

Jerry Rudibaugh
Municipal Tax Hearing Officer

DECISION OF MUNICIPAL TAX HEARING OFFICER

Decision Date: May 27, 2004
Decision: MTHO #135
Tax Collector: City of Phoenix
Hearing Date: January 23, 2004

DISCUSSION

Introduction

On July 31, 2003, **ABC, Inc.** as General Partner of **Taxpayer** (“Taxpayer”) filed a protest of a tax assessment made by the City of Phoenix (“City”). After review, the City concluded on August 1, 2003 that the protest was timely and in the proper form. On August 21, 2003, the Municipal Tax Hearing Officer (“Hearing Officer”) ordered the City to provide a response on or before October 6, 2003. The City filed a response to the protest on September 17, 2003. On September 21, 2003, the Hearing Officer ordered the Taxpayer to file any reply on or before October 16, 2003. On October 2, 2003, a Notice of Tax Hearing (“Notice”) was issued setting the matter for hearing on October 30, 2003. On October 14, 2003, the Taxpayer requested the hearing be rescheduled. The Taxpayer filed a reply on October 15, 2003. On October 16, 2003, the Hearing Officer granted the Taxpayer’s request to reschedule the hearing. On October 16, 2003, a Notice was issued rescheduling the hearing for December 4, 2003. On November 4, 2003 the City requested the hearing be rescheduled. On November 5, 2003, the City’s request to reschedule the hearing was granted. On December 2, 2003, a Notice was issued rescheduling the hearing for January 8, 2004. On December 5, 2003, a Notice was issued rescheduling the hearing for January 23, 2004. On January 23, 2004, the Taxpayer filed an Amendment to Protest and Petition For Hearing (“Amendment”). Both parties appeared and presented evidence at the January 23, 2004 hearing. On January 24, 2004, the Hearing Officer issued a letter indicating the City would file a closing brief on or before March 8, 2004 and the Taxpayer would file a reply brief on or before April 7, 2004. The City filed a closing brief on March 4, 2004 and the Taxpayer filed a reply brief on April 7, 2004. On April 12, 2004, the Hearing Officer issued a letter indicating the record was now closed and a written decision would be issued on or before May 27, 2004.

City Position

The City issued a Notice of Tax Assessment to **ABC, Inc.** (“Taxpayer No.1”) for sale of improved property by **XYZ LP** (“Taxpayer No.2”) to **DEF Center LLC** (“**DEF**”) for \$6,900,000.00. At the hearing, the Taxpayer introduced evidence that Taxpayer No.1 was not a general partner of Taxpayer No.2, nor did Taxpayer No.1 own an interest in **GHI Properties, LLC** or **JKL Investments, LLC**, the two general partners of Taxpayer No.2. As a result, the City now concedes that the wrong taxpayer was assessed. The City asserted that if it wins the second argument made by the Taxpayer in this case, the City will assess the correct Taxpayer.

The second argument made by the Taxpayer was that the transaction taxed in this matter was a change of ownership for financing purposes and not a sale. The City assessed the transfer of the improved real property located at _____ 51st Street (“51st Street Property”) in the City as a sale that resulted in a speculative builder tax of \$33,670.37 plus interest. According to the City, Taxpayer No.2 sold the 51st Street Property to **DEF** in August 2002. The City agrees with the Taxpayer that if there was a mere change in the type of ownership or in the form of ownership in the transaction in question and that the ownership in terms of proportion of ownership and ownership itself remained constant before and after the transaction in August of 2002, the transaction would not be a sale. The City argued that the documentation provided did not establish that the ownership remained constant.

Taxpayer Position

Taxpayer No. 1 was not a general partner of Taxpayer No.2, nor does Taxpayer No.1 own an interest in **GHI** Properties, LLC or **JKL** Investments, LLC of August 2002. As a result, the Taxpayer argued that the assessment against Taxpayer No.1 was improper and must be dismissed.

Even if the correct taxpayer was assessed, the Taxpayer argued the transaction was not a sale that would give rise to the City’s speculative builder provisions. According to the Taxpayer, the 51st Street Property was transferred from Taxpayer No.2 to **DEF** as part of the refinancing to take out the construction loan from Stearns Bank and replace it with permanent financing from PNC Bank. The Taxpayer asserted that Taxpayer No.2 and **DEF**; (1) shared common ownership; (2) the change in the form of ownership occurred solely as part of the refinancing of the project; and, (3) the financial investment in the project remained virtually unchanged after the financing. According to the Taxpayer, prior to the August 2002 refinancing, the 51st Street Property was owned by Taxpayer No.2, an Arizona limited partnership comprised of the following partners:

<u>General Partners</u>	<u>Interest</u>
GHI Properties, LLC	.5%
JKL Investments, LLC	.5%
<u>Limited Partners</u>	
MNO , LLC	.5%
DEF Air Park, LLC (“Air Park”)	44.5%
ABC LP	49.5%

The Taxpayer asserts that in August 2002, the Air Park changed its name to **DEF** and secured permanent financing from Stearns Bank in order to pay off the construction loan for the 51st Street Property. In order to secure the construction loan for the 51st Street Property the Air Park had put up as collateral \$1.8 million, a deed of trust in property at the Chandler Air Park worth approximately \$4 million, and an assignment of rents in the Chandler Air Park property. According to the Taxpayer, this gave the Air Park virtually a 100 percent financial investment in the 51st Street Property prior to the August 2002 refinancing. The Taxpayer indicated the only other financial investment in the project was a \$495 capital contribution by **ABC** LP. In order to

facilitate the financing, title to the 51st Street Property was transferred from Taxpayer No.2 to **DEF**. The Taxpayer argued that the City speculative builder tax does not apply to the refinancing of construction loans, and should not apply to this transaction, which is nothing more than a refinancing of the property to takeout the construction loan.

ANALYSIS

First, it is clear that the City assessed the wrong taxpayer in this matter. As a result, we will dismiss the assessment in this matter. Since the City has indicated they will be re-issuing the assessment to the proper taxpayer, we shall provide our ruling on the substance issue in this matter that would be issued once the correct taxpayer has been assessed. We note that the Taxpayer has emphasized that the financial investment has remained virtually unchanged and that the change in ownership occurred as in incidental part of the refinancing of the property. We must disagree.

Based on the record, there was a sale of vacant land, located in the City at _____ 51st Street, to **XYZ LP** in January 2001. **ABC LP** was a limited partner with a 49.5 percent ownership. While **ABC LP** only contributed \$495 of cash contribution, they also contributed sweat equity for their percentage of ownership. The sweat equity consisted of locating the property, developing the plans, and finding tenant for the property. In turn, **ABC LP** was going to receive 49.5percent of the profits. Everything went fine until September 11, 2001. As an aftermath to 9/11, the tenant for the property was no longer financially capable of leasing the property. When it came time for the construction loan to be replaced with permanent financing, it was necessary for the owners of the property to come up with additional cash to secure permanent financing. By putting up the additional funds/collateral, **DEF Air Park, LLC/DEF Center, LLL** purchased the improved property from **XYZ LP** and after the purchase owned 100% of the improved property. As a result of the sale, the right to 49.5 percent of the profits owned by **ABC LP** was transferred to **DEF Center LLC**. Based on all the above, we find there was a sale in August of 2002 from **XYZ, LP** to **DEF Center LLC**. Further, the sale would have been taxable as a speculative builder sale pursuant to City Code Section 14-416.

FINDINGS OF FACT

1. On July 31, 2003, the Taxpayer filed a protest of a tax assessment made by the City.
2. After review, the City concluded on August 1, 2003 that the protest was timely and in proper form.
3. On August 21, 2003, the Hearing Officer ordered the City to provide a response on or before October 6, 2003.
4. The City filed a response to the protest on September 17, 2003.

5. On September 25, 2003, the Hearing Officer ordered the Taxpayer to file any reply on or before October 16, 2003.
6. On October 2, 2003, a Notice was issued setting the matter for hearing on October 30, 2003.
7. On October 14, 2003, the Taxpayer requested the hearing be rescheduled.
8. The Taxpayer filed a reply on October 15, 2003.
9. On October 16, 2003, the Hearing Officer granted the Taxpayer's request to reschedule the hearing.
10. On October 16, 2003, a Notice was issued rescheduling the hearing for December 4, 2003.
11. On November 4, 2003, the City requested the hearing be rescheduled.
12. On November 5, 2003, the City's request to reschedule the hearing was granted.
13. On December 2, 2003, a Notice was issued rescheduling the hearing for January 23, 2004.
14. On January 23, 2004, the Taxpayer filed an Amendment.
15. Both parties appeared and presented evidence at the January 23, 2004 hearing.
16. On January 24, 2004, the Hearing Officer issued a letter indicating the record was now closed and a 'written decision would be issued on or before May 27, 2004.
17. The City issued a Notice of Tax Assessment to Taxpayer No.1 for sale of improved property by Taxpayer No.2 to **DEF** for \$6,900,000.00.
18. Taxpayer No.1 was not a general partner of Taxpayer No.2, nor did Taxpayer No.1 own an interest in **GHI** properties, LLC or **JKL** Investments, LLC, the two general partners of Taxpayer No.2.
19. There was a sale of vacant land, located in the City at _____ 51st Street to **XYZ** LP in January of 2001.
20. **ABC** LP only contributed \$495 of cash contributions but also contributed sweat equity for a 49.5 percent ownership in the limited partnership.
21. The sweat equity consisted of locating the property, developing the plans and finding a tenant for the property.

22. After 9/11, the tenant for the property was no longer financially capable of leasing the property.
23. Where it came time for the construction loan to be replaced with permanent financing, it was necessary for the owners of the property to come up with additional cash to secure permanent financing.
24. **DEF** Air Park, LLC/**DEF** Center, LLC put up the additional funds/collateral to secure permanent financing which increased their equity ownership percentage.
25. After the transfer from **XYZ**, LP to **DEF** Center LLC in August 2002, the right to 49.5 percent of the profits owned by **ABC** LP was transferred to **DEF** Center LLC.

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 on property sold by a speculative builder.
3. The Code defines a sale as being a “transfer of title” or a “change in equitable ownership”.
4. The transfer from **XYZ**, LP to **DEF** Center LLC in August 2002 was a sale under the provisions of Section 416.
5. **ABC, Inc.** was not the proper taxpayer to be assessed for the speculative builder sale.
6. The assessment against **ABC, Inc.** should be vacated.

ORDER

It is therefore ordered that the assessment against **ABC, Inc.** by the City of Phoenix is hereby vacated.

It is further ordered that this Decision shall be effective immediately.

Jerry Rudibaugh
Municipal Tax Hearing Officer