

DECISION OF MUNICIPAL TAX HEARING OFFICER

May 29, 2013

Taxpayer's Representative
Address of Taxpayer's Representative

Taxpayer
MTHO #769

Dear Taxpayer's Representative,

We have reviewed the evidence submitted for redetermination by *Taxpayer* and the City of Scottsdale (Tax Collector or City). The review period covered was January 2012. 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 based on the foreclosure and trustee's sale of a property Taxpayer developed. Taxpayer was unable to make payments on the loan. The bank sold the property for more than its cost. The bank as successor, and not Taxpayer, should be liable for the tax. In addition, Taxpayer did not receive any income subject to tax, penalties were improperly imposed and the Tax Collector failed to provide Taxpayer an informal conference before issuing the assessment, depriving Taxpayer of due process.

Tax Collector's Response

Taxpayer was the owner of the property. Taxpayer developed the property and was therefore an owner-builder. When the home was transferred by Trustee's deed, Taxpayer became a speculative builder. The sale of improved real property includes any form of transaction which in substance is a transfer of title to improved real property. Taxpayer met the definition of a speculative builder. Taxpayer received gross income because its debt was reduced. The penalties were proper. Finally, the Tax Collector mailed and faxed a preliminary assessment to Taxpayer and left a telephone message. Taxpayer did not return the call or respond to the preliminary assessment. Taxpayer did not request an informal conference. The assessment should therefore be upheld.

Discussion:

Taxpayer developed real property in the City. Taxpayer was unable to sell the property and the property was foreclosed by the bank. The property was sold at a trustee's sale in January 2012 for the approximate amount owed by Taxpayer on the loan. The City concluded that Taxpayer met the definition of "owner-builder" and "speculative builder" and was therefore subject to the City privilege tax on speculative builders. Taxpayer received consideration in the form of a reduction in the amount owed to the lender equal to the amount of the bid price.

The Tax Collector audited Taxpayer for the period January 2012 and mailed and faxed Taxpayer the preliminary assessment packet. Taxpayer did not contact the Tax Collector and the final assessment was issued. Taxpayer timely protested the assessment arguing:

- Taxpayer was erroneously assessed because the lending bank was subject to the tax as a successor under Scottsdale Tax Code (STC) § 595(c).
- Taxpayer had no gross receipts from the transaction at issue.
- Penalties assessed were not valid under STC § 540, and
- The Tax Collector failed to provide an informal conference prior to issuing the assessment as required by STC § 570(a).

Does STC § 595(c) preclude the assessment?

Taxpayer contends that the proper person subject to the tax was the bank because the bank was a successor in business to the property and ultimately sold the property for more than its cost. The City has in other cases assessed the tax against the successor under the successor liability statute, STC § 595. The statute requires the City to collect the speculative builder tax from a debtor's creditor.

STC § 595(c) makes a person acquiring the property liable for the speculative builder privilege tax that had not been paid on the property. While STC § 595(c) provides the City with an alternative remedy to collect unpaid speculative builder privilege taxes, the remedy is not exclusive. STC § 595(a) specifically states that successor liability is in addition to any remedy provided elsewhere in the City Code. STC § 595(c)(3) and (4) recognize that the availability of successor liability does not release the debtor's (original taxpayer's) liability. Paragraph (3) provides that if the successor pays the tax it owes, it is not liable for any outstanding tax, penalties or interest that may continue to be due from the debtor. Under paragraph (4) a creditor who pays the tax is entitled to a credit for any taxes later paid by the taxpayer.

The availability of the remedies under STC § 595(c) does not preclude the assessment against Taxpayer.¹

Did Taxpayer have taxable gross receipts from the transaction?

Taxpayer does not dispute that it was an owner-builder or speculative builder, but contends that it did not have any gross income from the transaction which can be assessed. While Taxpayer received a reduction in debt resulting from the property's transfer at the public auction, Taxpayer contends it had incurred costs greater than the reduction in debt. The bank on the other hand received income by selling the property for more than the property's cost to the bank.

Gross income includes a reduction of or forgiveness of indebtedness. STC § 200(a)(3). No deduction or exclusion is allowed from gross income on account of the cost of the property sold, the time value of money, expense of any kind or nature, losses, materials used or labor or service performed. STC § 200(c).

¹ Taxpayer references MTHO # 570/580 that payment of the tax in that case by the purchaser from the successor eliminated the assessments against both the taxpayer in that case and its successor. There is no indication here that the tax was paid by anyone.

The tax on speculative builders is measured by Taxpayer's gross income (the reduction of the debt) less allowable deductions and credits (factored tax and 35% exclusion). The costs incurred by Taxpayer may not be deducted under the Tax Code. Taxpayer had taxable receipts subject to the privilege tax.

Were penalties properly assessed?

The assessment included a 10% penalty for failure to pay the tax. Taxpayer argues that it had a reasonable basis to believe that the tax did not apply because the property was foreclosed upon and later sold by the bank. The penalty should therefore be abated.

The Tax Collector is authorized to assess penalties pursuant to STC § 540. STC § 540(f) sets out specific circumstances for penalty abatement and further provides that a taxpayer may request a waiver for a reason thought to be equally substantive to those listed.

The Arizona Department of Revenue has recognized that a taxpayer's financial difficulties may present reasonable cause for failure to timely pay the tax. *See*, Arizona Department of Revenue General Tax Ruling 04-2. Here, the record does not disclose a history of delinquent taxes or any basis to assume that Taxpayer would not have paid the tax had it successfully sold the property. The property was reposed by the bank because of Taxpayer's inability to pay the loan. Taxpayer clearly had financial difficulties. Taxpayer therefore had reasonable cause for failing to timely pay the tax. The failure to file penalty should be abated.

Did failure to provide an informal conference void the assessment?

Taxpayer contends it was deprived of due process because it was not given the opportunity to discuss the proposed assessment with the auditor prior to the issuance of the assessment. STC § 570(a) provides that a taxpayer has the right to discuss any proposed assessment with the auditor prior to the issuance of any assessment, but a conference is not required for the taxpayer to file a petition for administrative review.

The record does not disclose any request by Taxpayer for an informal conference or any action by the Tax Collector that prevented Taxpayer from requesting an informal conference. The Tax Collector mailed and faxed the preliminary assessment to Taxpayer and left a telephone message. Taxpayer did not respond or request an informal conference.

Providing an informal conference is not a due process requirement. In a tax dispute due process is generally satisfied as long as the taxpayer receives notice and an opportunity to be heard before the tax obligation becomes irrevocably fixed. Taxpayer received notice of the assessment and has exercised the opportunity to be heard in this redetermination process before the assessment becomes final. An informal conference was not required for Taxpayer to file its petition for administrative review. There was no deprivation of due process.

Based on the foregoing, the Tax Collector's assessment is upheld except for the late payment penalty.

Findings of Fact

1. Taxpayer acquired the property at issue in June 2005 and built a single family residence on the property.
2. Building permit was obtained August 14, 2007 and a certificate of occupancy was issued February 18, 2009.

3. Taxpayer was not able to make payment on the loan used to acquire the property and the bank repossessed the property.
4. The property was sold at a trustee's sale to ***Big Business Real Estate LLC*** on January 12, 2012 at a bid price of \$2,401,711, the approximate amount owed by Taxpayer on the loan.
5. The Tax Collector conducted an audit of Taxpayer for the period January 2012.
6. The Tax Collector determined that Taxpayer was taxable under the speculative builder classification based on the sale of the property at the trustee's sale less allowable deductions (factored tax and 35% exclusion).
7. The Tax Collector mailed the preliminary assessment packet to Taxpayer on May 11, 2012.
8. The Tax Collector faxed the preliminary assessment packet to Taxpayer on May 22, 2012 and left a telephone message.
9. Taxpayer did not contact the Tax Collector and the final assessment was mailed to Taxpayer on June 8, 2012.
10. The assessment included interest and a failure to pay penalty.
11. Taxpayer timely protested the assessment stating that
 - a. Taxpayer was erroneously assessed because the lending bank was subject to the tax as a successor under STC § 595(c).
 - b. Taxpayer had no gross receipts from the transaction at issue.
 - c. Penalties assessed were not valid under STC § 540, and
 - d. The Tax Collector failed to provide an informal conference prior to issuing the assessment as required by STC § 570(a).
12. The bank later sold the property to an unrelated party on March 9, 2012 for \$3,300,000.

Conclusions of Law

1. STC § 416 imposes a privilege tax measured by gross income.
2. 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.
3. Improved real property includes any real property upon which a structure has been constructed. STC § 416(a)(2)(A).
4. Taxpayer's property was improved real property.
5. 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. STC § 100.
6. Taxpayer was the owner of the property and had an improvement constructed on the property.

7. Taxpayer was an owner-builder.
8. 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).
9. The Trustee's sale transferred title to the property from Taxpayer to the bank.
10. The Trustee's sale was the sale of the property.
11. Taxpayer was a speculative builder during the audit period subject to the City's privilege tax.
12. Gross income includes all receipts, cash, credits, barter, exchange, reduction of or forgiveness of indebtedness, and property of every kind or nature derived from a taxable activity. STC § 200(a)(3).
13. No deduction or exclusion is allowed from gross income on account of the cost of the property sold, the time value of money, expense of any kind or nature, losses, materials used, labor or service performed, interest paid, or credits granted. STC § 200(c).
14. Taxpayer received gross income subject to the privilege tax when its debt was reduced.
15. The successor liability provisions of STC § 595 are in addition to any remedy provided elsewhere in the City Code that may apply. STC § 595(a).
16. STC § 595(c)(3) provides that once the subsequent sale by the creditor or its affiliate has occurred and the creditor or its affiliate has paid the tax due from it, neither the creditor nor its affiliate, nor any future owner, shall be liable for any outstanding tax, penalties or interest that may continue to be due from the debtor based on the transfer from the debtor to the creditor or its affiliate.
17. STC § 595(c)(4) provides that if any of the tax liability imposed by either STC § 416 or STC § 417 on the transfer of the improved real property to the creditor is paid by the debtor subsequent to payment of the tax by the creditor, the amount so paid may constitute a credit against the tax imposed on the creditor as a successor.
18. The penalty for failure to pay tax may be waived if the taxpayer can demonstrate reasonable cause for its failure to pay the tax. STC § 540.
19. A taxpayer's financial difficulties may constitute reasonable cause for failure to pay a tax. *See*, Arizona Department of Revenue General Tax Ruling 04-2.
20. Taxpayer demonstrated reasonable cause for its failure to pay the tax that was assessed and the penalty in the amount of \$2,532.37 is abated.
21. STC § 570(a) provides that a taxpayer has the right to discuss any proposed assessment with the auditor prior to the issuance of any assessment, but an informal conference is not required for the taxpayer to file a petition for administrative review.
22. In a tax dispute between a governmental entity and a private party, due process is generally satisfied as long as the taxpayer receives notice and an opportunity to be heard before the tax obligation becomes irrevocably fixed. *State ex rel. Arizona Dept. of Revenue v. Care Const. Corp.*, 166 Ariz. 294, 802 P.2d 445 (App. 1990).

23. Taxpayer received notice of the assessment and has exercised the opportunity to be heard in this redetermination process before the assessment becomes final.
24. The Tax Collector did not deprive Taxpayer of due process.
25. The assessment of tax and interest by the Tax Collector for the period January 2012 is upheld.
26. The assessment of late payment penalty by the Tax Collector for the period January 2012 is reversed.

Ruling

Taxpayer's protest of an assessment of privilege tax and interest made by the City of Scottsdale for the period January 2012 is denied consistent with Conclusion of Law number 25.

Taxpayer's protest of an assessment of late payment penalty made by the City of Scottsdale for the period January 2012 is granted consistent with Conclusion of Law numbers 20 and 26. The Tax Collector shall abate the penalty for failure to pay the tax that was included in assessment.

Both parties 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: ***Senior Tax Auditor***
Municipal Tax Hearing Office