

DECISION OF MUNICIPAL TAX HEARING OFFICER

September 30, 2010

Taxpayers

Taxpayer's Address

Taxpayers
MTHO #567

Dear *Taxpayers*:

We have reviewed the evidence presented by *Taxpayers* and the City of Scottsdale (Tax Collector or City) at the hearing on June 30, 2010. The review period covered was August 2007. Taxpayer's protest, Tax Collector's response, and our findings and ruling follow.

Taxpayer's Protest

Taxpayer was assessed City of Scottsdale privilege tax under the speculative builder classification for the sale of a home Taxpayer trust (Trust) had constructed in the City. The City does not tax the sale of a home built by a taxpayer if the taxpayer used the home as his principal place of family residence for the six (6) months next prior to the offer for sale. The *taxpayers* used the home as their principal place of residence for about a year after the home was completed. The *taxpayers* are the grantors of the Trust. The Trust is disregarded for federal income tax purposes. The Trust should be disregarded, the *taxpayers* should be considered the owners and sellers of the home and the sale should be exempt from the speculative builder's tax. Even though the home was placed on an MLS listing, the listing was done without Taxpayer's knowledge or approval.

Tax Collector's Response

Taxpayer was the owner of record of the property on which the home was constructed. Taxpayer met the definition of a speculative builder. The exclusion for a taxpayer's bona fide sale of his principal residence only applies to individuals. The home was owned by the Trust, not the individual grantors of the Trust. Under the City tax code the Trust is a separate taxable entity. The treatment of the Trust for federal income tax purposes is not relevant for City privilege tax purposes. The Trust cannot be disregarded by the Tax Collector. Taxpayer is therefore not entitled to the exclusion for a taxpayer's bona-fide sale of his personal residence.

Even if the exclusion applied, the home was offered for sale on the Arizona Regional Multiple Listing Service shortly after it was completed. The *taxpayers* did not use the home as their principal place of family residence for six months prior to offering the home for sale.

Discussion

The *taxpayers* acquired vacant land (Property) in the City by quitclaim deed dated July 5, 2005. On September 26, 2005 the *taxpayers* transferred the Property to the Taxpayer trust. Taxpayer had a new home constructed on the Property. The Certificate of Occupancy for the home was issued on August 10, 2006. The *taxpayers* used the home as their principal place of residence for at least six months after the Certificate of Occupancy was issued. On September 13, 2006 the home was placed on the Arizona Regional Multiple Listing Service. Taxpayer sold the Property on August 31, 2007.

The Tax Collector audited Taxpayer for the period August 2007 and assessed Taxpayer for city privilege tax under the speculative builder classification in the amount of \$10,548.41, interest through December 31, 2009 in the amount of \$1,341.27 and license fees and license fee penalties in the amount of \$261.00. No other penalties were assessed. The Tax Collector considered Taxpayer to be a speculative builder when it sold the Property in August of 2007.

Taxpayer protested the assessment stating it was not a speculative builder. The *taxpayers* were the grantors of the Trust which they created as an estate planning device. The *taxpayers* had used the home as their principal place of residence for over a year. They had intended the home to be their retirement home but decided to sell because the home was too expensive and remote. The Trust is disregarded for federal income tax purposes and should be disregarded here. The sale was not subject to the tax because it was the sale of the *taxpayers* principal place of residence. While the home was listed by a Multiple Listing Service, that was done without the *taxpayers* approval.

Was Taxpayer a speculative builder?

Taxpayer was assessed as a speculative builder. A speculative builder is defined by the code as including an owner-builder who sells, at any time, improved real property consisting of custom homes regardless of the stage of completion. To be a speculative builder, a person has to be an owner-builder.

An owner-builder is defined as including an owner or lessor of real property who, by himself or by or through others, constructs or has constructed or reconstructs any improvement to real property. Taxpayer held title to the Property and had an improvement constructed on the Property. Taxpayer was an owner-builder and the Property was improved real property.

When Taxpayer sold the Property in August of 2007, it was an owner builder who sold improved real property. Taxpayer was a speculative builder.

Was the sale exempt as a homeowner's bona fide non-business sale?

A sale of a custom home is considered a homeowner's bona fide non-business sale and not subject to the speculative builder tax if, among other requirements, the property was actually used as the principal place of family residence or vacation residence by the immediate family of the seller for the six (6) months next prior to the offer for sale.

The Tax Collector argues that under the Model City Tax Code Regulations the terms "Owner" and "Homeowner" only mean an individual, and no other entity. The exemption therefore only applies to individuals. Here the Trust owned the Property at the time of the sale in August 2007, not the individual grantors of the Trust. The Trust does not qualify for the exemption.

Taxpayer argues that the Trust is disregarded for federal income tax purposes and is not treated as an entity separate from the grantors. Taxpayer contends the Trust should be

disregarded so that the *taxpayers*, the grantors of the Trust, were the homeowners who sold the Property. The *taxpayers* are individuals so the exemption for a homeowner's bona fide sale applies.

The question presented is whether a trust that is disregarded for federal income tax purposes should therefore be disregarded for city privilege tax purposes. The Internal Revenue Code (IRC) has specific provisions establishing the circumstances under which a trust will be disregarded. IRC §§ 671 – 677. In general, income of a trust is taxed to a grantor if, for example:

- the grantor has retained a reversionary interest in the trust, within specified time limits;
- the grantor has certain powers over the beneficial interests under the trust;
- certain administrative powers over the trust exist under which the grantor can or does benefit;
- the grantor has a power to revoke the trust or return the corpus to the grantor, or
- the grantor has the power to distribute income to or for the benefit of the grantor or the grantor's spouse.

The Scottsdale Tax Code (STC) does not have similar provisions under which a trust would be disregarded. The code imposes the privilege tax on every person engaging or continuing in business as a speculative builder. A “person” is defined by the code as including an individual, firm, partnership, corporation, estate or trust. The code further provides that for the purposes of the tax, a person is to be considered a distinct and separate person from any general or limited partnership or joint venture or other association with which such person is affiliated. Therefore, the Trust and the *taxpayers* are separate entities for purposes of the city privilege tax. The Trust cannot be disregarded for city privilege tax purposes. Taxpayer's sale was not a homeowner's bona fide non-business sale.¹

Based on all the above, we conclude Taxpayer's protest should be denied. The City's privilege tax assessment against Taxpayer was proper.

Findings of Fact

1. Taxpayer is a Trust established by the *taxpayers*.
2. The Trust was created as an estate planning device.
3. The Trust is disregarded for federal income tax purposes.
4. The *taxpayers* acquired *lot ABCD* in the *desert somewhere* on July 5, 2005.
5. The *taxpayers* transferred the Property to the Taxpayer Trust on September 26, 2005.
6. The Property was vacant land at the time Taxpayer acquired it.
7. Taxpayer had a new home constructed on the Property.

¹ Since we decide that the Trust is not entitled to the homeowner's bona fide sale exemption because it is not an individual, it is not necessary to address whether placing the Property on the Arizona Regional Multiple Listing Service constituted offering the home for sale.

8. A Certificate of Occupancy was issued on August 10, 2006.
9. Taxpayer was listed as the owner on the Certificate of Occupancy.
10. On September 13, 2006 the home was placed on the Arizona Regional Multiple Listing Service.
- 11.** On August 31, 2007 Taxpayer sold the Property to the ***New Owners LLP***.
12. The sale price for the Property was \$2,750,000.00.
13. The Tax Collector conducted an audit assessment of Taxpayer for the period August 2007.
14. The Tax Collector assessed Taxpayer for city privilege tax under the speculative builder classification in the amount of \$10,548.41, interest through December 31, 2009 in the amount of \$1,341.27 and license fees and license fee penalties in the amount of \$261.00.
15. No other penalties were assessed.
- 16.** The Tax Collector based the assessment on the sales price of the Property to the ***New Owners LLP***.
17. Taxpayer timely protested the assessment by letter dated February 15, 2010.
18. Taxpayer believed it was exempt from the speculative builder tax because the ***taxpayers***, the grantors of the Trust, used the residence as their principal place of residence for over a year.

Conclusions of Law

1. An Owner-Builder is defined as an owner or lessor of real property who, by himself or by or through others, constructs or has constructed or reconstructs any improvement to real property. Scottsdale Tax Code (STC) § 100.
2. Taxpayer had title to the Property and had an improvement constructed on the Property.
3. Taxpayer was an owner-builder.
4. A speculative builder includes an owner-builder who sells, at any time, improved real property consisting of custom homes regardless of the stage of completion. STC § 100.
5. Improved real property includes any real property upon which a structure has been constructed. STC § 416(a)(2)(A).
6. The Property was improved real property.
7. Sale of improved real property includes any form of transaction which in substance is a transfer of title of improved real property. STC § 416(a)(3).
8. Taxpayer sold improved real property when it transferred title to the Property to the ***New Owners LLP***.
9. Taxpayer was a speculative builder during the audit period when it sold the Property.

10. STC § 416 imposes the city privilege tax on a person engaging in business as a speculative builder.
11. A sale of a custom home is considered a "homeowner's bona fide non-business sale" and excluded from the tax on speculative builders if, among other things, the property was actually used as the principal place of family residence or vacation residence by the immediate family of the seller for the six (6) months next prior to the offer for sale. Regulation 416.1(a)(1).
12. As used in the regulation, the terms "Owner" and "Homeowner" only mean an individual, and no other entity, association, or representative, other than an administrator, executor, personal representative, or guardian, qualifies. Regulation 416.1(d).
13. Taxpayer is a Trust and not an individual.
14. Person means an individual, firm, partnership, joint venture, association, corporation, estate, trust, receiver, syndicate, broker, the Federal Government, this State, or any political subdivision or agency of this State. STC § 100.
15. A person is considered a distinct and separate person from any general or limited partnership or joint venture or other association with which such person is affiliated. STC § 100.
16. The Internal Revenue Code has specific provisions establishing the circumstances under which a trust will be disregarded for federal income tax purposes. IRC §§ 671 – 677.
17. The City of Scottsdale Tax Code does not have specific provisions establishing circumstances under which a trust would be disregarded for city privilege tax purposes.
18. Taxpayer Trust is a separate and distinct person from the *taxpayers*, the grantors of the Trust.
19. Taxpayer is not an owner or homeowner within the meaning of Regulation 416.1(a)(1).
20. Taxpayer's sale was not a homeowner's bona fide non-business sale excluded from the tax on speculative builders. Regulation 416.1(a)(1).
21. The City's privilege tax assessment against Taxpayer was proper.

Ruling

The protest by Taxpayer of an assessment made by the City of Scottsdale for the period August 2007 is denied.

The Tax Collector's Notice of Assessment for the period August 2007 is upheld.

The Taxpayer has timely rights of appeal to the Arizona Tax Court pursuant to Model City Tax Code Section –575.

Sincerely,

Hearing Officer

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c: Tax Audit Manager
Municipal Tax Hearing Office