

DECISION OF MUNICIPAL TAX HEARING OFFICER

December 17, 2012

Taxpayers Representative
Address of Taxpayer's Representative

Taxpayers
Successor to Custom Homes, LLC
MTHO #704

Dear *Taxpayer's Representative*:

We have reviewed the evidence and information presented by *Taxpayers, Successor to Custom Homes, LLC* and the City of Mesa (Tax Collector or City) at the hearing on August 1, 2012 and in post-hearing memoranda. The review period covered was September 2008. Taxpayers' protest, Tax Collector's response, and our findings and ruling follow.

Taxpayers' Protest

The Tax Collector issued a Notice of Succession to Taxpayers as successors to *Custom Homes, LLC (Custom Homes)*, a speculative builder, from whom Taxpayers purchased a home. Taxpayers protested the Notice because:

1. Taxpayers purchased the property with title insurance protecting them against covered risks including outstanding sales taxes,
2. Disbursements for sales taxes were made at real estate closing, and
3. Taxpayers are neither speculative builders nor owner builders.

Taxpayers further argued in post hearing memoranda:

1. The Notice stated the wrong tax period and must be dismissed,
2. Taxpayers were not engaged in business,
3. Even if the tax applied, Taxpayers would only be taxable on their sale of the home,
4. The application of successor liability is discretionary,
5. Applying the successor liability provision against the ultimate purchaser is a new interpretation that can only be applied prospectively, and
6. The City should first exhaust its personal liability ordinance against the principals of the speculative builder.

Tax Collector's Response

The City issued an assessment against *Custom Homes* for the speculative builder tax due on the sale of improved real property to Taxpayers. *Custom Homes* did not protest the assessment and has not paid the taxes due. Taxpayers are purchasers of the property and are therefore liable for the tax as successors. The inaccuracy of the tax period stated in the Notice did not invalidate the Notice. The successor liability provisions apply to any person who is a successor. The successor does not himself have to be in business. Deferring the successor's tax liability until the

successor sells the property only applies to creditors who purchased the property through foreclosure. Application of successor liability is not discretionary. Applying the tax to the ultimate purchaser is not a new interpretation of the provision. The City's personal liability ordinance was not enacted until after the tax period in issue and can only be applied prospectively.

Discussion

Taxpayers purchased a home from *Custom Homes*. *Custom Homes* did not pay City privilege tax on its sale of the home to Taxpayers. The City audited *Custom Homes* and issued an assessment. *Custom Homes* did not protest the assessment and is final. *Custom Homes* has not paid the assessment. In order to collect the tax, the City issued a Notice of Succession to Taxpayers as the successors to *Custom Homes*. Taxpayers protested arguing that they were not liable for *Custom Homes* taxes as successors.

Is the Notice void because it stated the wrong tax period?

The home was sold by *Custom Homes* to Taxpayers by deed dated September 15, 2008. The Notice of Succession identified the period of liability as June 2008. Taxpayers argue that this error voids the Notice of Succession.

First, the Mesa Tax Code (MTC) does not prescribe the content of an assessment or a notice of succession.¹ (*See, Pepsico, Inc. v. Bouchard*, 102 A.D.2d 1000, 477 N.Y.S.2d 892 (1984)). Second, the wrong date in the Notice did not prevent Taxpayers from timely filing a protest addressing the substantive issues presented in the City's Notice. The issue of the wrong tax period being stated in the Notice was not raised until Taxpayers' post-hearing memorandum.

A similar question was addressed by the Indiana Tax Court in *Horrall v. Indiana Department of State Revenue*, 687 N.E.2d 1219 (1997). There the court held that having the wrong assessment period did not render the assessment fatally defective. The factual error did not impact the substantive question of the taxpayer's liability, the taxpayer was not lulled into failing to file a written protest and his preparation of his case was not affected. The court concluded that the notice of proposed assessment is an important procedural device and the factual error in the notice of proposed assessment did not impact the substantive question of the taxpayer's tax liability.

The same is true here. We therefore hold that the Notice was not void because it stated the wrong tax period.²

Does a successor have to be independently engaged in business?

Taxpayers argue that under MTC § 5-10-400(a), the privilege tax is imposed upon persons on account of their business activities. The successor liability provisions in MTC § 5-10-595 must therefore be limited to persons purchasing real property in furtherance of a business activity. Taxpayers purchased a home that they use as their personal residence. Taxpayers are not engaged in any business activities the City can tax.

¹ In contrast, for example, Internal Revenue Service regulation § 301.6203-1 does require that the taxable period, if applicable, be included in an assessment.

² Even if we held the Notice was void, the City could issue another Notice for the correct period.

The City argues that MTC § 5-10-595 does not require that a successor be engaged in business. Subsection (C) specifically applies to “[a]ny person who purchases or who acquires ... improved real property ... for which the Privilege Tax imposed by this Chapter has not been paid....”

MTC § 5-10-400(a)(1) imposes the privilege tax on persons on account of their business activities to the extent provided in Article IV. Article IV specifies the business activities subject to the privilege tax. The successor liability provision (MTC § 5-10-595) is in Article V. The language of MTC § 5-10-595(C) applies to any purchaser and does not require that a successor also be engaged in a taxable business.

Can Taxpayers defer the payment of tax until they sell the property?

Taxpayers contend that because a successor is responsible for the payment of the tax as a speculative builder or owner builder, Taxpayers would only be liable for speculative builder tax upon their sale of the property.

The City argues that the deferral of the tax until the subsequent sale of the property is an action only allowed to creditors or affiliates of a creditor who have purchased the real property through foreclosure.

While MTC § 5-10-595 applies the successor liability provisions generally to all taxable classifications, subsection (C) applies specifically to speculative builders and owner builders. Subsection (C) applies to any purchaser of improved real property where the tax has not been paid. When subsection (C) provides that a person purchasing property for which the Privilege Tax has not been paid shall be responsible for payment of such tax as a speculative builder, the term “such tax” refers back to the tax that should have been paid by the speculative builder.

Paragraphs (1) through (5) of subsection (C) apply specifically to creditors of the speculative builder. In general, under paragraph (1), a creditor who acquired the property from the debtor is to pay the tax based on the amount received by the creditor in a subsequent sale. However, under paragraph (2), if a creditor uses the property for its own purposes unrelated to selling the property, the creditor is taxable at that time based on the value of the property on the date it acquired the property.

Paragraph (2) supports the City’s position that, except in the case of a creditor who acquires property from a debtor and sells the property, the tax is due at the time of the acquisition by the successor.

Is the application of successor liability discretionary?

Taxpayer argues that the successor liability provisions are discretionary and the City should have used its discretion not to apply the provisions in this case. The City contends the provisions are not discretionary and the City has the right to impose successor liability if the City has been unsuccessful in collecting the unpaid taxes directly from the taxpayer.

The Tax Collector cannot audit or collect from every taxpayer, and there is no requirement that it audit or pursue collection from every taxpayer. The Tax Collector has the discretion to use its limited resources in the most efficient way. *See, Tucson Mechanical Contracting, Inc. v. Arizona Department of Revenue*, 175 Ariz. 176, 854 P.2d 1162 (1992). Taxpayers have presented no evidence to show that they were issued the Notice for some improper reason or that the Tax Collector has systematically and deliberately discriminated against Taxpayers. The Tax Collector did not improperly issue Taxpayers the Notice.

Is applying the successor liability provision against the ultimate purchaser a new interpretation that can only be applied prospectively?

Taxpayers argue that applying the successor liability provisions to an ultimate purchaser, such as them, is a new interpretation or application of law that can only be applied prospectively. The City contends that it is not a new interpretation or application of the law.

MTC § 5-10-542(B) provides that if the Tax Collector adopts a new interpretation or application of any provision or determines that any provision applies to a new or additional category or type of business, and the change in interpretation or application is not due to a change in the law, the change in interpretation or application applies prospectively only unless it is favorable to taxpayers. Subsection (C) provides that the term "new interpretation or application" includes policies and procedures which differ from established interpretations.

No evidence was presented showing that the City's Notice was a new interpretation or application of the successor liability provisions. There was no identification of any established interpretation that was being changed.

Also, MTC § 5-10-595(C)(2) appears to support the City's position. Under paragraph (2), if a creditor uses the property for its own purposes unrelated to selling the property, the creditor is taxable at that time based on the value of the property on the date of acquisition. This supports the argument that the code contemplates imposing successor liability on the ultimate purchaser. The Notice was therefore not precluded by MTC § 5-10-542.

Must the City first exhaust its personal liability ordinance against the principals of the speculative builder before seeking payment from a successor?

Custom Homes was a limited liability company and its members were not personally liable for *Custom Homes* debts. The City did not attempt collection against the members. The City has now passed personal liability provisions that may allow collection from members of a limited liability company. Taxpayers contend that the City must first attempt collection of the liability from the principals of *Custom Homes* under the personal liability provisions.

The City contends that those provisions did not go into effect until November 4, 2010 and, unless otherwise directed by law, the City is required to apply the new law prospectively. Because the sale of the property to Taxpayers occurred in September 2008, before the new law was enacted, those provisions cannot be used against the members of *Custom Homes*.

MTC § 5-10-595(A) provides that the successor liability provisions are in addition to any other applicable remedy provided in the City Code. The City has been unable to collect the tax from *Custom Homes*. The code does not specify any particular remedy that must first be exhausted before the successor liability provisions may be used. The City was thus not precluded from utilizing the successor liability provisions in this case.

Based on the foregoing, Taxpayer's protest of the Tax Collector's Notice of Succession assessment for the period September 2008 is denied.

Findings of Fact

1. Taxpayers purchased improved real property from *Custom Homes* in September 2008.
2. *Custom Homes* was a limited liability company engaged in business as a speculative builder.

3. *Custom Homes* did not pay City privilege tax on its sale of the property to Taxpayers.
4. The Tax Collector issued a jeopardy assessment against *Custom Homes* for the period September 2008 in February 2009.
5. *Custom Homes* did not protest the assessment and it is final.
6. *Custom Homes* did not pay the assessment.
7. The City filed a Notice of Claim of Lien against *Custom Homes* on March 10, 2009.
8. The City has been unsuccessful in collecting the privilege tax due from *Custom Homes*.
9. The City issued a Notice of Succession to Taxpayers as the successor to *Custom Homes*.
10. The Notice of Succession identified the period of liability as June 2008.
11. Taxpayers timely protested arguing that they were not liable for *Custom Homes* tax due on the sale of the property as successors to *Custom Homes*.
12. Taxpayers use the property purchased from *Custom Homes* as their personal residence.
13. Taxpayers are not engaged in a business taxable under the MTC.
14. Taxpayers were not creditors of *Custom Homes* or affiliated with a creditor of *Custom Homes*.
15. The City did not attempt collection against the members of *Custom Homes*.
16. The parties submitted post-hearing memoranda.
17. Taxpayers first raised the argument that the Notice of Succession stated the wrong tax period in their post-hearing memorandum.

Conclusions of Law

1. *Custom Homes* was a speculative builder within the City.
2. *Custom Homes* is liable for privilege tax due on the sale of the property to Taxpayers.
3. The City may collect taxes from a purchaser of property from a speculative builder if the taxes were not paid by the speculative builder. MTC § 5-10-595(C).
4. The City may issue notice of deficiency and notice of succession to collect taxes from a successor. MTC §§ 5-10-545 and 5-10-595.
5. MTC §§ 5-10-545 and 5-10-595 do not prescribe the content of a notice of deficiency or notice of succession.
6. Failure to include the correct tax or assessment period in the Notice of Succession did not invalidate the Notice of Succession. *Pepsico, Inc. v. Bouchard*, 102 A.D.2d 1000, 477 N.Y.S.2d 892 (1984); *Horrall v. Indiana Department of State Revenue*, 687 N.E.2d 1219 (1997).
7. The City privilege tax is imposed on persons engaging in certain businesses. MTC § 5-10-400(a).
8. MTC § 5-10-595(C) applies to any purchaser of property from a speculative builder if the taxes are not paid by the speculative builder. MTC § 5-10-595(C).

9. MTC § 5-10-595(C)(1) deferring the payment of the tax by a successor only applies to creditors or affiliates of creditors who acquired property from a debtor through foreclosure or a deed in lieu of foreclosure.
10. Taxpayers were not creditors of *Custom Homes*.
11. Taxpayers were liable as successors to the taxes imposed on *Custom Homes* sale of the property to Taxpayers. MTC § 5-10-595(C).
12. The Tax Collector was authorized to issue a Notice of Succession. MTC § 5-10-595(C).
13. The Tax Collector is not required to audit or pursue every taxpayer. *Tucson Mechanical Contracting, Inc. v. Arizona Department of Revenue*, 175 Ariz. 176, 854 P.2d 1162 (1992).
14. The Tax Collector may use his discretion to select some taxpayers for enforcement. *Tucson Mechanical Contracting, Inc. v. Arizona Department of Revenue, supra*.
15. The fact that the Tax Collector subjects a taxpayer to an audit and assessment does not establish a denial of equal protection absent a showing that the action was based upon an unjustifiable standard, such as race, religion or some other arbitrary classification. *Tucson Mechanical Contracting, Inc. v. Arizona Department of Revenue, supra*.
16. The Tax Collector's reason for selecting Taxpayer for collection as a successor to *Custom Homes* was not based on an unjustifiable standard.
17. If the Tax Collector adopts a new interpretation or application of any provision or determines that any provision applies to a new or additional category or type of business, and the change in interpretation or application is not due to a change in the law, the change in interpretation or application applies prospectively only unless it is favorable to taxpayers. MTC § 5-10-542(B).
18. A new interpretation or application includes policies and procedures which differ from established interpretations. MTC § 5-10-542(C).
19. It has not been shown in this case that issuing the Notice of Succession to Taxpayers constituted a new interpretation or application of MTC § 5-10-595.
20. The successor liability provisions are in addition to any other applicable remedy provided in the City Code. MTC § 5-10-595(A).
21. The code does not specify any particular remedy that must first be exhausted before the successor liability provisions may be used.
22. The City was not precluded from utilizing the successor liability provisions in this case.
23. The Tax Collector's Notice of Succession to Taxpayers was proper.
24. Taxpayers' protest to the Tax Collector's Notice of Succession is denied.

Ruling

Taxpayers' protest of a Notice of Succession made by the City of Mesa for the period September 2008 is denied.

The Tax Collector's Notice of Succession dated December 21, 2011 is upheld.

Taxpayers have 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: *Mesa Tax Administrator*
Municipal Tax Hearing Office