

DECISION OF MUNICIPAL TAX HEARING OFFICER

Decision Date: August 3, 2006
Decision: MTHO # 302
Tax Collector: City of Scottsdale
Hearing Date: None

DISCUSSION

Introduction

On March 10, 2006, *Taxpayer ABC* (“Taxpayer”) filed a protest of a tax assessment made by the City of Scottsdale (“City”). After review, the City concluded on March 30, 2006, that the protest was timely and in the proper form. On April 5, 2006, the Municipal Tax Hearing Officer (“Hearing Officer”) classified this matter as a redetermination and ordered the City to file a response to the protest on or before May 19, 2006. On May 18, 2006 the City filed a response to the protest. On May 23, 2006, the Hearing Officer ordered the Taxpayer to file any reply on or before June 22, 2006. On June 22, 2006, the Taxpayer filed a reply. On July 1, 2006, the Hearing Officer indicated the record was closed and a written decision would be issued on or before August 15, 2006.

City Position

The City performed an audit of the Taxpayer for the period June 2001 through June 2005. The City concluded the Taxpayer constructed three homes during the audit period:

- 1) *Location 123* – Completed 04/26/2002
- 2) *Location 456* -- Completed 09/23/2004
- 3) *Location 789* – Completed 01/25/2005

Subsequently, the *Location 123* was sold on 11/21/2003 for \$1,400,000. The *Location 456* was sold on 10/14/2004 for \$650,000. The *Location 789* was sold on 02/24/2005 for \$965,635. As a result, the City assessed the Taxpayer for understated speculative builder income pursuant to City Code Section 416 (“Section 416”). The City assessed the Taxpayer for additional taxes in the amount of \$17,311.09 and interest up through December 2005 in the amount of \$2,517.53.

The City disputed the Taxpayer’s claim to have lived in the *Location 123* for 26 months prior to the sale. According to the City, the completion date of the home based on the permit was April 26, 2002. The home was listed for sale one and one-half months later in the *Advertisement*. The City asserted that in order for the Taxpayer to have lived there for 26 months, the Taxpayer would have had to live in the home since September 2001. The City noted that would have been seven months prior to the Certificate of Occupancy (“Certificate”) being issued. Additionally, the City asserted the utility billing records and the water consumption for the period September 2001 through March 2002 was not

indicative of an occupied residence. Those records showed the usage for that period to average approximately 4,000 gallons per month. In April 2002, the usage jumped to 27,220 gallons per month and remained above 20,000 gallons per month for the next twenty months. Based on the above, the city argued the Taxpayer did not qualify for the “homeowner’s bona fide nonbusiness sale of a family residence”, as outlined in City Regulation 416.1 (“Regulation 416.1”). The City also disputed the Taxpayer’s claim to have filed gross receipts of \$853,518 in November 2002. According to the City, the Taxpayer’s handwritten note of the check and date submitted was for November 2004.

The City disputed the Taxpayer’s claim to have received an audit assessment in December 2004 for the sale of the **Location 456**. The City indicated that a privilege and use tax statement was sent to the Taxpayer in December 2004 based on a mathematical miscalculation on the tax return filed by the Taxpayer for the period October 2004. The city’s audit did not commence until August 3, 2005. As a result of the audit, the City concluded the Taxpayer had overstated deductions and used an incorrect tax rate. The City assessed the Taxpayer based on corrected amounts.

The City sent a privilege and use tax statement to the Taxpayer in May 2005 regarding the sale of the **Location 789**. The City indicated their statement was based on the tax return filed by the Taxpayer for the period February 2005 which contained overstated deductions. As a result of the audit commenced on August 3, 2005, the City assessed the Taxpayer based on corrected deductions.

The City concluded the Taxpayer improved real estate by building three single family residential homes and subsequently selling them speculatively. The City requested the assessment by upheld.

Taxpayer Position

The Taxpayer argued that the sale of the **Location 123** was not a speculative builder sale. The Taxpayer asserted he was a resident of the property for 26 months. According to the Taxpayer, electrical service and telephone service were established in July 2001. The Taxpayer indicated all necessary inspections for the utilities were completed in order to allow the Taxpayer to begin residency in September 2001. The Taxpayer acknowledged the **Location 123** was first listed on the **Advertisement** in June 2002. The Taxpayer asserted the June 2002 contract was cancelled because of the effect of 9/11. The **Location 123** was re-listed on 12/02 and again on 09/03. The house was sold on November 21, 2003.

In response to the City’s arguments about water consumption at the **Location 123**, the Taxpayer indicated that a family member moved into Arizona in April and established residency. Secondly, the Taxpayer noted the swimming pool was completed and thirdly, the sprinkler system was completed and placed in use. Based on all the above, the Taxpayer argued the **Location 123** was clearly a “homeowner’s bona fide non-business sale of a family residence”.

The Taxpayer asserted that for both the **Location 456** and the **Location 789**, the Taxpayer

had timely filed returns and timely paid the taxes. According to the Taxpayer, the City processed and audited these returns and sent correspondence to the Taxpayer. The Taxpayer indicated he considered the audit was completed and taxes were paid in full. The Taxpayer argued that the City should not be allowed to do a subsequent audit to uncover errors in the tax returns.

ANALYSIS

For each of the properties involved, the Taxpayer was an owner-builder that had the properties improved. It is also clear that each of the properties were sold prior to the expiration of the twenty-four months of substantial completion. As a result, each of the sales were taxable speculative builder sales pursuant to Section 416. The only remaining issue for the *Location 123* was whether or not the sale would be exempt from Section 416 as a “homeowner’s bona fide non-business sale of a family residence” pursuant to Regulation 416.1. As sale meets the requirements of Regulation 416.1 if “the property was actually used as the principle place of family resident ... by the immediate family of the seller for the six (6) months next prior to the offer for sale.” We must determine the date of the offer for sale that resulted in the sale. While the property was initially offered for sale in June 2002, the *Advertisement* expired for a period of time and the listing that resulted in the sale commenced September 2003. As a result, the Taxpayer would have to have used the property as a family residence by March 2003 for Regulation 416.1 to apply. Based on the water usage information provided the City, the Taxpayer was using the property as a family residence as of April 2002. We also note that the Taxpayer’s address listed on the Affidavit of Property Value (“Affidavit”) was for the *Location 123*. Accordingly, we conclude that the Taxpayer did meet the requirements of Regulation 416.1 of using the *Location 123* as the principal place of family residence by the immediate family of the seller for six months “next prior to the offer for sale.” As a result, the *Location 123* sale was exempt from the Section 416 speculative builder sale.

The only issue for the *Location 456* and the *Location 789* property was whether or not the City had previously processed and audited these sales. We conclude they did not. The City simply reviewed the tax returns filed by the Taxpayer without auditing the information provided in the returns by the Taxpayer. The first time the City would have reviewed the accuracy of the information provided by the Taxpayer would have been from this audit. Accordingly, the Taxpayer’s protests for the *Location 456* and the *Location 789* are denied.

FINDINGS OF FACT

1. On March 10, 2006, the Taxpayer filed a protest of a tax assessment made by the City.
2. After review, the City concluded on March 30, 2006, that the protest was timely and in the proper form.

3. On April 5, 2006, the Hearing Officer classified this matter as a redetermination and ordered the City to file a response to the protest on or before May 19, 2006.
4. On May 18, 2006, the City filed a response to the protest.
5. On May 23, 2006 the Hearing Officer ordered the Taxpayer to file any reply on or before June 22, 2006.
6. On June 22, 2006, the Taxpayer filed a reply.
7. On July 1, 2006, the Hearing Officer indicated the record was closed and a written decision would be issued on or before August 15, 2006.
8. The City performed an audit of the Taxpayer for the period June 2001 through June 2005.
9. The Taxpayer constructed three homes during the audit period: the **Location 123** was completed on April 26, 2002; the **Location 456** was completed on September 23, 2004; and, the **Location 789** was completed on January 25, 2005.
10. The **Location 123** was sold on November 21, 2003 for \$1,400,000.
11. The **Location 456** was sold on October 14, 2004 for \$650,000.
12. The **Location 789** was sold on February 24, 2005 for \$965,635.
13. The City assessed the Taxpayer for additional taxes in the amount of \$17,311.09 and interest up through December 2005 in the amount of \$2,517.53.
14. The water consumption for the **Location 123** for the period September 2001 through March 2002 averaged approximately 4,000 gallons per month.
15. In April 2002, the usage jumped to 27,220 gallons per month and remained above 20,000 gallons per month for the next twenty months.
16. The Taxpayer filed gross receipts of \$853,518 in November 2004 for the **Location 123**.
17. In December 2004, the City sent the Taxpayer a privilege and use tax statement for the **Location 456** which was based on information filed by the Taxpayer.
18. In May 2005, the City sent the Taxpayer a privilege and use tax statement for the **Location 789** which was based on information filed by the Taxpayer.
19. The Taxpayer listed the **Location 123** on the **Advertisement** in June 2002.

20. The listing on the *Location 123* ran out in December 2002 and the Taxpayer had it re-listed.
21. The second listing on the *Location 123* ran out and the Taxpayer had it re-list a third time.
22. The sale of the *Location 123* resulted from the *Advertisement* listing that commenced in September 2003.
23. The Taxpayer was using the *Location 123* as the principal place of family residence on or before April 2002.

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. During the audit period, the Taxpayer was an owner-builder that had three properties improved.
3. The sales of the *Location 456* and the *Location 789* were taxable speculative builder sales pursuant to Section 416.
4. The offer for sale which resulted in the sale of the *Location 123* commenced in September 2003.
5. The sale of the *Location 123* was a “homeowner’s bond fide non-business sale of a family residence” pursuant to Regulation 416.1.
6. The City conducted only one audit involving the *Location 456* and the *Location 789*.
7. The Taxpayer’s protest should be partly granted and partly denied consistent with the Discussion, Findings, and Conclusions herein.

ORDER

It is therefore ordered that the March 10, 2006 protest of *Taxpayer ABC* of a tax assessment made by the City of Scottsdale is hereby granted, in part, and denied, in part, consistent with the Discussion, Findings, and Conclusions herein.

If is further ordered that the City of Scottsdale shall revise the assessment by removing the sale of the property at *Location 123* as a speculative builder sale.

It is further ordered that this Decision is effective immediately.

Jerry Rudibaugh
Municipal Tax Hearing Officer