

DECISION OF MUNICIPAL TAX HEARING OFFICER

Decision Date: February 28, 2011

Decision: MTHO # 570/580

Tax Collector: City of Scottsdale

Hearing Date: December 29, 2010

DISCUSSION

Introduction

On March 16, 2010, a letter of protest was filed by *taxpayer #1* and on April 22, 2010, a protest was filed by *Taxpayer #2* (Collectively, *taxpayer #1* and *taxpayer #2* are referred to as "Taxpayers") of tax assessments made by the City of Scottsdale ("City"). The assessment for *Taxpayer #1* and the assessment for *Taxpayer #2* involved the same subject property and were consolidated for hearing purposes. A hearing was commenced before the Municipal Tax Hearing Officer ("Hearing Officer") on December 29, 2010. Appearing for the City was the City Attorney, the Tax Audit Manager, and a Senior Tax Auditor. Taxpayers failed to make an appearance. At the conclusion of the December 29, 2010 hearing, the Hearing Officer granted Taxpayers until January 31, 2011 to file any additional information. On February 4, 2011, the Hearing Officer indicated Taxpayers had failed to file any additional information and as a result, the record was closed and a written decision would be issued on or before March 11, 2011.

DECISION

The City conducted a review of *Taxpayer #1* for the month of January 2009. The City concluded *Taxpayer #1* had made a speculative builder sale on January 29, 2009 to *Taxpayer #2*. Simultaneously, *Taxpayer #2* transferred the property to an unrelated third party for \$6,450,000.00. *Taxpayer #2* is the only Member of *Taxpayer #1*. The City assessed *Taxpayer #1* for additional taxes in the amount of \$69,176.25, interest up through December 2009 in the amount of \$2,363.55, and penalties for late filing, late payment and tax evasion in the amount of \$41,505.76. In addition, the City conducted a review of *Taxpayer #2* for the month of January 2009. The City concluded *Taxpayer #2* was a successor in interest pursuant to City Code Section 595 ("Section 595") to *Taxpayer #1*. The City assessed *Taxpayer #2* for additional taxes in the amount of \$69,176.25.

Taxpayer #1 constructed a single family home at *123 N. Street* in the City. Building Permit #108464 was issued on March 15, 2005. The City became aware of the on-going

construction and on February 22, 2007 sent a letter to **Taxpayer #1** to inform them that the future transfer of the improved property would be subject to the speculative builder tax pursuant to City Code Section 416 (“Section 416”). The City noted that **Taxpayer #1** had been licensed with the City since December 14, 1998. The City had previously assessed **Taxpayer #1** on an earlier speculative builder sale. The home in this matter was completed on August 16, 2007. The January 29, 2009 sale was not reported to the City.

The City imposed a tax on the January 29, 2009 sale pursuant to Section 416 which provides for a tax on the gross income of a speculative builder for the sale of improved real property. City Code Section 100 (“Section 100”) defines a “speculative builder” to mean an owner-builder who sells or contracts to sell, at any time, improved real property consisting of custom, model, or inventory homes, regardless of the stage of completion of such home. Section 100 defines an “owner-builder” as an owner of real property who, by himself or by or through others, constructs any improvement to real property.

The City imposed a tax on **Taxpayer #2** pursuant to City Code Section 595(c) (“Section 595(c”). Section 595(c) provides that: “Any person who purchases, or who acquires by foreclosure, by sale under trust deed or warranty deed in lieu of foreclosure, or by any other method, improved real property or a portion of improved real property for which the Privilege Tax imposed by this Chapter has not been paid shall be responsible for payment of such tax as a speculative builder or owner builder, as provided in Sections 416 and 417.”

At the hearing, the City introduced evidence that the third party buyer had paid the tax assessment in this matter. As a result, the City issued a revised Statement of Account (“Statement”) for both **Taxpayer #1** and **Taxpayer #2**. Based on the Statement for Taxpayer #1, interest has accrued up through January 2009 in the amount of \$3,379.89 and penalties have accrued in the amount of \$41,505.76. Based on the Statement for Taxpayer #2, interest has accrued up through January 2009 in the amount of \$3,395.96 and penalties have accrued in the amount of \$6,917.62.

Taxpayer #1 and **Taxpayer #2** had argued that the City had incorrectly assessed taxes on both **Taxpayer #2** and **Taxpayer #1**. Both argued that the proper taxpayer was **Taxpayer #2** as that was the entity that sold the property to the third party buyer for \$6,450,000.00. As a result, both argued that all penalties should be waived in these matters.

There was no dispute that the sale of the single family home at **123 N. Street** was a speculative builder sale in the City. While the transfer from **Taxpayer #1** to **Taxpayer #2** was for a nominal amount, City Code Section 210 (“Section 210”) provides that the City shall determine the market value when the transaction between related entities is not indicative of the market value of the transaction. In this case, the City determined the market value from the transfer from **Taxpayer #2** to an unrelated third party. As a result, we conclude the City’s assessment of taxes on the **Taxpayer #1** transfer to **Taxpayer #2** was proper. Since **Taxpayer #1** failed to pay the tax assessment, **Taxpayer #2** was responsible for the tax assessment pursuant to Section 595(c) as a successor in business. Subsequent to both of these assessments, the City has collected the tax assessment from

the third party buyer which eliminates the tax assessment for both *Taxpayer #1* and *Taxpayer #2*.

The City assessed *Taxpayer #1* for penalties pursuant to Section 540 for late payment and for evasion of taxes. We conclude the penalties for late payment was proper since the taxes were not timely paid and *Taxpayer #1* has not provided reasonable cause to have the penalties waived. We also conclude the penalties for evasion of taxes was proper. The City provided evidence that *Taxpayer #1* had a history of not reporting speculative builder sales. In addition, the City had provided written notice to *Taxpayer #1* that when the improved property at *123 N. Street* was sold, *Taxpayer #1* was required to pay taxes on the sale. Lastly, *Taxpayer #1* provided no business reason for the transfer to *Taxpayer #2* simultaneous with the transfer to an unrelated third party. Based on the above, we conclude *Taxpayer #1* was attempting to evade paying taxes on the sale. Even though the third party buyer has now paid the underlying taxes, we conclude that does not relieve *Taxpayer #1* from the penalties and interest liability.

We note that the City did not assess *Taxpayer #2* for any interest and penalties in its March 9, 2010 notice of assessment. *Taxpayer #2* filed a timely appeal of that assessment on April 22, 2010. Prior to that appeal being decided, the taxes were paid by the third party purchaser which relieved *Taxpayer #2* of any tax obligation. As a result, we do not find any basis for the City to now assess *Taxpayer #2* for any interest and/or penalties. Accordingly, all interest and penalties assessed on *Taxpayer #2* should be denied.

FINDINGS OF FACT

1. On March 16, 2010, *Taxpayer #1* filed a protest of a tax assessment made by the City.
2. On April 22, 2010, *Taxpayer #2* filed a protest of a tax assessment made by the City.
3. The City conducted a review of *Taxpayer #1* for the month of January 2009.
4. The City concluded *Taxpayer #1* made a speculative builder sale on January 29, 2009 to *Taxpayer #2*.
5. Simultaneously with the transfer from *Taxpayer #1* to *Taxpayer #2*, *Taxpayer #2* transferred the property to an unrelated third party for \$6,450,000.00.
6. Prado is the only member of *Taxpayer #1*.
7. The City assessed *Taxpayer #1* for additional taxes in the amount of \$69,176.25, interest up through December 2009 in the amount of \$2,363.35, and penalties for late

filing, late payment and tax evasion in the amount of \$41,505.76.

8. The City conducted a review of *Taxpayer #2* for the month of January 2009.
9. The City assessed *Taxpayer #2* as a successor in interest with additional taxes due in the amount of \$69,176.25.
10. *Taxpayer #1* constructed a single family home at *123 N. Street* in the City.
11. Building Permit # 108464 was issued on March 15, 2005.
12. The home was completed on August 16, 2007.
13. The January 29, 2009 sale was not reported to the City.
14. Subsequent to the assessments to *Taxpayer #1* and *Taxpayer #2*, the third party buyer of the *123 N. Street* property paid the tax portion of the assessments.
15. The City issued a revised Statement for both *Taxpayer #1* and *Taxpayer #2*.
16. Based on the Statement for *Taxpayer #1*, interest has accrued up through January 2009 in the amount of \$3,379.89 and penalties have accrued in the amount of \$41,505.76.
17. Based on the Statement for *Taxpayer #2*, interest has accrued up through January 2009 in the amount of \$3,395.96 and penalties have accrued in the amount of \$6,917.62.
18. The transfer from *Taxpayer #1* to *Taxpayer #2* was for a nominal amount.
19. *Taxpayer #1* had a history of not reporting speculative builder sales.
20. *Taxpayer #1* had been licensed with the City since December 14, 1998.
21. The City became aware of the on-going construction on *123 N. Street* and on February 22, 2007 sent a letter to *Taxpayer #1* to inform them that the future transfer of the improved property at *123 N. Street* would be subject to the speculative builder tax pursuant to Section 416.
22. *Taxpayer #1* provided no business reason for the transfer to *Taxpayer #2* simultaneous with the transfer to an unrelated third party.
23. The City did not assess *Taxpayer #2* for any interest and penalties in its March 9, 2010 notice of assessment.

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. *Taxpayer #1* was an owner-builder pursuant to Section 100.
3. The sale of the new home at *123 N. Street* was a speculative builder sale pursuant to Sections 100 and 416.
4. The transfer from *Taxpayer #1* to *Taxpayer #2* was a transaction between related entities.
5. Section 210 provides the City shall determine market value when the transaction between related parties is not indicative of the market value of the transaction.
6. The City's determination of the market value of the transaction between *Taxpayer #1* and *Taxpayer #2* was reasonable.
7. Since *Taxpayer #1* failed to pay the tax assessment on the sale, *Taxpayer #2* was responsible for the tax assessment pursuant to Section 595(c).
8. *Taxpayer #1* and *Taxpayer #2* were relieved of any tax obligation when the third party buyer paid the tax portion of the assessments.
9. Since *Taxpayer #1* failed to timely pay its taxes, it was proper for the City to assess penalties pursuant to Section 540.
10. The evidence demonstrates that *Taxpayer #1* attempted to evade paying the City a speculative builder tax.
11. *Taxpayer #1* failed to demonstrate reasonable cause to have any of the penalties waived.
12. *Taxpayer #2* timely appealed the City's March 9, 2010 notice of assessment.
13. Prior to *Taxpayer #2's* appeal being decided, the taxes were paid by the third party purchaser.
14. There is no basis for the City to now assess *Taxpayer #2* for any interest and/or penalties.

15. All interest and penalties assessed on *Taxpayer #2* were improper and should be denied
16. *Taxpayer #1's* March 16, 2010 protest should be denied, consistent with the Discussion, Findings, and Conclusions, herein.
17. *Taxpayer #2's* April 22, 2010 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 March 16, 2010 protest by Taxpayer #1 of a tax assessment made by the City of Scottsdale should be denied consistent with the Discussion, Findings, and Conclusions, herein.

It is further ordered that the April 22, 2010 protest by Taxpayer #2 of a tax assessment made by the City of Scottsdale should be denied consistent with the Discussion, Findings, and Conclusions, herein.

It is further ordered that the City of Scottsdale's December 28, 2010 Statement of Account for Taxpayer #1 is hereby approved.

It is further ordered that the City of Scottsdale's December 28, 2010 Statement of Account for Taxpayer #2 is hereby denied.

It is further ordered that this Decision is effective immediately.

Municipal Tax Hearing Officer