

DECISION OF MUNICIPAL TAX HEARING OFFICER

Decision Date: March 28, 2011

Decision: MTHO # 591

Taxpayer:

Tax Collector: City of Scottsdale

Hearing Date: February 24, 2011

DISCUSSION

Introduction

On August 27, 2009 and as amended on August 13, 2010, a letter of protest was filed by ***Taxpayer*** of a tax assessment made by the City of Scottsdale (“City”). A hearing was commenced before the Municipal Tax Hearing Officer (“Hearing Officer”) on February 24, 2011. Appearing for Taxpayer was ***his Representative, a Managing Member of Taxpayer, and a General Partner***. Appearing for the City was ***the Deputy City Attorney, the Tax and License Supervisor and the Tax Auditor***. On February 28, 2011, the Hearing Officer closed the record and indicated a written decision would be issued on or before April 11, 2011.

DECISION

The City conducted an audit of Taxpayer for the period of June 2004. The City concluded that Taxpayer was in the business activity of a speculative builder pursuant to City Code Section 416 (“Section 416”). The City assessed Taxpayer for additional taxes in the amount of \$13,169.81, penalties in the amount of \$1,316.98, and interest up through June 2009 in the amount of \$5,536.29.

Taxpayer developed fifty lots on sixty acres in the City and paid City taxes when the lots were sold. Taxpayer sold Lot #33 to ***Great Contractors*** on June 9, 2000. On December 1, 2000, the City issued building permit ***#123456789*** to ***Great Contractors*** for the construction of a single family home. ***Great Contractors*** had largely completed the home when it defaulted on the construction loan. Prior to the default, ***Great Contractors*** had listed the property on the multiple listing services (“MLS”). In March of 2002, Taxpayer acquired the property at a Trustee’s Sale for \$364,865.15. Taxpayer also assumed the first deed of trust totaling \$877,500.00 for a total sum of \$1,242,365.15. After acquiring improved Lot #33, Taxpayer had additional construction work totaling \$52,520.50 to complete the home. The additional work included painting, constructing a retaining wall, exterior landscaping, and plumbing repairs. On March 7, 2003, a final Certificate of

Occupancy (“COO”) was issued on Lot #33. On July 28, 2004, Lot #33 was transferred from Taxpayer to *New Owners #1 and New Owner #2*. *New Owner #2* was a principal of *a Revocable Trust*, a member of Taxpayer. While no affidavit of value was recorded, the property was listed for sale at \$1,695,000.00. On November 15, 2005, the property was transferred back to Taxpayer and simultaneously transferred to an *unrelated third party*, for \$1,549,000.00. Subsequently, the City assessed a speculative builder tax on the July 28, 2004 transfer to the *New Owners #1 and New Owner #2*. Since there was no value stated on the transfer and the transfer was to related parties, the City determined market value using the list price of \$1,695,000.00 as the market value pursuant to City Code Section 210 (“Section 210”).

Taxpayer had argued that the City should have assessed *Great Contractors* for the March 2002 transfer to Taxpayer. Taxpayer also argued that it had no intention of being a speculative builder but finalized the construction in order to recoup its losses.

Our first issue is to decide whether or not the *Great Contractor’s* transfer to Taxpayer was a taxable speculative builder sale. City Code Section 100 (“Section 100”) defines a “speculative builder” as an owner-builder who sells or contracts to sell improved real property regardless of the stage of completion. Section 416 defines a “sale of improved real property” to include any form of transaction which in substance is a transfer of title of improved real property. As a result, we conclude the transfer by *Great Contractors* to Taxpayer was a taxable speculative builder sale pursuant to Section 416. Based on the inspection list provided by the City, the *Great Contractor’s* transfer would have been a transfer of “partially improved residential real property” since the property was not substantially complete at the time of transfer. Based on the definition set forth in Section 100 of “substantially complete”, the property would not be substantially complete until it was ready for its intended use. In this case, the intended use was for a residential home. Based on the inspection list, there had not been approval for electric, natural gas, or sewer utilities at the time of the *Great Contractor’s* transfer. Clearly, the home was not ready to be lived in. There is a provision in Section 416 that allows a speculative builder to exclude the gross income when certain conditions are met whereby the purchaser agrees to be responsible for the taxes. There was no evidence of any such agreement in this matter and accordingly, the *Great Contractor’s* transfer was a taxable speculative builder sale. Unfortunately for Taxpayer, *Great Contractors* never paid the taxes on the sale and Taxpayer becomes liable pursuant to City Code Section 595 (“Section 595”). Section 595(c) provides that any person who purchase or acquires by foreclosure, by sale under deed of trust or by any other method, improved real property for which the Privilege Tax imposed by this Chapter has not been paid shall be responsible for payment of such tax as a speculative builder. Section 595(d) provides protection for a successor if they obtain a written certificate at the time of transfer that all City taxes have been paid. There was no evidence of such a certificate in this matter. Accordingly, Taxpayer is liable for the tax on the *Great Contractor’s* transfer.

At the time of the transfer from Taxpayer to *New Owner’s #1 and New Owner #2*, there was evidence that the home was now substantially complete as a COO was issued on March 7, 2003. As a result, this would be a second speculative builder sale. This sale

would receive a credit for any taxes paid for the *Great Contractor's* transfer. As noted by the City, there was no value placed on this transfer to related entities. Section 210 provides that when the transaction between related entities is not indicative of the market value, the City shall determine the market value. In this case, the City concluded the listing price of \$1,695,000.00 at the time of the transfer was a reasonable market value. We would have preferred an actual sale to a listing but the sale to a third party never occurred until approximately fifteen months later for \$1,549,000.00. We conclude it would be reasonable to average the list price and the sale price to arrive at a reasonable estimate for the market price on July 28, 2004. Accordingly, we conclude a fair gross income for the speculative builder transfer on July 28, 2004 would be \$1,622,000.00. The tax on this transfer would receive a credit for any tax paid on the *Great Contractors* transfer.

City Code Section 540 provides for interest to be assessed on taxes due. Under the circumstances of this case, we conclude that any interest assessed Taxpayer, even on the Stripling transfer, should not begin until after the transfer by Taxpayer on July 28, 2004. Lastly, we conclude that Taxpayer has provided reasonable cause to have all penalties waived in this matter. Based on all the above, we find that Taxpayer's protest should be partly denied, and partly granted, consistent with the Discussion, Findings, and Conclusions, herein.

FINDINGS OF FACT

1. On August 27, 2009 and as amended on August 13, 2010, Taxpayer filed a protest of a tax assessment made by the City.
2. The City conducted an audit of Taxpayer for the period of June 2004.
3. The City assessed Taxpayer for additional taxes in the amount of \$13,169.81, interest up through June 2009 in the amount of \$5,536.29, and penalties totaling \$1,316.98.
4. Taxpayer developed fifty lots on sixty acres in the City and paid City taxes when the lots were sold.
5. Taxpayer sold Lot #33 to *Great Contractors* on June 9, 2000.
6. On December 1, 2000, the City issued building permit #123456789 to *Great Contractors* for the construction of a single family home.
7. *Great Contractors* had largely completed the home when it defaulted on the

construction loan.

8. Prior to the default, **Great Contractors** had listed the property on the MLS.
9. In March 2002, Taxpayer acquired the property at a Trustee's Sale for \$364,865.15.
10. Taxpayer also assumed the first deed of trust totaling \$877,500.00 for a total sum of \$1,242,365.15.
11. After acquiring improved Lot #33, Taxpayer had additional construction work totaling \$52,520.50 to complete the home.
12. The additional work included painting, construction of a retaining wall, exterior landscaping, and plumbing repairs.
13. On March 7, 2003, a final COO was issued on Lot #33.
14. On July 28, 2004, Lot #33 was transferred to **New Owner's #1 and New Owner #2**.
15. **New Owner #2** was a principal of **the Revocable Trust**, a member of Taxpayer.
16. While no affidavit of value was recorded, the property was listed for sale at \$1,695,000.00 at the time of transfer.
17. On November 15, 2005, the property was transferred back to Taxpayer and simultaneously transferred to an **unrelated third party**, for \$1,549,000.00.
18. Subsequently, the City assessed a speculative builder tax on the July 28, 2004 transfer to the **New Owner's #1 and New Owner #2**.
19. **Great Contractors** did not pay any speculative builder tax to the City on the transfer to Taxpayer.

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. Section 100 defines a “speculative builder” as an owner-builder who sells or contracts to sell improved real property regardless of the stage of completion.
3. Section 416 defines a “sale of improved real property” to include any form of transaction which in substance is a transfer of title of improved real property.
4. The transfer by **Great Contractors** to Taxpayer was a taxable speculative builder sale pursuant to Section 416.
5. Based on the definition set forth in Section 100 for “substantially complete”, the improved real property would not be substantially complete until it was ready for its intended use.
6. Based on the City’s inspection list, the improved Lot #33 had not received final approval for electric, natural gas, or sewer utilities at the time of the **Great Contractors** transfer and the home was not ready to be lived in.
7. Based on the inspection list provided by the City, the **Great Contractors** transfer would have been a transfer of “partially improved residential real property” since the property was not substantially complete at the time of transfer.
8. Section 416 provides for a speculative builder to exclude the gross income from a sale of partially improved real property when certain conditions are met whereby the purchaser agrees to be responsible for the taxes.
9. There was no evidence of any such agreement between **Great Contractors** and Taxpayer and accordingly the **Great Contractors** transfer was a taxable speculative builder sale.
10. Section 595 provides that any person who purchases or acquires by foreclosure, by sale under deed of trust or by any other method, improved real property for which the Privilege Tax imposed by this Chapter has not been paid shall be responsible for payment of such tax as a speculative builder.
11. Section 595 provides protection for a successor if they obtain a written certificate at the time of transfer that all City taxes have been paid.
12. Taxpayer provided no written certificate for the **Great Contractors** transfer.
13. Taxpayer is liable for the taxes on the **Great Contractors** transfer pursuant to Section 595.
14. Taxpayer’s transfer to **New Owner’s #1** and **New Owner #2** was a speculative builder sale pursuant to Section 416.
15. Taxpayer’s speculative builder sale would receive a tax credit for any taxes paid

- for the *Great Contractors* transfer.
16. Section 210 provides that when a transaction between related entities is not indicative of the market value, the City shall determine the market value.
 17. A reasonable market value for the July 28, 2004 transfer by Taxpayer would be \$1,622,000.00.
 18. Section 540 provides for interest to be assessed on taxes due.
 19. Any interest assessed on Taxpayer, even on the *Great Contractors* transfer, should not begin until after the July 28, 2004 transfer.
 20. Section 540 authorizes the City to impose penalties.
 21. Taxpayer has provided reasonable cause to have all penalties waived in this matter.
 22. Taxpayer's protest should be partly granted and partly denied, consistent with the Discussion, Findings, and Conclusions, herein.
 23. The parties have timely appeal rights pursuant to Model City Tax Code Section 575.

ORDER

It is therefore ordered that the August 27, 2009 and as amended on August 13, 2010, protest by *Taxpayer* of a tax assessment made by the City of Scottsdale is hereby partly denied and partly granted, consistent with the Discussion, Findings, and Conclusions, herein.

It is further ordered that *Taxpayer* is liable for the speculative builder sale taxes on the *Great Contractors* transfer pursuant to Section 595.

It is further ordered that *Taxpayer* is liable for the speculative builder taxes on the July 28, 2004 transfer to *New Owners #1 and New Owner #2*.

It is further ordered that the City of Scottsdale shall utilize a market value of \$1,622,000.00 for the transfer by *Taxpayer to New Owners #1 and New Owner #2*.

It is further ordered that *Taxpayer* shall receive a tax credit on its July 28, 2004 speculative builder sale for any taxes paid on the *Great Contractors* speculative builder sale.

It is further ordered that any interest assessed *Taxpayer*, even on the *Great Contractors* transfer, shall not begin until after the July 28, 2004 transfer.

It is further ordered that the City of Scottsdale shall remove all penalties assessed in this matter.

It is further ordered that this Decision is effective immediately.

Municipal Tax Hearing Officer