DECISION OF MUNICIPAL TAX HEARING OFFICER

Decision Date: August 16, 2004
Decision: MTHO #107
Tax Collector: City of Phoenix
Hearing Date: August 25, 2003

DISCUSSION

Introduction

On March 14, 2003, ***Taxpayer*** ("Taxpayer") filed a protest of a tax assessment made by the City of Phoenix ("City"). After review, the City concluded on March 26, 2003 that the protest was timely and in the proper form. On March 28, 2003, the Municipal Tax Hearing Officer ("Hearing Officer") ordered the City to file any response on or before May 12, 2003. On May 1, 2003, the City requested an extension until June 1, 2003. On May 5, 2003, the Hearing Office granted the City an extension until June 12, 2003. The City filed its response on June 9, 2003. On June 11, 2003, the Hearing Officer ordered the Taxpayer to file any reply on or before July 2, 2003. A Notice of Tax Hearing ("Notice") was issued on June 13, 2003 setting the matter for hearing commencing on July 10, 2003. On June 18, 2003, the Taxpayer filed a Request for Extension of Time to File Taxpayer's Reply and Request to Reschedule the Hearing ("Request"). On June 21, 2003, the Hearing Officer granted the Request and ordered the Taxpayer to file any reply on or before August 4, 2003. On June 25, 2003, a Notice was issued rescheduling the hearing to commence on August 25, 2003. On August 4, 2003, the Taxpayer filed a reply. The Taxpayer and City appeared and presented evidence at the August 25, 2003 hearing. On August 27, 2003, the Hearing Officer ordered the Taxpayer to provide additional documents requested by the City at the hearing on or before September 10, 2003; the City would file a closing memorandum on or before December 17, 2003. On September 24, 2003, the City requested additional documentation from the Taxpayer. On September 30, 2003, the Hearing Officer ordered the parties to attempt to resolve the documentation issue and ordered a conference call to be established for either October 8th or 9th, 2003. Subsequently, the parties resolved the documentation issue and the City requested an extension to file its closing brief until December 3, 2003. On November 5, 2003, the Hearing Officer granted the City until December 3, 2003 to file their closing brief and the Taxpayer's reply deadline was extended until January 30, 2004. On November 25, 2003, the City requested another extension until December 19, 2003. On November 28, 2003, the Hearing Officer granted the City an extension for its closing brief until December 19, 2003 and the Taxpayer's reply deadline was extended to February 16, 2004. The City filed its closing brief on December 19, 2003. On February 6, 2004, the Taxpayer requested an extension for its reply brief in order to discuss possible settlement with the City. On February 9, 2004, the Hearing Officer granted the Taxpayer an extension until March 31, 2004 in which to file a reply brief. On March 24, 2004, the Taxpayer requested an additional extension until May 14, 2004. The City did not

oppose the extension and on March 29, 2004, the Hearing Officer granted the extension until May 14, 2004. On May 13, 2004, the Taxpayer requested another extension in order to discuss settlement with the City. On May 14, 2004, the Hearing Officer granted the extension for a reply brief until June 14, 2004. On June 9, 2004, the Taxpayer again requested an unopposed extension until June 28, 2004. On June 10, 2004, the Hearing Officer granted the extension. On June 28, 2004, the Taxpayer filed a reply brief. On June 30, 2004, the Hearing Officer indicated the record was closed and a written decision would be issued on or before August 16, 2004.

The Taxpayer acquired vacant land and developed the ***ABC*** Golf Resort ("Resort") located in the City at _____. The Resort consisted of 164 timeshare units. During the audit period of January 1999 through July 2001, the Taxpayer was assessed a speculative builder tax for every property that was transferred by the Taxpayer. The City assessed the Taxpayer for additional taxes due in the amount of $773,090.02 plus associated interest.

City Position

Under the Phoenix City Code Section 100 ("Section 100") a "speculative builder" is defined as an owner-builder who sells or contracts to sell improved real property on or before the expiration of 24 months after the improvement's substantial completion. The City argued that for each of the two scenarios described in this case, the Taxpayer owned real property within the City, the Taxpayer improved the real property, by or through others, and sold the improved real property within 24 months after the improvements were substantially complete. As a result, the City concluded the Taxpayer's activities were those of a speculative builder.

1. Sales to Individual Purchasers from January 1999 through June 1999

   According to the City, the Taxpayer had improvements made to real property during the period January 1999 through June 1999 and sold as timeshare intervals to individual buyers. According to the City, there were 548 timeshare intervals that were deeded to the individual buyers with the sale amounts recorded in the Maricopa County Recorder's Office. The City indicated they had reviewed various documents including a Special Warranty Deed, a Deed of Trust, an Affidavit of Value, and a purchase and sale agreement. According to the City, the documents reflect that the parties viewed the transaction as involving a transaction of real property. As an example, the following was extracted by the City from a Deed of Trust: That Trustor irrevocably grants and conveys to Trustee in Trust, with Power of Sale, that real property (the "Interval") described as follows, including all improvements…" (emphasis added) Nowhere does the Deed state that "Intangible Benefits" were also purchased. The Deed states that "real property" was transferred. Therefore, the values on the Deeds of Trust and/or Affidavits of Property Value represent the total selling price of the real property and the gross income of the Taxpayer.

   The City argued that the "Intangible Benefits" were not guaranteed to the purchasers and all of the documents suggest a sale of improve real estate. Further, there is no breakdown in the sales agreements as to a portion of the sales price being for improved real property and another portion being for something else. As a result, the City argued any apportionment would be purely speculative. The City further argued that if the City Council had intended the tax to be based on "value" instead of "selling price" they would have stated that. However,

the City asserted that was not done because of the nebulous concept of value. The City argued that for the period from January 1999 through June 1999, the Taxpayer sold timeshare intervals to individual purchasers and deeded them to the individual buyers. According to the City, there were 548 intervals sold during the applicable period which were taxable as speculative builder sales pursuant to Phoenix City Code Section 416 ("Section 416").

2. Taxability of Transactions to Club Association from April 1999 through July 2001

The structure of the time-share sales to customers was changed in April 1999. Instead of conveying the intervals directly to customers, a non-profit association was created which held title to the real property and a point system was created to establish ownership in the timeshares by individual owners. A vacation club, ***XYZ*** Vacation Club-Arizona ("Club Developer") was formed from which individual purchasers could purchase a Club Membership ("Membership"). The Club Developer did not own any assets but merely acts as a conduit that processes the money from the consumer and passes it to the Taxpayer. At the same time, a non-profit entity called ***XYZ*** Owners Club-Arizona ("Club Association") was formed to hold all of the real estate assets on behalf of the members. The Taxpayer transferred the Intervals to the club Association. In this model used by the Taxpayer, the ultimate consumer never obtains title to the Intervals. The only legal transfer of the title occurs when the Taxpayer transfers the improved property to the Club Association. According to the City, title to the property was transferred by the Taxpayer to the Club Association within 24 months of substantial completion of the improvements. The City argued that Section 416 imposes the speculative builder tax on the total selling price from the sale of improved real property and that there is no requirement for consideration. The City emphasized that it was not taxing the transaction to the ultimate time-share owner but was taxing the transfer to the Club Association. The City argued that the transfer was a "sale of improved property" as defined in City Code Section 14-416(a)(3) ("Section 416(a)(3):

> "Sale of improved real property" includes any form of transaction, whether characterized as a lease or otherwise, which in substance of title of, or equitable ownership in, improved real property and includes any lease of the property for a term of thirty years or more (with all options for renewal being included as a part of the term). In the case of multiple unit projects, "sale" refers to the sale of the entire project or to the sale of any individual parcel or unit.

While the Taxpayer has argued there was no sale because there was no consideration, the City argued Section 416(a)(3) does not require consideration. Even if there was a requirement for consideration, the City argued there was consideration to the Taxpayer pursuant to this transaction. According to the City, there was tri-party agreement entered into between the Taxpayer, Club Developer, and Club Association. Under that agreement, the Taxpayer transferred title to the properties to Club Association. Upon marketing and sale of a time-share unit, Club Developer paid the Taxpayer as units were sold. The City argued this was clearly compensation.

Taxpayer Position

The Taxpayer argued that the City's speculative builder tax assessment suffers from at least two fatal flaws. According to the Taxpayer, the City has overstated the portion of the selling price of Interval Packages that is attributable to "improved real property". The Taxpayer asserts the City is attempting to impose the speculative builder tax on 100 percent of any consideration paid by Interval Package purchases as though 100 percent of the consideration is attributable to "improved real property". The Taxpayer argued the City's exclusive focus on the words "total selling price" in the City Tax Code Section 416.a.1 ("Section 416.a.1") renders the critical works that follow – "from the sale of improved property" – meaningless.

The Taxpayer also argued that the City erroneously seeks to classify the Taxpayer as a speculative builder with respect to transfers of improved real property to the Club Association. The Taxpayer asserted that it did not receive consideration at the time of the transfer. According to the Taxpayer, it may receive true, valuable consideration, only if Club Memberships are sold. The Taxpayer argued that even if it received consideration, only the market value may be imputed pursuant to City Tax Code Section 14-210 ("Section 210"). The Taxpayer asserted that the testimony establishes that the "market value" of the transfers was de-minimis at best.

1. Sales to Individual Purchasers from January 1999 through June 1999

   The Taxpayer argued that the undisputed facts establish that the Interval Package consists of valuable rights and privileges separate and apart from any interest in real property. According to the Taxpayer, the portion of the purchase price attributable to these non-real property rights is not subject to the speculative builder tax. The Taxpayer provided testimony at the hearing that "approximately one-half of first-time resort timeshare purchasers would not have purchased without the exchange opportunity". The Taxpayer also provided testimony that approximately 70 percent of the original Interval Package purchasers live in Arizona. According to the Taxpayer, the per-Interval Package cost to develop the dwellers units was approximately 25 percent of the sales price of each Interval Package. As a result, the Taxpayer argued that no more than 25 percent of the total selling price of the Interval Packages should be subject to the speculative builder tax.

   The Taxpayer argued that value is an appropriate tax base as set forth in Phoenix City Code section 14-200.a.1: "[g]ross income includes … the value proceeding or accruing from the sale of property". Additionally, Phoenix City Code Section 14-210 ("Section 210") states that:

   > [i]n transactions between affiliated companies or persons, or in other circumstances where the relationship between the parties is such that the gross income from the transaction is not indicative of the *market value* of the subject matter of the transaction, the Tax Collector shall determine the "*market value*" upon which the City Privilege and Use Taxes shall be levied.

   According to the Taxpayer, the City's assessment assumes that each 1256 square foot, two-bedroom, multi-family dwelling unit, subject to many use-and-enjoyment restrictions, sold for a whopping $771,200. This compares to the current list price of two-bedroom condominiums

at the ***ABC*** Golf Resort average only $173,567. The Taxpayer also noted that the Arizona legislature has recognized that a substantial portion of the gross sales price of timeshare intervals represents non-real property components. In computing valuation for property tax purposes, the legislature has mandated that the county assessor shall deduct sixty-five percent of the original gross sales price of the timeshare interval.

2. Taxability of Transactions to Club Association from April 1999 through July 2001

The Taxpayer indicated that in April 1999, in an effort to increase sales, a new business model was adopted that altered the nature of the benefits received by new customers. The result was a vacation club, Club Developer in which individual purchasers purchase a Club membership ("Membership"). According to the Taxpayer, a Membership provides the purchaser with many rights and privileges but does not transfer title to the Club Member. Under Arizona law, Club memberships cannot be sold unless the Club possesses sufficient real property so that members use rights will never exceed the Club's use capacity. As a result, before the Taxpayer, through the Club Developer, could sell Memberships, it transferred to the Club Association the real property interests' necessary to support the use right associated with those memberships. The Taxpayer argued that transfers of bare legal title to the Club Association in compliance with the law, are not subject to the speculative builder tax because the Taxpayer received no consideration for the transfers. The Taxpayer received no income until the Club Developer, acting as the Taxpayer's agent, sells Club Memberships to individual Club purchasers. As Memberships are sold, the Club Developer must transfer and/or pay to the Taxpayer the proceeds of the sale of Membership. The Taxpayer argued at the time of the transfer, the Taxpayer was entitled to the hypothetical consideration of proceeds from sales of Club Memberships that may be sold at some future date. The Taxpayer argued that City Code Section 14-416(a)(1) ("Section 416(a)(1)") requires consideration to be present "at the time of … transfer of title." According to the Taxpayer, the consideration that may result from potential future sales of Club Memberships was not present at the time title to the improved real property was transferred to the Club Association. As a result, the Taxpayer argued the speculative builder tax did not apply. Further, the Taxpayer argued that the owner-builder tax pursuant to City Tax Code Section 14-417 ("Section 417") does not apply because the Taxpayer did not issue a written declaration to the contractors that they were not responsible for the construction contracting tax imposed by City Tax Code Section 14-415 ("Section 415").

Even if this Tribunal were to determine that the Taxpayer received consideration at the time of transfer of title, only the "market value" of the property may be imputed. City Code Section 14-210 ("Section 210") requires that in transactions between affiliated companies or persons, is such that the gross income from the transactions is not indicative of the market value, the Tax Collector shall determine the "market value" upon which the tax shall be levied. The Taxpayer argued that since the Club Association received only bare legal title to the property without any corresponding right to use or enjoy the property, the market value of the property transferred to the Club Association was de-minimis.

The Intervals transferred over a 26 month period represented approximately 153.25 units. According to the Taxpayer, the total "sales" imputed to the transfers to the Club Association equaled $112,365,321.12. This translates to an imputed sales price of over $733,000.00 for

each two-bedroom, two-bathroom condominium. The Taxpayer indicated that comparable units at the Resort were selling for only about $175,000 a full two years after the final transfer to the Club Association. The Taxpayer asserts it is unconscionable for the City to impute a value of over $733,000 per unit transferred in bulk to the Club Association where the Club Association's use and enjoyment is severely restricted.

ANALYSIS

1. Sales to Individual Purchasers from January 1999 through June 1999

During this time period, there was no dispute that the Taxpayer was properly assessed for a speculative builder tax. The dispute was on the amount of the total selling price of the improved real property. The City has relied on the Warranty Deeds, Deeds of Trust, and Affidavit of Values while the Taxpayer relied upon expert testimony that the value of the improved property was only about one-quarter of the value of the overall package of benefits. We concur with the Taxpayer that the focus is not just on the "selling price" but the "selling price of the improved property". Where we differ with the Taxpayer is how to determine that value. We believe the most reliable value is what the individual purchasers believe they have purchased. Based on the documents provided by the City, we conclude that it would be reasonable for an individual purchaser to believe their total purchase amount was for improved property. If that was not true, the Taxpayer could have easily broken down the selling price into a proportion for improved real property and a proportion for intangibles. That was not done and as a result we concur with the City that the total selling price of each Interval Package is subject to the speculative builder tax.

2. Taxability of Transactions to Club Association from April 1999 through July 2001

We concur with the Taxpayer that there does need to be consideration in order for a sale to exist. We also agree with the City that there was consideration to the Taxpayer since they were to receive monies as the units were sold. The actual speculative builder assessment was on the transfer from the Taxpayer to a related entity, Club Association. Since there was no dollar amount set forth at that time, we find that it is appropriate to determine the "market value" pursuant to Section 210. Based on the evidence, we find the most reasonable value for the "market value" at the time of transfer would be the comparable units at the Resort or $175,000 per unit. Accordingly, the City should revise the assessment to reflect this per unit value.

FINDINGS OF FACT

1. On March 14, 2003, the Taxpayer filed a protest of a tax assessment made by the City.

2. After review, the City concluded on March 26, 2003 that the protest was timely and in proper form.

3. On March 28, 2003, the Hearing Officer ordered the City to file any response on or before May 12, 2003.

4. On May 1, 2003, the City requested an extension until June 12, 2003.

5. On May 5, 2003, the Hearing Officer granted the City an extension until June 12, 2003.

6. The City filed its response on June 9, 2003.

7. On June 11, 2003, the Hearing Officer ordered the Taxpayer to file any reply on or before July 2, 2003.

8. A Notice was issued on June 13, 2003 setting the matter for hearing commencing on July 10, 2003.

9. On June 18, 2003, the Taxpayer filed a Request.

10. On June 21, 2003, the Hearing Officer granted the Request and ordered the Taxpayer to file any reply on or before August 4, 2003.

11. On June 25, 2003, A Notice was issued rescheduling the hearing to commence on August 25, 2003.

12. On August 4, 2003, the Taxpayer filed a reply.

13. The Taxpayer and City appeared and presented evidence at the August 25, 2003 hearing.

14. On August 27, 2003, the Hearing Officer ordered the Taxpayer to provide additional documentation requested by the City at the hearing on or before September 10, 2003; the City would file a closing memorandum on or before November 3, 2003; and, the Taxpayer would file a reply memorandum on or before December 17, 2003.

15. On September 24, 2003, the City requested additional documentation from the Taxpayer.

16. On September 30, 2003, the Hearing Officer ordered the parties to attempt to resolve the documentation issue and ordered a conference call to be established for either October 8th or 9th, 2003.

17. Subsequently, the parties resolved the documentation issue and the City requested an extension to file its closing brief until December 3, 2003.

18. On November 5, 2003, the Hearing Officer granted the City until December 3, 2003 to file their closing brief and the Taxpayer's reply deadline was extended until January 30, 2004.

19. On November 25, 2003, the City requested another extension until December 19, 2003.

20. On November 28, 2003, the Hearing Officer granted the City an extension for its closing brief until December 19, 2003 and the Taxpayer's reply deadline was extended until February 16, 2004.

21. The City filed its closing brief on December 19, 2003.

22. On February 6, 2004, the Taxpayer requested an extension for its reply brief in order to discuss possible settlement with the City.

23. On February 9, 2004, the Hearing Officer granted the Taxpayer an extension until March 31, 2004 in which to file a reply brief.

24. On March 24, 2004, the Taxpayer requested an additional extension until May 14, 2004.

25. The City did not oppose the extension and on March 29, 2004, the Hearing Officer granted the extension until May 14, 2004.

26. On May 13, 2004, the Taxpayer requested another extension in order to discuss settlement with the City.

27. On May 14, 2004, the Hearing Officer granted the extension for a reply brief until June 14, 2004.

28. On June 9, 2004, the Taxpayer again requested an unopposed extension until June 28, 2004.

29. On June 10, 2004, the Hearing Officer granted the extension.

30. On June 30, 2004, the Taxpayer filed a reply brief.

31. On June 30, 2004, the Hearing Officer indicated the record was closed and a written decision would be issued on or before August 16, 2004.

32. The Taxpayer acquired vacant land and developed the Resorts located in the City at 6808 South 32nd Street.

33. The Resort consisted of 164 timeshare units.

34. During the audit period of January 1999 through July 2001, the Taxpayer was assessed a speculative builder tax for every property that was transferred by the Taxpayer.

35. The City assessed the Taxpayer for additional taxes due in the amount of $773,090.02 plus associated interest.

36. The Taxpayer had improvements made to real property during the January 1999 through June 1999 and sold as timeshare intervals to individual buyers.

37. There were 548 timeshare intervals that were deeded to individual buyers with the sale amounts recorded in the Maricopa County Recorder's Office.

38. Various documents including special Warranty Deeds, Deeds of Trust, and Affidavits of Value reflected that the parties viewed the transaction as involving a transfer of real property.

39. There was no breakdown in the sales agreements as to any portion of the sales price being for intangible benefits.

40. In 1999, Club Developer was formed from which individual purchasers could purchase a Membership.

41. The Club Developer did not own any assets but merely acted as a conduit that processes the money from the consumer and passes it to the Taxpayer.

42. At the same time, Club Association was formed to hold all of the real estate assets on behalf of the members.

43. The Taxpayer transferred the Intervals to the Club Association.

44. In this model used by the Taxpayer, the ultimate consumer never obtains title on the Intervals.

45. The only legal transfer of the title occurs when the Taxpayer transfers the improved property to the Club Association.

46. Title to the property was transferred by the Taxpayer within 24 months of substantial completion of the improvements.

47. A reasonable market value of the units transferred from the Taxpayer to the Club Association is $175,000 per unit.

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 being in business as a speculative builder within the City.

3. Section 100(1) defines speculative builder as an owner-builder who sells improved real property consisting of "custom, model, or inventory homes…".

4. Section 100(2) generally indicates the sale of improved property other than those specified in Section 100(1) will be taxable speculative builder sales for up to twenty-four months after the improvements of the real property sold are substantially complete.

5. During the audit period, the Taxpayer was a speculative builder pursuant to Section 100(2).

6. The speculative builder tax is imposed on the "selling price of the improved property".

7. It is reasonable to conclude that an individual purchaser would believe their total purchase amount was for improved property.

8. There needs to be consideration in order for a sale to exist.

9. The Taxpayer received consideration when they transferred the real estate assets to the Club Association.

10. Since the transfer from the Taxpayer was to a related entity, Club Association, it is appropriate to determine the "market value" pursuant to Section 210.

11. The most reasonable value for the "market value" at the time of transfer would be the comparable units at the Resort.

12. The City should revise the assessment for the transactions with the Club Association to reflect a per unit value of $175,000.

ORDER

It is therefore ordered that the March 14, 2003 protest of ***Taxpayer*** of a tax assessment by the City of Phoenix is hereby partially granted and partially denied consistent with the Discussion herein.

It is further ordered that the City of Phoenix shall revise the tax assessment for the transactions with the Club Association to reflect a per unit value of $175,000.

It is further ordered that this Decision is effective immediately.

Jerry Rudibaugh
Municipal Tax Hearing Officer