DECISION OF MUNICIPAL TAX HEARING OFFICER

Decision Date: March 30, 2009
Decision: MTHO #448
Taxpayer: ***Taxpayer ABC***
Tax Collector: City of Phoenix
Hearing Date: November 10, 2008

DISCUSSION

Introduction

On June 13, 2008, ***Taxpayer ABC*** ("Taxpayer") filed a protest of a tax assessment made by the City of Phoenix ("City"). After review, the City concluded on June 26, 2008 that the protest was timely and in the proper form. On June 30, 2008, the Municipal Tax Hearing Officer ("Hearing Officer") ordered the City to file any response on or before August 14, 2008. The City sent an August 14, 2008 email requesting an extension. Taxpayer sent an August 15, 2008 email indicating it had no objection to the City request. On August 18, 2008, the Hearing Officer granted the City an extension until September 15, 2008 to file a response. On September 4, 2008, the City filed a response. On September 8, 2008, the Hearing Officer ordered Taxpayer to file any reply on or before October 8, 2008. On October 2, 2008, a Notice of Tax Hearing ("Notice") scheduled the matter for hearing commencing on October 27, 2008. On October 7, 2008, Taxpayer requested the hearing be rescheduled. On October 8, 2008, Taxpayer filed a reply. On October 10, 2008, a Notice rescheduled the hearing to commence on November 10, 2008. Both parties appeared and presented evidence at the November 10, 2008 hearing. On November 12, 2008, the Hearing Officer indicated the record was closed and a written decision would be issued on or before December 29, 2008 unless the parties agreed to a post-hearing briefing schedule. On November 13, 2008, Taxpayer sent an email indicating the parties had agreed upon a post-hearing briefing schedule. On November 17, 2008, the Hearing Officer indicated the parties had agreed to the following briefing schedule: Taxpayer would file an opening brief on or before January 9, 2009; the City would file a response brief on or before February 6, 2009; and Taxpayer would file a reply brief on or before February 23, 2009. On January 15, 2009, the Hearing Officer indicated that to date, Taxpayer had not filed an opening brief and the deadline was being extended until January 26, 2009. On January 16, 2009, Taxpayer filed a brief which Taxpayer indicated had been emailed on January 9, 2009. On February 4, 2009, the City filed a response brief. On February 23, 2009, Taxpayer filed a reply brief. On February 24, 2009, the Hearing Officer indicated the record was closed and a written decision would be issued on or before April 10, 2009.

City Position

The City issued an estimated tax assessment against Taxpayer for the period October 2003 through December 2006. The City assessed additional taxes in the amount of $39,049.69, interest up through April 2008 in the amount of $11,332.82, and penalties for failing to timely pay taxes in the amount of $3,905.02. The City indicated the review was closed as an estimate because Taxpayer did not provide all of the documents necessary to permit the City to perform an audit of its records. The City noted that Taxpayer did not protest $11,393.43 in taxes plus interest and penalties, related to use tax purchases.

The City asserted the issue in this case relates to contracting work that Taxpayer performed for ***Contractor A*** so that ***Contractor A*** could meet its standard of work to the City. According to the City, ***Contractor A*** was asking Taxpayer to repair infrastructure that had been damaged by others. The City noted that Taxpayer was not being asked to repair work that it had itself constructed in a non-standard manner. As a result, the City assessed Taxpayer on the contracting work performed for ***Contractor A*** pursuant to City Code Section 14-415 ("Section 415"). In response to Taxpayer's position, the City argued that Taxpayer does not qualify for the subcontractor exemption set forth in Subsection 415(c). While Taxpayer has provided an owner-builder declaration, dated February 29, 2008, for one project, the City asserted the declaration does not meet the requirements of Subsection 415(c). According to the City, the requirement for the owner-builder to provide the "subcontractor" with its privilege license tax number was not complied with.

The City noted that the work taxed in this case occurred after the improved lots had already been purchased by homeowners. As a result, the City argued that the subcontractor exemption set forth in Subsection 415(c) does not apply in this case. The auditor accepted a provision relating to the subcontractor exemption set forth in contractor agreements for the initial construction work done by the Taxpayer. The City argued that Taxpayer has provided no such similar documents or language that covers the subsequent repair work done by Taxpayer. While Taxpayer had provided an owner-builder written declaration dated February 29, 2008, the City argued the owner-builder had not provided the "subcontractor" with its privilege license tax number.

Taxpayer Position

Taxpayer protested $26,113.46 of the additional taxes assessed by the City. Taxpayer asserted that the City's assessment will result in a double assessment of the privilege tax on the same revenues. Taxpayer argued that the revenue has been subject to assessment when the lots/homes were sold by ***Contractor A***, the owner-builder. Taxpayer indicated it entered into a contract with ***Contractor A*** to develop and construct roads, sewer, gutters and sidewalks and other infrastructure ("Infrastructure") involved in a subdivision developed by ***Contractor A***. According to Taxpayer, the development and dedication of the roadway system was a condition of the acceptance of the plat by the City. Further, the dedication of all Infrastructure to the City was done without consideration. Taxpayer asserted that the value of the Infrastructure was included in the sale price of the

lots/homes sold by ***Contractor A*** and bore privilege tax at the closing of each sale to the residential customer. Taxpayer noted the Infrastructure was initially completed and signed off for acceptance but were subsequently damaged by the contractors constructing residencies on the lots. Taxpayer indicated that ***Contractor A*** retained it to restore and modify the Infrastructure. According to Taxpayer, the protested assessment in this matter was made against the restoration and modification payments. As part of the audit process, Taxpayer noted the City requested a written declaration from ***Contractor A*** meeting the exemption requirements for a "subcontractor" pursuant to Subsection 415(c). Taxpayer asserted that ***Contractor A*** has provided a written declaration conforming to Subsection 415(c). Taxpayer indicated the auditor had raised the question as to whether ***Contractor A*** had provided its City privilege license number. As a result, Taxpayer obtained the City license number from ***Contractor A*** and provided it to the City. In reply to the City, Taxpayer argued that there is no temporal requirement set forth as to the receipt of the "declaration" required by Subsection 415(c). According to Taxpayer, the value of the warranty work is included in the value of the improved real property sold by the speculative owner-builder in the same way Infrastructure is included. Taxpayer indicated that all homeowners receive a warranty with the improved residential property covering defects for a period of time. Taxpayer argued that all record keeping requirements of Subsection 415(c) have been met.

Taxpayer asserted that the proof of exemption required by City Regulation 14-360.2 applies to resale "certification" involving retail/wholesale sales, not declarations providing confirmation that the taxpayer's principal is paying the tax. According to Taxpayer, the exemption claims are covered by City Regulation 14-350.1(d)(2) and that there is no issue those requirements were met.

Taxpayer indicated there is no distinction between onsite and offsite real property improvements or between initial work and warranty work. Taxpayer asserted it is all construction contracting done by a subcontractor that is exempt. According to Taxpayer, its value is clearly included in the value and price of the improved real estate sold to owner users and subject to tax. Taxpayer argued that if it was taxed on such work, it would result in the same revenue being taxed twice.

Taxpayer provided the following excerpt from section 10.12 of its September 16, 2004 contract with ***Contractor A***:

> Taxes Except for any municipal privilege license (sales) taxes imposed as a result of the work to be performed by Contractor hereunder, which shall be paid by Owner pursuant to the Subcontractor Declaration executed in connection with this project (attached hereto), the Contractor shall pay all other privilege, sales, consumer, and other similar taxes for the Work of portions theereof [sic] provided by the Contractor, including, without limitation, those which are legally enacted at and after the time bids for the Work are received, whether or not yet effective.

Taxpayer notes that its contract with ***Contractor A*** makes it clear that ***Contractor A*** had agreed to pay the City privilege tax and to treat Taxpayer as a subcontractor. Taxpayer asserts that the "warranty work" it performed was not work fulfilling any warranty of quality by Taxpayer and that Taxpayer was being compensated to repair defective work of other subcontractors Taxpayer argued that because residential customers bought

beneficial enjoyment of the roadway system, curbs, gutters, and sidewalks in an acceptable state, the warranty work was part of the sale price of the lot. Taxpayer indicated that since the City has already received privilege tax on the sale of the improved lot, no further tax payments are due with respect to the warranty work.

Taxpayer asserted there is "no shifting of liability to someone else" as the City alleges. Taxpayer argued that the declarations of ***Contractor A*** and Taxpayer and the specific language of Section 10.12 of the contract confirm that ***Contractor A*** is the proper taxpayer. Taxpayer indicated ***Contractor A*** has paid taxes on the sale of the improved lots and the City's reference to a whipsaw is without merit.

ANALYSIS

Taxpayer performed contracting work on Infrastructure for ***Contractor A***. ***Contractor A*** provided Taxpayer with a written declaration pursuant to Subsection 415(c) so that Taxpayer qualified for the subcontractor exemption. The City received taxes from ***Contractor A*** when the improved property was sold. There was no dispute that the initial contracting work by Taxpayer qualified for subcontractor exemption.

While the homes were being constructed, some of the Infrastructure was damaged to the point the City would not accept the Infrastructure until repairs were made.

While Taxpayer was not the one responsible for causing the damage, ***Contractor A*** hired Taxpayer to make the necessary repairs for the City to accept the Infrastructure. ***Contractor A*** paid Taxpayer for the contracting work while ***Contractor A*** received no additional income for the repair work. Our issue is whether or not ***Contractor A*** was no longer an exempt subcontractor when performing the repair work. We conclude from the September 16, 2004 contract with ***Contractor A*** and the October 7, 2008 letter from ***Contractor A*** that Taxpayer had a written declaration from ***Contractor A*** that satisfied Subsection 415(c) as an exempt subcontractor. We don't believe there would be an issue if the repair work had been performed directly on the improved lots that were sold to consumers. Home builders include costs for anticipated warranty work in the sales prices of the homes and taxes are paid on those sales prices including the warranty costs. Is the repair work to the Infrastructure after the homes have been sold any different? We think not. There was no dispute that the initial work done by Taxpayer on the Infrastructure was exempt and we do not find any dispute that the initial costs of the Infrastructure were part of the sales price in which ***Contractor A*** paid City taxes. As a result, we conclude that the costs of the subsequent repair work done by Taxpayer for ***Contractor A*** would also have been included in the sales prices of the improved real property sold by ***Contractor A*** to consumers. We believe that is consistent with the fact that ***Contractor A*** never received any additional revenues for the repair work. Based on all the above, we conclude the City has already received taxes from ***Contractor A*** on the repair work done by Taxpayer and that Taxpayer is entitles to a subcontractor exemption pursuant to Subsection 415(c). We conclude that consistent with the Discussion, Findings, and

Conclusions, herein, Taxpayer's protest should be granted.

FINDINGS OF FACT

1. On June 13, 2008, Taxpayer filed a protest of a tax assessment made by the City.

2. After review, the City concluded on June 26, 2008 that the protest was timely and in the proper form.

3. On June 30, 2008, the Hearing Officer ordered the City to file any response to the protest on or before August 14, 2008.

4. On August 14, 2008, the City sent an email requesting an extension for the City response.

5. Taxpayer sent an August 15, 2008 email indicating it had no objection to the City's request.

6. On August 18, 2008, the Hearing Officer granted the City an extension until September 15, 2008 to file a response.

7. On September 4, 2008, the City filed a response to the protest.

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

9. On October 2, 2008, a Notice scheduled the hearing to commence October 27, 2008.

10. On October 7, 2008, Taxpayer requested the hearing be rescheduled.

11. On October 8, 2008, Taxpayer filed a reply.

12. On October 10, 2008, a Notice rescheduled the hearing to commence on November 10, 2008.

13. Both parties appeared and presented evidence at the November 10, 2008 hearing.

14. On November 12, 2008, the Hearing Officer indicated the record was closed and a written decision would be issued on or before December 29 unless the parties agreed to a post-hearing briefing schedule.

15. On November 13, 2008, Taxpayer sent an email indicating the parties had agreed to a post-hearing briefing schedule.

16. On November 17, 2008, the Hearing Officer indicated the parties had agreed to

the following briefing schedule: Taxpayer would file an opening brief on or before January 9, 2009; the City would file a response brief on or before February 6, 2009; and Taxpayer would file a reply brief on or before February 23, 2009.

17. On January 15, 2009, the Hearing Officer indicated that, to date, Taxpayer had not filed an opening brief and the deadline was being extended until January 26, 2009.

18. On January 16, 2009, Taxpayer filed an opening brief which Taxpayer indicated had been mailed on January 9, 2009.

19. On February 4, 2009, the City filed a response brief.

20. On February 23, 2009, Taxpayer filed a reply brief.

21. On February 24, 2009, the Hearing Officer indicated the record was closed and a written decision would be issued on or before April 10, 2009.

22. The City issued an estimated tax assessment against Taxpayer for the period October 2003 through December 2006.

23. The City assessed additional taxes in the amount of $39,049.69, interest up through April 2008 in the amount of $11,332.82, and penalties for failing to timely pay taxes in the amount of $3,905.02.

24. The City closed the review as an estimate because Taxpayer did not provide all the documents necessary to permit the City to perform an audit of its records.

25. Taxpayer did not protest the portion of the assessment related to use tax purchases.

26. The contracting work assessed in this matter related to the warranty work that Taxpayer performed for ***Contractor A*** so that ***Contractor A*** could meet its standard of work to the City.

27. The development and dedication of the roadway system was a condition of the acceptance of the plat by the City.

28. The dedication of all Infrastructure to the City was done without consideration.

29. Taxpayer was repairing Infrastructure work that had been damaged by others.

30. The warranty work in this case was done after the improved lots had already been purchased by homeowners.

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 was a construction contractor pursuant to Section 100.

3. Taxpayer's initial contracting work on the Infrastructure qualified for the subcontractor exemption pursuant to Subsection 415(c).

4. ***Contractor A*** provided Taxpayer with a written declaration through its September 16, 2004 contract with Taxpayer and with its October 7, 2008 letter to Taxpayer that meets the written declaration requirements of Subsection 415(c).

5. The City has received taxes from ***Contractor A*** on the sale of the improved lots that were sold to consumers.

6. ***Contractor A*** received no additional revenues for the repair work done by Taxpayer on the Infrastructure.

7. The costs of all repair work/warranty work would have been included by ***Contractor A*** in the sale price of the improved lots to consumers.

8. The City has already received taxes from ***Contractor A*** on the repair work done by Taxpayer and Taxpayer is entitled to a subcontractor exemption pursuant to Subsection 415(c).

9. Taxpayer's protest should be granted consistent with the Discussion, Findings, and Conclusions, herein.

ORDER

It is therefore ordered that the June 13, 2008 protest of ***Taxpayer ABC*** of a tax assessment made by the City of Phoenix is hereby granted consistent with the Discussion, Findings, and Conclusions, herein.

It is further ordered that the City of Phoenix shall exempt the income that ***Taxpayer ABC*** received from ***Contractor A*** for repair work on the Infrastructure.

It is further ordered that this Decision is effective immediately.

Jerry Rudibaugh
Municipal Tax Hearing Officer