DECISION OF MUNICIPAL TAX HEARING OFFICER

Decision Date: August 31, 2009
Decision: MTHO # 467
Taxpayer
Tax Collector: City of Mesa
Hearing Date: None

DISCUSSION

On November 13, 2008, a letter of protest was filed by ***Taxpayer*** of a tax assessment made by the City of Mesa ("City"). At the request of Taxpayer, this matter was classified as a redetermination. After final submission of all memoranda by the parties, the Municipal Tax Hearing Officer ("Hearing Officer") closed the record on August 3, 2009.

DECISION

The initial decision in this matter is whether or not the City's Notice of Assessment for the month of November 2007 ("Second Assessment") was an impermissible additional examination. The City acknowledged that the Notice of Assessment issued for the month of October 2007 (First Assessment") was in error as the sale by Taxpayer of a parcel of land located at the Southeast Corner of ***G*** and ***E*** Roads in the City ("Subject Property") to ***XYZ Corporation*** for $4,600,000.00 did not close escrow until November 2007. As a result, the City withdrew the First Assessment and issued a Notice of Assessment for the month of November 2007 ("Second Assessment"). Since Taxpayer had not filed a tax return for November 2007, the City was authorized pursuant to City Code Section 550 ("Section 550") to assess taxes for that month at any time. Once the City has completed an examination pursuant to Section 550 and issued a written determination of a deficiency, City Code Section 556 ("Section 556") precludes the City from conducting any additional audit or examination for the time period subjected to the examinations. The issue to be resolved in this matter is what time period was subjected to examination by the City in the First Assessment of Taxpayer for October 2007. The City has argued that the time period examined was the time period of the assessment which was October 2007. The Taxpayer has argued that the examination period must have included November 2007. The City's sole basis for imposing the speculative builder tax derives from a single transaction which was Taxpayer's sale of the Subject Property. Since the sale occurred in November 2007, Taxpayer argued that the City would have examined that period as part of its First Assessment. The City is required pursuant to City Code Section 555 ("Section 555") to provide a written notice of a deficiency. The City provided a written notice to Taxpayer for the First Assessment for only the period of October 2007. After review of Section 550, 555, and 556, as well as the First Assessment,

the only period we can conclude the City examined was for the period of assessment or October 2007. We conclude that the "written notice of determination of a deficiency" for which Section 556 sets forth the assessment period for which Taxpayer's liability is fixed and no additional audit or examination by the City may be conducted for such time period. No assessment against Taxpayer was made by the City for November 2007 until the Second Assessment. Based on the above, we conclude that the City's Second Assessment was not an impermissible additional assessment.

Taxpayer argued that the sale of the "Subject Property" was not a sale of "improved real property" pursuant to City Code Section 416 ("Section 416"). We note that Section 416(a)(2) enumerates four possible definitions of "improved real property." It's clear in this case that prior to the sale of the "Subject Property" that Taxpayer had water and sewer lines constructed across the "Subject Property." Taxpayer has argued that the definition in Section 416(a)(2)(D) does not apply because there is a requirement for water and sewer lines being constructed to the property line as well as a road being constructed to the property line. Since there was no road constructed to the property line, we must agree with Taxpayer that Section 416(a)(2)(D) does not apply. The City argued that Section 416(a)(2)(B) does apply in this case. Section 416(a)(2)(B) defines "improved real property" to be real property where improvements have been made to land containing no structure (such as paving or landscaping). We conclude that constructing water and/or sewer lines across real property clearly is a valuable additional to that property and would fall within the definition of "improved real property" set forth in Section 416(a)(2)(B). While Section 416(a)(2)(B) does provide paving and landscaping as examples, it does not limit improvements to those examples.

We cannot agree with Taxpayer's argument that the City's use of Section 416(a)(2)(B) somehow reads Section 416(a)(2)(D) as being meaningless. We agree with the City's conclusion that Section 416(a)(2)(B) applies to improvements on the property while Section 416(a)(2)(D) applies to the construction of water, power, and streets to the property line. Clearly, Subsections B and D capture different sales. We also must disagree with Taxpayer's argument that Subsection B only applies to surface lot improvements. While the two examples listed in Subsection B are surface lot improvements, the definition refers to "improvement to land containing no structure." If the drafters of Subsection B had intended the definition to only apply to surface lot improvements, they could have done that by changing the language from "improvements to land" to "surface lot improvements to land." Since that was not done, we are unable to conclude that Subsection B improvements only apply to surface lot improvements. Based on all of the above, we conclude that the sale of the Subject Property was a sale of "improved real property" pursuant to Section 416(a)(2)(B).

The next issue is whether or not there should be an adjustment to the selling price of the Subject Property for an in-place lease, building plans, permits, etc. Consistent with the law that tax imposition statutes are to be strictly construed against the taxing jurisdiction, we find that the intangible value of the lease was not part of the selling price of the "improved real property". Since the lease was not part of the "improved real property", we need to determine how much of the selling price was for the "improved real property"

and how much was for the value of the lease (non-improved real property).

The Purchase and Sale Agreement ("PSA") between Taxpayer and the buyer of the Subject Property provided for a purchase price of $4,600,000.00 which included the land, plans, permits and studies, and Taxpayer's rights to all leases. At the time of the sale of the Subject Property, Taxpayer had secured a long-term tenant, ***ABDC Fitness***, to anchor the eventual commercial development. The initial term of the lease was for 246 months with the annual rent ranging from $660,000.00 to $927,300.00. Taxpayer performed a present value calculation to arrive at a value for the lease of $1,925,086.00. When that amount is subtracted from the $4,600,000.00 purchase price, the resulting price of the "improved real property" would be $2,674,914.00. While the City disputed any reduction for the lease value, the City provided no analysis of the reasonableness of Taxpayer's present value analysis. We note that Taxpayer provided the Maricopa County Assessor's ("Assessor") determination of the 2009 fair market value of the Subject Property which was $2,643,000.00. We find that the Assessor's valuation provides support for the reasonableness of Taxpayer's present value calculation. Accordingly, we approve Taxpayer's present value calculation for the in-place lease and the resulting selling price of the "improved real property" to be $2,674,914.00.

Taxpayer also requested the value of the plans, permits and studies transferred to the buyer of the Subject Property be deducted from the selling price as not being part of the "improved real property". Taxpayer indicated the value of the plans, etc. was $215,997.00. It's not clear to the Hearing Officer that the plans, permits, and studies can be separated out from the total selling price of the "improved real property". The PSA refers to the Purchase Price shall include "all plans permits and studies completed or partially completed upon close of Escrow". It appears to the Hearing Officer that these are simply costs incurred in the improvement of the real property for sale. While there could have been a sale of "improved real property" without a lease, we conclude the plans, permits and studies were an integral part of the "improved real property." Accordingly, we do not have sufficient evidence to conclude the cost of plans, permits, and studies were not part of the "improved real property."

Lastly, Taxpayer requested a deduction for eight inch pipes and valves that are to be used to transport water through the subject property. Taxpayer asserted the pipes and valves would be exempt income-producing capital equipment pursuant to Section 416 (c) (1) (A) and City Code Sections 465(g) and 110 ("Sections 465(g) and 110"). While this equipment appears to fall under the exempt category set forth in Sections 465(g) and 110, we simply do not have any evidence of the costs for the pipes and valves. Accordingly, we conclude that Taxpayer has failed to meet its burden of proof for an exemption pursuant to Sections 416, 465, and City Code Section 360 ("Section 360").

FINDINGS OF FACT

1. Taxpayer is a development firm which develops, manages, and sells commercial real estate development projects.

2. On November 1, 2007, Taxpayer sold the Subject Property to ***XYZ Corporation*** for $4,600,000.00.

3. The City conducted an examination of Taxpayer and on February 6, 2008, issued a Notice of Assessment for the month of October 2007 ("First Assessment").

4. The First Assessment was for a total for $50,664.59 in speculative builder tax, interest and licensing fees.

5. Taxpayer timely protested the First Assessment.

6. Since Taxpayer had no gross receipts or income for the period of October 2007, the City withdrew the First Assessment.

7. On October 2, 2008, the City issued the Second Assessment.

8. The Second Assessment was for speculative builder taxes in the amount of $49, 968.05, interest in the amount of $2,040.36, and a license fee in the amount of $50.00.

9. Taxpayer filed a timely protest of the Second Assessment.

10. On January 10, 2006, Taxpayer sold a parcel of land contiguous to the Subject Property to ***DS Properties***.

11. The parcel of land sold to ***DS Properties*** was vacant land.

12. Subsequent to the sale to ***DS Properties***, Taxpayer installed water and sewer lines and electricity and telephone lines to the parcel of land.

13. In order to stub the water lines to the south property line of the ***DS Property***, Taxpayer had to run the main lines through the Subject Property.

14. Prior to the sale of the Subject Property, Taxpayer acquired plans and designs for the eventual development and construction of the property as a commercial site and shopping center.

15. Taxpayer incurred $215,997.00 in expenses to secure architectural drawings, engineering reports, environmental testing and permit fees prior to the sale of the Subject Property.

16. Prior to the sale of the Subject Property, Taxpayer secured a long-term tenant, ***ABDC Fitness*** to anchor the eventual commercial development by leasing space for its 35,000 square-foot health club facility.

17. The initial term of the ***ABDC Fitness*** lease was for 246 months.

18. The annual rent for the ***ABDC Fitness*** lease for the initial term varies from $660,000.00 to $927,300.00 with a total income stream of $16,236,000 over the initial term.

19. The PSA provided for a purchase price of $4,600,000.00 which included the land, plans, permits and studies, and Taxpayer's rights to all leases.

20. Taxpayer performed a present value calculation of the ***ABDC Fitness*** lease and arrived at a value of $2,674,914.00.

21. The Assessor determined the fair market value of the Subject Property was $2,643,000.00

22. Taxpayer constructed eight inch pipes and valves across the Subject Property for transporting of water.

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. Since Taxpayer failed to file a return for the month of November 2007, the City was authorized pursuant to Section 550 to assess taxes for that month at any time.

3. Once the City completed an examination of November 2007 pursuant to Section 550 and issued a written determination of a deficiency, Section 556 precludes the City from conducting any additional audit or examination for the time period subjected to the examination.

4. After review of Sections 550, 555, and 556, as well as the First Assessment, the only period we can conclude the City examined for the First Assessment was for October 2007.

5. No assessment was made by the City for November 2007 until the Second Assessment.

6. The City's Second Assessment was not an impermissible additional assessment.

7. Section 416(a)(2)(B) defines "improved real property" to be real property where improvements have been made to land containing no structure (such as paving or landscaping).

8. Constructing of water and/or sewer lines across real property is a valuable addition to that property and would fall within the definition of "improved real property" set forth in Section 416(a)(2)(B).

9. The law requires tax imposition statutes to be strictly constrained against the taxing jurisdiction.

10. The intangible value of Taxpayer's long-term lease with ***ABDC Fitness*** was not part of the selling price for the "improved real property" for the Subject Property sale.

11. The County Assessor's valuation for the Subject Property provides support for the reasonableness of Taxpayer's present value calculation for the ***ABDC Fitness*** lease.

12. The plans, permits and studies were an integral part of the "improved real property."

13. The plans, permits and studies were costs incurred by Taxpayer in the improvement of the real property for sale.

14. There was no evidence presented of any costs associated with the eight inch pipes and valves that were constructed across the Subject Property.

15. Taxpayer failed to meet its burden of proof for an exemption for the eight inch pipes and valves pursuant to Sections 416,465, and 360.

16. Taxpayers' protest should be partly granted and partly denied consistent with the Discussion, Findings, and Conclusions, herein.

ORDER

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

It is further ordered that the City of Mesa shall revise the assessment for ***Taxpayer*** by removing the $2,674,914.00 value of the ***ABDC Fitness*** lease from the Purchase Price of the Subject Property.

It is further ordered that this Decision is effective immediately.

Municipal Tax Hearing Officer