

DECISION OF MUNICIPAL TAX HEARING OFFICER

Decision Date: May 17, 2014

Decision: MTHO # 819

Taxpayer:

Tax Collector: City of Scottsdale

Hearing Date: April 30, 2014

DISCUSSION

Introduction

On May 30, 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 April 30, 2014. Appearing for the City were a Senior Tax Auditor a Business Service Manager and a Deputy City Attorney. Appearing for Taxpayer was *himself*, as Trustee. On May 2, 2014, the Hearing Officer closed the record on this matter. The Hearing Officer indicated a written decision would be issued to the parties on or before June 16, 2014.

DECISION

On April 4, 2013, the City issued an assessment to Taxpayer for additional taxes in the amount of \$8,990.43, penalties in the amount of \$2,247.61, license and application fees in the amount of \$124.00, license fee penalties in the amount of \$50.00, and interest up through March 2013 in the amount of \$362.47. The audit period was for the month of October 2011. The assessment was based on an unreported speculative builder sale pursuant to City Code Section 416 (“Section 416”).

On January 19, 2010, Taxpayer purchased a partially improved lot (“Lot 8”) in a *subdivision with the City of Scottsdale*. On January 26, 2010, a City building permit (“City Permit”) was issued to Taxpayer as an owner-builder for the construction of a single family residence on Lot 8. On September 27, 2010, a temporary certificate of occupancy (“TCOO”) was issued for Lot 8. On October 18, 2011, the improved Lot 8 was transferred by warranty deed from Taxpayer to *TRUST Associates, LLC (“TA”)*. Subsequently, the City issued an assessment to Taxpayer for a speculative builder sale

pursuant to Section 416.

Taxpayer asserted that it transferred the improved property to an LLC controlled by the Trustee. Taxpayer argued there was no effective change in ownership or control of the property and thus the transfer does not meet the definition of a speculative builder. In 2009, the disabled parents of *Taxpayer/Trustee* contacted *Trustee* to request the parents be allowed to move in with *Trustee* and his family. As a result, Taxpayer was formed in order to build a house that would accommodate both families. At completion of the improved *Lot 8*, the two families moved into the completed house. Taxpayer borrowed \$440,000.00 from *Big Bucks Capital, LLC (“BBC”)* for the initial purchase and for construction funding. The parents of *Trustee* loaned Taxpayer an additional \$230,000.00 to assist in funding of the construction. Subsequently, the parents formed another trust (“*2nd Trust*”) which became the holder of the notes for the \$230,000.00 loaned by the parents. Finally, on October 14, 2011, Taxpayer conveyed its interest in the improved Lot 8 to *TA, LLC*. The warranty deed listed a sale price of \$849,600.00. As part of the transfer, *TA, LLC* assumed the liability for notes to *2nd Trust* totaling \$241,500.00. *Trustee/Taxpayer* indicated his estate attorney advised them to do the transfer and to utilize a cost of property value for the sale price. At the same time, Taxpayer valued the improved property at the time of the transfer at \$1,045,000.00.

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, at any time, improved real property consisting of a custom home regardless of the stage of completion of such home. 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 8 which was substantially completed on or before September 27, 2010 when a TCOO was issued. On October 18, 2011, the improved property was transferred by Taxpayer to *TA, LLC* by warranty deed. We note that “persons” is defined in Section 100 to mean an individual, firm, partnership, joint venture, association, corporation, estate, trust, etc. Based on this definition, Taxpayer and *TA, LLC* were separate persons. 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. In this case, Taxpayer transferred the title to improved Lot 8 to *TA, LLC* and *TA, LLC* assumed notes totaling \$241,500.00. Based on the above, we conclude that the transfer from Taxpayer to *TA, LLC* resulted in a “sale” pursuant to Section 100. The remaining issue was whether or not there was consideration as required for there to be a sale. City Code Section 200 (“Section 200”) defines “gross income” to include a “reduction of or forgiveness of indebtedness”. As a result of the transfer, Taxpayer had a reduction or forgiveness of its indebtedness. That reduction in indebtedness represented gross income to Taxpayer pursuant to Section 416. Taxpayer has argued that the improved Lot 8 was a homeowner’s bona fide non-business sale of a family residence. City Regulation 416.1 (“Regulation 416.1”) defines homeowner’s non-business sale as one in which the property was actually used as the principal place of family residence by the immediate

family of the seller. Regulation 416.1 goes on to indicate a “homeowner” shall only mean an individual, and no other entity, association or representation shall qualify. Since Taxpayer is a trust and not an individual, the homeowner exception in Regulation 416.1 does not apply. Based on all the above, the City’s tax assessment is upheld. While Taxpayer was free to use whatever form of business it chose, it must also accept its advantages and disadvantages. In this case, Taxpayer received some advantages for estate planning but had the disadvantage of the transfer resulting in a speculative builder sale.

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. Since Taxpayer relied on an attorney in making the transfer, we conclude there was reasonable cause to waive the penalties in this case. Lastly, we note that Taxpayer has indicated a willingness to have the improved property transferred back to it. Unfortunately, the taxable transaction occurred in October of 2011 and there are no provisions in the City Code that would permit a taxable transaction to be undone.

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

FINDINGS OF FACT

1. On April 4, 2013, the City issued an assessment to Taxpayer for additional taxes in the amount of \$8,990.43, penalties in the amount of \$2,247.61, license and application fees in the amount of \$124.00, license fee penalties in the amount of \$50.00, and interest up through March 2013 in the amount of \$362.47.
2. The audit period was for the month of October 2011.
3. The assessment was based on a unreported speculative builder sale pursuant to Section 416.
4. On May 30, 2013, Taxpayer filed a letter of protest for a tax assessment made by the City.
5. On January 19, 2010, Taxpayer purchased Lot 8 in a *subdivision* located in the City.
6. On January 26, 2010, a City Permit was issued to Taxpayer as an owner-builder for the construction of a single family residence on Lot 8.

7. On September 27, 2010, a TCOO was issued for Lot 8.
8. On October 18, 2011, the improved Lot 8 was transferred by warranty deed from Taxpayer to **TA, LLC**.
9. In 2009, the disabled parents of **Trustee/Taxpayer** contacted **Trustee/Taxpayer** to request the parents be allowed to move in with **Trustee/Taxpayer** and his family.
10. Taxpayer was formed in order to build a house to accommodate both families.
11. At completion of the improved Lot 8, the two families moved into the completed house.
12. Taxpayer borrowed \$440,000.00 from **BBC** for the initial purchase of Lot 8 and for construction funding.
13. The parents loaned Taxpayer an additional \$230,000.00 to assist in funding of the construction.
14. The parents formed the **2nd Trust** which became the holder of the notes for the \$230,000.00 loaned by the parents.
15. The warranty deed for the transfer of improved Lot 8 from Taxpayer to **TA, LLC** listed a sale price of \$849,600.00.
16. As part of the transfer of improved Lot 8, **TA, LLC** assumed the liability for notes totaling \$241,500.00.
17. **Trustee/Taxpayer** was advised by his estate attorney to have Taxpayer transfer the improved Lot 8 to **TA, LLC** and to utilize a cost of property value for the sale price.
18. At the time of the transfer of improved Lot 8, Taxpayer valued the improved property at \$1,045,000.00.

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. Section 100 defines a speculative builder as an owner-builder who sells or contracts to sell, at any time, improved real property consisting of custom homes regardless of the stage of completion of such homes.
4. Section 100 defines an owner-builder as an owner who, by himself or by or through others, has constructed any improvements to real property.
5. 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.
6. The transfer by warranty deed of improved Lot 8 resulted in a “sale” as there was a transfer of title or possession of improved real property for a consideration pursuant to Section 100.
7. Section 200 defines “gross income” to include a “reduction of or forgiveness of indebtedness”.
8. As a result of the transfer of improved Lot 8 to *TA, LLC*, Taxpayer had a reduction of its indebtedness which resulted in gross income to Taxpayer pursuant to Section 200.
9. The sale by warranty deed of Lot 8 was a speculative builder sale as Taxpayer was an owner-builder who sold an improved custom home pursuant to Sections 100 and 416.
10. Regulation 416.1 provides for an exception for a homeowner’s bona fide non-business sale.
11. Regulation 416.1 indicates a “homeowner” shall only mean an individual, and no entity, association or representation shall qualify.
12. Since Taxpayer is a trust and not an individual, the homeowner exception in Regulation 416.1 does not apply.
13. While Taxpayer was free to use whatever form of business it chose, it must also accept its advantages and disadvantages.
14. Taxpayer received some advantages for estate planning but had the disadvantage of the transfer of improved Lot 8 resulting in a speculative builder sale.
15. The City was authorized pursuant to Section 540 to assess penalties for failure to file and failure to timely pay taxes.

16. Taxpayer has demonstrated reasonable cause to have all penalties waived in this matter pursuant to Section 540.
17. With the exception of the penalties, Taxpayers protest should be denied, consistent with the Discussion, Findings, and Conclusions, herein.
18. The parties have timely appeal rights pursuant to Model City Tax Code Section 575.

ORDER

It is therefore ordered that the May 30, 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 therefore 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