taxpayer Exhibit No. 7.

Taxpayer Position

Taxpayer indicated that ***Home Corporation*** is a nationwide homebuilder. Taxpayer asserted that ***Home Corporation*** operates in Arizona under what is commonly called a two-tier structure. Under this structure, ***Home Corporation*** owns the land to be developed and sells homes to its customers. According to Taxpayer, it acts as the prime contractor for offsite, lot, and vertical construction under contract with ***Home Corporation*** and is the taxable party for state and county purposes. Taxpayer argued that the cities have not historically recognized this structure and have imposed a speculative builder tax pursuant to Section 416 on the entity which sells the home, which is ***Home Corporation***. As part of ***Fun City, Home Corporation*** had constructed recreational facilities comprised of a golf course, recreation site, restaurant, pro shop and golf maintenance facility. Taxpayer indicated there is an agreement with the Association to turn the ownership of these amenities to the Association on a scheduled basis at no charge.

Taxpayer argued that the Town assessment is inappropriate when amenities are going to be turned over at no charge to the Association. According to Taxpayer, a ruling request was made by ***DLW*** in 1996 to the UAC. The request was whether contractors constructing a golf course and recreation center that were going to be turned over to a homeowners association could be treated as nontaxable subcontractors since the cost of the amenities would be built into the home prices upon which the city would be paid a speculative builder tax. While ***Home Corporation*** subsequently acquired ***DLW***, they continued to use the brand name for ***OP communities***. Taxpayer indicated UAC has never rescinded the ruling. Taxpayer argued that any change to UAC policy would have to be made prospectively pursuant to Model City Tax Code Section 542 ("Section 542"). Taxpayer noted that the UAC guideline stated as follows: "These cities would capture the tax at the time of sale since the sales price is reflective of all improvements." Taxpayer argued that it is clear the UAC intended that all contracts for improvements that would be captured in the sales price of the homes would be exempted from the municipal transaction privilege tax because the tax upon the sale of the homes would capture all the costs. According to Taxpayer, the UAC encourages the homebuilders to provide subcontractor declaration to all offsite contractors in order to simplify the tax reporting process.

Taxpayer argued that the Town is barred from assessing tax at this time. Taxpayer indicated that Model City Tax Code Section 100 ("Section 100") defines a speculative builder as a person who sells improved real property, other than residential property, within twenty-four months of substantial completion. Taxpayer asserted that until that time has passed, the Town cannot presume it was improper for the contractors working on the amenities to have received a speculative builder exemption certificate.

Taxpayer indicated that the owner of the land, ***Home Corporation***, was a speculative builder for the ***Fun City Project*** pursuant to Section 416 and Taxpayer was a construction contractor pursuant to Section 415. Taxpayer argued that it was responsible for the State transaction privilege tax but was not responsible for the Town Transaction privilege tax because it was working for a speculative builder.

If any of part of the tax assessed by the Town is upheld, Taxpayer requested the penalties to be waived. Based on the UAC policy guidelines, Taxpayer asserted it had a reasonable basis to believe that the Town Transaction privilege tax did not apply to Taxpayer's contracting activity.

In reply to the Town, Taxpayer noted the company has utilized a two-tier structure approved by the Arizona Department of Revenue ("DOR") for over twenty years. Taxpayer asserted that because of different laws at the state and municipal levels, there are different taxpayers to be taxable on a single project. According to Taxpayer, Taxpayer is the taxable party for state purposes as a prime contractor pursuant to ARS Section 42-5075 ("Section 5075"). For Town purposes, Taxpayer stated that the land owner acts a speculative builder pursuant to Section 416 which results in ***Home Corporation*** being a taxable speculative builder and Taxpayer acts as a qualified

subcontractor pursuant to Section 415(c).

According to Taxpayer, the golf course and other recreational amenities being constructed as part of ***Fun City*** will be turned over to the Association at no cost. Taxpayer opined that these amenities are included in the "common facilities" discussed in the Public Report for the ***FC Project***. Taxpayer noted that pursuant to the Public Report, the common facilities will be owned by the Association. Taxpayer asserted that since ***Home Corporation*** is not going to sell the recreational facilities to the Association, it must build those costs into the sale price of the lot and home. Taxpayer argued that ***Home Corporation*** built those costs into the pricing of the homes through the mechanism of a common cost pool which divides the cost among the lots. While the Association charges membership fees, Taxpayer indicated those fees are used to maintain and operate the recreational facilities and not to reimburse ***Home Corporation*** for its development costs. Taxpayer asserted the fact that the Association charges those fees is irrelevant to whether ***Home Corporation*** is recovering its costs in the price of the homes.

Taxpayer argued that it had laid complete foundation for its Exhibits. Accordingly, Taxpayer requested that the Exhibits be admitted into evidence.

ANALYSIS

We have reviewed the responses to Taxpayer's Exhibits and will admit them for what value they may have.

Taxpayer is a construction contractor pursuant to Town Code Section 100 ("Section 100"). As a result, Taxpayer is liable for a tax on the income from the business activity of construction contracting within the Town pursuant to Section 415. Subsection 415(b) provides that "gross income derived from acting as a "subcontractor" shall be exempt from the tax imposed by this Section." The primary issue we must resolve was whether or not Taxpayer acted as "subcontractor" during the audit period and thus Taxpayer's gross income was exempt from the tax. Subsection 415(c) defines a "subcontractor" as a construction contractor performing work for an "owner-builder" who has provided the subcontractor with a written declaration that

(1) the owner-builder is improving the real property for sale; and
(2) the owner-builder will be liable for the transaction privilege tax; and
(3) the owner-builder has provided the contractor with his City Privilege License Tax number.

In this case, Taxpayer has provided a copy of a Form 5005 which designated ***Home Corporation*** as the Prime Contractor and Taxpayer as the Subcontractor. Pursuant to the Form 5005, ***Home Corporation*** certified that it was "assuming the prime contracting transaction privilege tax liability." The Form 5005 also provides the transaction privilege license number of ***Home Corporation***. The Town acknowledged that a properly filled out Form 5005 would satisfy the written declaration requirement of Subsection 415(c). The Town argued that the Form 5005 provided by Taxpayer was not properly filled out. Unfortunately, the Form 5005 is a State form that utilizes state terminology which is

inconsistent with terminology utilized by the cities and towns. There is no reference in the Model City Tax Code to a Prime Contractor.

In our review of Section 5075, we conclude that ***Home Corporation*** does not qualify as a Prime Contractor under the State definition. In spite of that, we conclude that under the totality of the circumstances, Taxpayer's Form 5005 satisfies the written declaration requirement of Subsection 415(c***). Home Corporation*** clearly certified in the Form 5005 that it would be assuming any transaction privilege tax liability of Taxpayer. Consistent with the certification, ***Home Corporation*** reported and paid speculative builder tax as an owner-builder pursuant to Section 416. The Town recently audited ***Home Corporation*** as speculative builder pursuant to Section 416. Based on all the above, we conclude that during the audit period, Taxpayer was an exempt subcontractor pursuant to Subsection 415(b).

The Town questioned whether or not the construction of the golf course was properly included in the sales price of a home sold by **Home Corporation**. As a result, the Town questioned whether or not construction of the Golf Course is escaping taxation altogether. There was no dispute that the Golf Course ownership would be transferred to the Homeowners Association at no cost. Because Association members are requested to pay a membership fee to use the Golf Course, the Town had argued it was not a true "common area" appropriate for inclusion in the sale price by a speculative builder.

Based on the record, we conclude the membership fees charged to Association members were to cover on-going operations and maintenance costs and not for recovery of capital costs. It is clear that the Golf Course is being transferred to the Homeowner Association at no cost to the Association. As a result, the only way for ***Home Corporation*** and/or Taxpayer could recover the costs of the Golf Course is through the sale of the homes as part of the common costs. That conclusion is supported by the Public Report which refers to the Golf Course being part of the common facilities which will be owned by the Homeowners Association. That is further corroborated by the definition of "common area" set forth in the CC&Rs for ***Fun City*** which indicates "land operated as a Gold Course" is part of the common area. Based on all the above, we conclude that the costs of the Golf Course were included as part of the sale price of the homes and a transaction privilege tax on Taxpayer for the construction of the Golf Course would result in the identical costs being taxed twice.

Consistent with our conclusions on the taxes, all penalties should be waived. We note that even if we had not agreed with Taxpayer on the taxes assessed we would have found that Taxpayer had a reasonable basis to believe the tax did not apply based on the UAC ruling. We conclude that Taxpayer's protest should be granted.

We note that much of the controversy in this matter had been cause by the differences in the tax laws of the State and Town. Our focus has been on balancing the Town's right to receive all taxes due to them and to not double tax the Taxpayer.

FINDINGS OF FACT

1. On May 21, 2008, Taxpayer filed a protest of a tax assessment made by the Town.

2. After review, the Town concluded on May 28, 2008 that the protest was timely and in the proper form.

3. On May 30, 2008, the Hearing Officer ordered the Town to file any response on or before July 15, 2008.

4. On June 6, 2008, the Town sent an email requesting an extension for the response.

5. On June 7, 2008, the Hearing Officer granted the Town an extension until July 31, 2008.

6. On July 25, 2008, Taxpayer filed an Amendment and Supplemental Protest.

7. On July 25, 2008, the Hearing Officer extended the Town's response deadline until August 15, 2008.

8. On July 31, 2008, the Town filed a response to the protest.

9. On August 18, 2008, the Hearing Officer ordered Taxpayer to file any reply on or before September 8, 2008.

10. On September 8, 2008, Taxpayer filed a reply.

11. On September 8, 2008, a Notice scheduled this matter for hearing commencing on October 9, 2008.

12. Both parties appeared and presented evidence at the October 9, 2008 hearing.

13. On October 13, 2008, the Hearing Officer indicated the parties had agreed to the following schedule: the town would file any comments/disagreements with Exhibit Nos. 4-8 on or before November 6, 2008; Taxpayer would file any reply on or before November 20, 2008.

14. On November 3, 2008, the Town requested Taxpayer be ordered to provide certain documents.

15. On November 8, 2008, the Hearing Officer ordered Taxpayer to provide the requested documents on or before November 28, 2008.

16. On November 8, 2008, the Hearing Officer extended the Town's deadline for filing comments/recommendations until December 12, 2008 and Taxpayer's reply deadline until December 29, 2008.

17. On December 8, 2008, the Town filed comments/recommendations.

18. On December 11, 2008, Taxpayer requested an extension for its reply.

19. On December 13, 2008, the Hearing Officer extended Taxpayer's reply deadline until January 9, 2009.

20. On January 9, 2009, Taxpayer filed a reply.

21. On January 14, 2009, the Hearing Officer indicated that the record was closed and a written decision would be issued on or before March 2, 2009.

22. The Town conducted an audit of Taxpayer for the period November 2005 through January 2008.

23. The Town assessed Taxpayer for additional taxes in the amount of $272,499.97, interest up through April 2008 in the amount of $34,276.77, and penalties totaling $67,316.69.

24. Taxpayer constructed the community amenities for Fun City comprised of the Golf Course which is commercially operated and open to the general public.

25. Title to the Golf Course is currently held in part by Home Corporation and in part by the Association.

26. Titles to the remaining portion of the Golf Course will be transferred over to the Association on a scheduled basis from March 30, 2007 through January 1, 2015 at no cost to the Association.

27. ***Home Corporation*** had provided the Town a Form 5005 on which ***Home Corporation*** is listed as the "prime contractor" and Taxpayer as the "subcontractor."

28. The Town acknowledged that if Form 5005 was properly completed, it would satisfy the requirements of Section 415(c)(1).

29. Taxpayer had both a residential and commercial construction license with the ROC while ***Home Corporation*** had only a residential construction license.

30. The Town has made the Declaration available to the general public.

31. Taxpayer did not provide a Declaration to the Town.

32. In its petition, Taxpayer acknowledged that for state and county purposes it acts as a prime contractor while it acts as a subcontractor for the purposes of the Town privilege tax.

33. Taxpayer contracted with ***Home Corporation*** to be responsible for the state transaction tax and the county excise tax.

34. A buyer of a home from ***Home Corporation*** is not entitled to use the Golf Course unless the homebuyer pays additional membership fees.

35. Section 16.1 of the CC&Rs provides that the purchase of a home from ***Home Corporation*** does not entitle a homeowner the use of such a golf course and related amenities.

36. The UAC's 1996 letter was to ***DLW***.

37. Subsequent to the 1996 letter, the stock of ***DLW*** was purchased by ***Home Corporation.***

38. ***DLW, Home Corporation***, and Taxpayer are separate and distinct legal entities.

39. ***Home Corporation*** is a nationwide homebuilder.

40. ***Home Corporation*** operates in Arizona under what is commonly called a two-tier structure.

41. Under the two-tier structure, ***Home Corporation*** owns the land to be developed and sells homes to its customers.

42. The Cities and Towns have not historically recognized the two-tier structure and have imposed a speculative builder tax pursuant to Section 416 on the entity which sells the home, which is ***Home Corporation***.

43. As part of ***Fun City, Home Corporation*** is constructing recreational facilities comprised of a golf course, recreation center, restaurant, pro shop, and golf maintenance facility.

44. After purchase of ***DLW, Home Corporation*** continued to use the brand name for ***OC communities.***

45. A ruling request was made by ***DLW*** in 1996 to the UAC regarding the taxability of the construction of a golf course and recreation center that was going to be turned over to a homeowners association at no cost.

46. UAC has never rescinded the 1996 ruling made for ***DLW***.

47. ***Home Corporation*** has utilized a two-tier structure approved by the DOR for over twenty years.

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. Taxpayer Exhibit Nos. 4-8 are admitted into evidence for what value they may have.

3. Taxpayer is a construction contractor pursuant to Section 100.

4. ***Home Corporation*** does not qualify as a Prime Contractor under Section 5075.

5. Under the totality of the circumstances, Taxpayer's Form 5005 satisfies the written declaration requirement of Subsection 415(c).

6. Taxpayer acted as a "subcontractor" during the audit period and thus Taxpayer's construction income was exempt pursuant to Subsection 415(c).

7. ***Home Corporation*** reported and paid speculative builder tax as an owner-builder pursuant to Section 416.

8. The membership fees charged to the Association members were to cover on-going operations and maintenance costs and not for recovery of capital costs.

9. The only way for ***Home Corporation*** and/or Taxpayer to recover the costs of the Golf Course is through the sale of the homes as part of the common costs.

10. The Public Report and the CC&Rs refer to the Golf Course as being part of the common area/facilities.

11. The costs of the Golf Course were included in the sale price of the homes.

12. A transaction privilege tax on Taxpayer for the construction of the Golf Course would result in the identical costs being taxed twice.

13. Taxpayer had a reasonable basis for believing the contracting tax did not apply to it.

14. Taxpayer's protest should be granted.

ORDER

It is therefore ordered that the May 21, 2008 protest by ***Taxpayer*** of a tax assessment made by the Town of Buckeye is hereby granted.

It is further ordered that this Decision is effective immediately.

Municipal Tax Hearing Officer