

## DECISION OF MUNICIPAL TAX HEARING OFFICER

Decision Date: December 16, 2013

Decision: MTHO # 808

***Taxpayer:***

Tax Collector: City of Scottsdale

Hearing Date: November 15, 2013

### DISCUSSION

#### Introduction

On June 11, 2013, ***Taxpayer*** filed a letter of protest for a tax assessment made by the City of Scottsdale (“City”). A hearing was commenced before the Municipal Tax Hearing Officer (“Hearing Officer”) on November 15, 2013. Appearing for the City were the ***Business Services Manager***, a ***Senior Tax Auditor*** and the ***Deputy City Attorney***. Appearing for the Taxpayer was his ***representative***. On November 16, 2013, the Hearing Officer closed the record and indicated a written decision would be issued to the parties on or before December 31, 2013.

### DECISION

On May 7, 2013, the City issued an assessment to Taxpayer for additional taxes in the amount of \$10,046.81, penalties in the amount of \$2,511.70, and interest up through April 2013 in the amount of \$1,390.99. The audit period was for June 2009. The assessment was based on an unreported speculative builder sale pursuant to City Code Section 416 (“Section 416”).

On July 6, 2005, Taxpayer purchased ***Lot ABC***. On May 9, 2007, a Deed of Trust (“Deed”) was recorded between Taxpayer and First Arizona Savings (“Bank”) secured by ***Lot ABC*** as a construction mortgage. On May 14, 2007, City building permit # ***000000*** (“City Permit”) was issued for the construction of a single family residence on ***Lot ABC***. On July 24, 2008, a certificate of occupancy (“COO”) was issued for ***Lot ABC***. On June 11, 2009, the Bank acquired the property from Taxpayer as the highest bidder at the trustee’s sale for \$1,170,000.00. On May 7, 2013, the City assessed the transfer of ***Lot ABC*** as a speculative builder sale pursuant to Section 416.

Taxpayer protested the assessment arguing there was no sale or transfer of any kind from Taxpayer. According to Taxpayer, it went into default on the payments and the Bank foreclosed on the property. Taxpayer asserted there was no income realized from the property as the property was not sold but foreclosed on. The foreclosure resulted in a deficiency balance owed by Taxpayer. The City assessed tax on the sale of the improved *Lot ABC* on the successful bid price at the trustee's sale with allowed deductions and credits.

Section 416 authorizes a tax on the total selling price from the sale of improved real property by a speculative builder. City Code Section 100 ("Section 100") defines a speculative builder as an owner-builder who sells or contracts to sell improved real property before the expiration of twenty four months after the improvements of the real property sold are substantially complete. Section 100 defines an owner-builder as an owner who, by himself or by or through others, has constructed any improvements to real property. In this case, Taxpayer had improvements made to *Lot ABC* which were substantially completed on July 24, 2008 as evidenced by a COO being issued. As a result, Taxpayer meets the definition of an owner-builder pursuant to Section 100. The primary issue in this matter is whether or not the trustee sale constituted a sale pursuant to Section 416 resulting in a speculative builder sale. Section 100 defines a "sale" to mean any transfer of title or possession in any manner or by any means whatsoever, including consignment transactions and auctions of property for a consideration. Taxpayer acquired *Lot ABC* by warranty deed, dated June 22, 2005 with a total sale price of \$450,000.00. Subsequently, Taxpayer obtained a construction loan in the amount of \$1,600,000.00 from the Bank which was secured by a Deed, dated May 3, 2007. The Deed granted the Bank the power to sell the property at a trustee sale if Taxpayer failed to meet its obligations set forth in the Deed. Taxpayer maintained the right to sell the property pursuant to Section 18 of the Deed with the Bank's prior written approval. Section 6 of the Deed granted Taxpayer the right to occupy and use the property as its principal residence. Based on the above, we conclude that the trustee sale resulted in a "sale" pursuant to Section 100. Even if we accepted Taxpayer's argument that there was no transfer of title, there clearly was a transfer of possession as set forth in Section 100. The remaining issue was whether or not there was consideration as required for a "sale" in Section 100. City Code Section 200 ("Section 200") defines "gross income" to include a "reduction of or forgiveness of indebtedness". Section 22 of the Deed provides that the Trustee shall apply the proceeds of the sale in the following order: (a) to cover all expenses of the sale ;(b) to cover all sums secured by the Deed; etc. As a result of the Trustee sale, Taxpayer had a reduction of its indebtedness to the Bank. That reduction in indebtedness represented gross income to Taxpayer pursuant to Section 416. While the transfer sale was for \$1,170,000.00, it is unclear how much, if any, the expenses were for the sale. Any expenses from the sale need to be deducted from the sale amount to establish the amount of the reduction of indebtedness of Taxpayer and thus the taxable gross income to Taxpayer pursuant to Sections 100 and 416. We note that these expenses may have already been removed by the City.

Lastly, we note that the City was authorized pursuant to City Code Section 540 (“Section 540”) to assess penalties for failure to file and failure to timely pay taxes. Those penalties may be waived for reasonable cause pursuant to Section 540. While we disagreed with Taxpayer on the underlying tax assessment, we do conclude that Taxpayer had a reasonable belief that taxes did not owe on the transfer of improved *Lot ABC* at the trustee sale. Accordingly, we shall waive all penalties in this matter.

Based on all the above, we conclude that Taxpayer’s protest should be partly granted and partly denied, consistent with the Discussion, Findings, and Conclusions, herein.

### **FINDINGS OF FACT**

1. On May 7, 2013, the City issued an assessment to Taxpayer for additional taxes in the amount of \$10,046.81, penalties in the amount of \$2,511.70, and interest up through April 2013 in the amount of \$1,390.99.
2. The audit period was for June 2009.
3. The assessment was based on an unreported speculative builder sale pursuant to Section 416.
4. On June 11, 2013, Taxpayer filed a letter of protest for a tax assessment made by the City.
5. Taxpayer purchased Lot 243 by warranty deed, dated June 22, 2005, with a total sale price of \$450,000.00.
6. On May 9, 2007, a Deed was recorded between Taxpayer and the Bank secured by Lot 243 as a construction mortgage.
7. On May 14, 2007, City Permit was issued for the construction of a single family residence on *Lot ABC*.
8. On July 24, 2008, a COO was issued on *Lot ABC*.
9. On June 11, 2009, the Bank acquired the improved *Lot ABC* from Taxpayer as the highest bidder at the trustee’s sale for \$1,170,000.00.
10. Taxpayer obtained a construction loan from the Bank in the amount of \$1,600,000.00

11. The Deed granted the Bank the power to sell the property at a trustee sale if Taxpayer failed to meet its obligations set forth in the Deed.
12. Taxpayer maintained the right to sell the property pursuant to Section 18 of the Deed with the Bank's prior written consent.
13. Section 6 of the Deed granted Taxpayer the right to occupy and use the property as its principal residence.
14. Section 22 of the Deed provides that the Trustee shall apply the proceeds of the sale in the following order: (a) to cover all expenses of the sale; (b) to cover all sums secured by the Deed; etc.
15. While the trustee sale was for \$1,170,000.00, it is unclear how much, if any, the expenses were for the sale.

### 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 416 imposes a tax on the gross income from the business activity upon every person engaging in the business of speculative building within the City.
3. Taxpayer was a speculative builder of *Lot ABC* pursuant to Section 100 as Taxpayer sold or had contracted to sell improved real property within twenty-four months after the improvements were substantially completed.
4. Section 100 defines a "sale" to mean any transfer of title or possession in any manner or by any means whatsoever, including consignment transactions and auctions of property for a consideration.
5. The trustee sale of *Lot ABC* resulted in a "sale" as there was a transfer of title or possession of improved real property for a consideration pursuant to Section 100.
6. Section 200 defines "gross income" to include a "reduction of or forgiveness of indebtedness".

7. As a result of the trustee sale, Taxpayer had a reduction of its indebtedness to the Bank which resulted in gross income to Taxpayer pursuant to Section 200.
8. Any expenses from the trustee sale need to be deducted from the sale amount to establish the amount of the reduction of indebtedness of Taxpayer to the Bank and thus the gross income to Taxpayer pursuant to Sections 100 and 416.
9. The City was authorized pursuant to Section 540 to assess penalties for failure to file and failure to timely pay taxes.
10. Taxpayer has demonstrated reasonable cause to have all penalties waived in this matter pursuant to Section 540.
11. Taxpayers protest should be partly granted and partly denied, consistent with the Discussion, Findings, and Conclusions, herein.
12. The parties have timely appeal rights pursuant to Model City Tax Code Section 575.

### **ORDER**

It is therefore ordered that the June 11, 2013 protest by *Taxpayer* of a tax assessment made by the City of Scottsdale is hereby partly granted and partly denied consistent with the Discussion, Findings, and Conclusions, herein.

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

It is further ordered that the City of Scottsdale shall remove any expenses from the sale amount that has not already been removed to arrive at the reduction of indebtedness of Taxpayer and thus the taxable gross income.

It is further ordered that this Decision is effective immediately.

***Municipal Tax Hearing Officer***