

DECISION OF MUNICIPAL TAX HEARING OFFICER

October 11, 2011

Taxpayer

Taxpayer's Address

Taxpayer
MTHO #646

Dear Taxpayer:

We have reviewed the evidence submitted for redetermination by *Taxpayer* and the City of Tempe (Tax Collector or City). The review period covered was July 2010. Taxpayer's protest, Tax Collector's response, and our findings and ruling follow.

Taxpayer's Protest

Taxpayer was assessed City of Tempe privilege tax under the speculative builder classification for the sale of eight condominium units. Taxpayer purchased the property from the lender that had foreclosed on the property. When Taxpayer purchased the units, they were substantially completed. The prior developer or the mortgage company that had foreclosed on the original developer owes any tax due. At a minimum the City must offset the assessment by taxes assessed against or paid by the lender or prior developer.

Tax Collector's Response

Taxpayer was the owner of record to improved real property. Taxpayer had made improvements to the property and was therefore an owner-builder. Taxpayer sold the properties to another entity. A speculative builder is an owner-builder who sells improved real property. A sale is defined as any transfer of title by any means whatsoever. Taxpayer's sale met the definition for sale by a speculative builder and was subject to the City's privilege tax. Taxpayer was allowed credits for all substantiated taxes paid by others on the property.

Discussion

Taxpayer purchased the property at issue for \$1,075,000 on March 11, 2008 from a lender that had foreclosed on the property. After purchasing the property, Taxpayer made improvements to the property in excess of \$340,000 in order to get a certificate of occupancy. A certificate of occupancy was issued August 11, 2008. Taxpayer sold the property to ***Big Top Real Estate Holdings*** on July 9, 2010 for \$1,500,000.

The Tax Collector conducted an audit assessment of Taxpayer for the period July 2010 and issued an assessment for City privilege tax in the amount of \$9,482.66, interest calculated through April 2011 in the amount of \$229.18, penalties in the amount of \$2,370.67 and license fees in the amount of \$50.00. The assessment was based on the sales price of \$1,500,000. The Tax Collector allowed a credit for taxes paid by ***Murky Waters Construction***, the contractor Taxpayer hired to make the improvements so Taxpayer could get the certificate of occupancy.

Taxpayer timely protested the assessment contending:

1. Taxpayer was not a speculative builder because:
 - Taxpayer was not an owner-builder because it did not own the condominium complex at the time it was constructed.
 - The property was substantially completed prior to the time it went into foreclosure. Taxpayer only made minor improvements in order to get a certificate of occupancy.
2. The lender that foreclosed on the property would be subject to any tax that was due.
3. At a minimum the City must offset the assessment by taxes assessed against or paid by the lender or prior developer.

Taxpayer was a speculative builder

Taxpayer was assessed as a speculative builder. A speculative builder includes an owner-builder who sells or contracts to sell improved real property. To be a speculative builder, a person has to be an owner-builder and the property sold has to be improved real property.

Taxpayer was an owner-builder

An owner-builder is defined as an owner or lessor of real property who, by himself or by or through others, constructs or has constructed or reconstructs any improvement to real property. Taxpayer contends that the condominium complex was constructed before it purchased the property and therefore the property was substantially completed at the time of Taxpayer's purchase.

The property was not substantially complete at the time Taxpayer purchased it. The term "substantially complete" means the construction contracting or reconstruction contracting:

1. has passed final inspection or its equivalent; or
2. certificate of occupancy or its equivalent has been issued; or
3. is ready for immediate occupancy or use.

When Taxpayer purchased the property, a certificate of occupancy had not been issued. There is no evidence in the record that the property passed a final inspection or its equivalent. Therefore the question is whether the property was ready for immediate occupancy or use.

After Taxpayer purchased the property it hired a contractor to complete the project so that a certificate of occupancy could be issued. The contractor's invoices to Taxpayer dated before the certificate of occupancy was issued totaled in excess of \$340,000 for work to be done.

The work listed in the invoices included removing and resetting bathtubs, installing sinks, toilets and guest bathroom fixtures, installing 40 gallon water heaters, installing kitchen sink fixtures, faucet, drain and disposal and replacing the shower P-traps because they were full of grout from the prior contractor. Without this additional work the units were not ready for immediate occupancy or use. Therefore the property was not substantially complete when Taxpayer purchased it. Taxpayer constructed improvements to the property and therefore was within the definition of an owner-builder.

The property was improved real property

Improved real property includes any real property upon which a structure has been constructed. Taxpayer owned the property on which a structure had been constructed and Taxpayer constructed additional improvements to the property. The property was improved real property.

Sale of improved real property includes any form of transaction which in substance is a transfer of title of improved real property. Taxpayer sold the property to *Big Top Real Estate Holdings*. Taxpayer met the definition of a speculative builder and is liable for the City privilege tax on its sale as a speculative builder.

Taxpayer is not entitled to additional tax credits

The Tax Collector allowed a credit for taxes paid on the construction of improvements *Murky Waters Construction*. Taxpayer argues that it should also be allowed a credit for taxes assessed against or paid by the lender or prior developer. The Tax Collector stated it would be willing to allow additional credits for taxes paid to the extent Taxpayer demonstrates its entitlement to additional credits.

Credits for taxes paid are allowed by Tempe City Code (TCC) § 16-416(c)(3). That section states in part:

(3) Tax credits.

The following tax credits are available to owner-builders or speculative builders, not to exceed the tax liability against which such credits apply, provided such credits are documented to the satisfaction of the tax collector:

(A) A tax credit equal to the amount of city privilege or use tax, or the equivalent excise tax, paid directly to a taxing jurisdiction or as a separately itemized charge paid directly to the vendor with respect to the tangible personal property incorporated into the said structure or improvement to real property undertaken by the owner-builder or speculative builder.

(B) A tax credit equal to the amount of privilege taxes paid to this City, or charged separately to the speculative builder, by a construction contractor, on the gross income derived by said person from the construction of any improvement to the real property.

The burden is on the Taxpayer to show he is entitled to a deduction, exclusion or credit. The code specifically requires that Taxpayer document to the satisfaction of the Tax Collector either that the tax was separately charged to Taxpayer or that the tax was paid to the City. It is the Tax Collector's position that Taxpayer failed to provide any documentation of entitlement for additional credits.

The only document submitted by Taxpayer was a lien recorded by the City against the lender for audit period October 2007 in the total amount of \$34,390.89. No evidence was submitted that the lien was for the lender's foreclosure of the property or that any payments had been made on the lien. There is no evidence in the record showing payment of any privilege taxes to the City on the project or that any construction contractor working for the prior developer separately billed City privilege taxes on the project. Based on the record, Taxpayer has not met its burden

to shown that it is entitled to any credit or deduction in addition to the amounts allowed by the Tax Collector.

Any possible liability of the lender is not before the Hearing Office in this case

Taxpayer also argued that the lender that foreclosed on the property would be the party subject to any tax that was due. Whether the lender may be liable for tax as a speculative builder or as a successor under TCC § 16-595(c) is not before the Hearing Office. The question presented is whether Taxpayer was subject to tax as a speculative builder. To the extent the lender may be subject to tax on the project and pays the tax, Taxpayer may be entitled to a credit. However, Taxpayer has not submitted evidence of payment by the lender.

Taxpayer's ability to pay does not bear on the validity of the assessment.

Taxpayer indicates it does not have the ability to pay the assessment. The purpose of the protest and hearing process is to determine whether the assessment was valid under the City code. *See*, TCC § 16-570(b)(1). Whether Taxpayer has the ability to pay the assessment does not bear on the validity of the assessment and is not an issue to be considered by the Hearing Office.

Based on all the above, Taxpayer's protest of the assessment for the period July 2010 is denied. The City's assessment of privilege tax, interest, combined penalties and fees against Taxpayer was proper.

Findings of Fact

1. Taxpayer purchased the property at issue for \$1,075,000 on March 11, 2008 from a lender that had foreclosed on the property.
2. The property consisted of two buildings with a common area and a total of four commercial units and eight condominium units.
3. The commercial units were previously sold and are not involved in the assessment.
4. Taxpayer contracted with *Murky Waters Construction* to make improvements to the condominium units in order to get a certificate of occupancy.
5. There were five construction invoices dated before August 2008 that totaled in excess of \$340,000.
6. The work to be performed for all units under the construction invoices consisted of, among other things:
 - a. Removing and resetting bathtubs,
 - b. Installing sinks, toilets and guest bathroom fixtures,
 - c. Installing 40 gallon water heaters,
 - d. Installing kitchen sink fixtures, faucet, drain and disposal,
 - e. Replacing the shower P-traps because they were full of grout from the prior contractor.
7. A certificate of occupancy was issued August 11, 2008.
8. Taxpayer sold the property to *Big Top Real Estate Holdings* on July 9, 2010 for \$1,500,000.

9. The Tax Collector conducted an audit assessment of Taxpayer for the period July 2010.
10. The Tax Collector issued an assessment dated April 1, 2011 for City privilege tax in the amount of \$9,482.66, interest calculated through April 2011 in the amount of \$229.18, penalties in the amount of \$2,370.67 and license fees in the amount of \$50.00.
11. The assessment was based on the sales price of \$1,500,000.
12. The assessment allowed a credit for taxes paid on the construction of improvements by *Murky Waters Construction*.
13. Taxpayer timely protested the assessment contending:
 - a. Taxpayer was not a speculative builder because:
 - i. Taxpayer was not an owner-builder because it did not own the condominium complex at the time it was constructed.
 - ii. The property was substantially completed prior to the time it went into foreclosure. Taxpayer only made minor improvements in order to get a certificate of occupancy.
 - b. The lender that foreclosed on the property would be subject to any tax that was due.
 - c. At a minimum the City must offset the assessment by taxes assessed against or paid by the lender or prior developer.
14. The City recorded a lien against the lender for audit period October 2007 in the total amount of \$34,390.89.
15. No evidence was submitted whether the lender or the prior developer paid any privilege taxes to the City on the project.
16. No evidence was submitted whether any construction contractor working for the prior developer separately billed City privilege taxes on the project.

Conclusions of Law

1. TCC § 16-416(a) imposes a privilege tax on persons engaging in business as a speculative builder within the City.
2. The tax is measured by the taxpayer's gross income from the business. TCC § 16-416(a).
3. The gross income of a speculative builder considered taxable includes the total selling price from the sale of improved real property at the time of closing of escrow or transfer of title. TCC § 16-416(a)(1).
4. A speculative builder includes an owner-builder who sells or contracts to sell improved real property. TCC § 16-100.
5. Improved real property includes any real property upon which a structure has been constructed. TCC § 16-416(a)(2)(A).
6. The properties were improved real property.

7. An owner-builder is defined as an owner or lessor of real property who, by himself or by or through others, constructs or has constructed or reconstructs any improvement to real property. TCC § 16-100.
8. Taxpayer was the owner of the properties.
9. "Substantially Complete" means the construction contracting or reconstruction contracting:
 - a. has passed final inspection or its equivalent; or
 - b. certificate of occupancy or its equivalent has been issued; or
 - c. is ready for immediate occupancy or use. TCC § 16-100.
10. The record does not show that the property had passed a final inspection or its equivalent at the time Taxpayer purchased the property.
11. A certificate of occupancy was not issued until after Taxpayer purchased the property.
12. The work performed under the construction invoices indicates that the property was not ready for immediate occupancy or use.
13. Taxpayer constructed improvements on the properties.
14. Taxpayer was an owner-builder.
15. Sale of improved real property includes any form of transaction which in substance is a transfer of title of improved real property. TCC § 16-416(a)(3).
16. Taxpayer sold the property to ***Big Top Real Estate Holdings*** in July 2010.
17. Taxpayer was a speculative builder during the audit period.
18. A credit is allowed for taxes paid directly by a vendor to a taxing jurisdiction or charged separately to the speculative builder by the vendor with respect to the tangible personal property incorporated into the structure being constructed by the speculative builder. TCC § 16-416(c)(3)(A).
19. A credit is allowed for taxes paid by a construction contractor to the City or charged separately to the speculative builder on the gross income derived by the contractor from the construction of any improvement to the real property. TCC § 16-416(c)(3)(B).
20. Entitlement to the credit must be documented to the satisfaction of the tax collector. TCC § 16-416(c)(3).
21. Tax statutes are construed strictly against a party who claims an exemption or a credit. *Davis v. Arizona Department of Revenue*, 197 Ariz. 527, 529-30, 4 P.3d 1070, 1072-73 (App. 2000).
22. The burden is on the taxpayer to show he is entitled to a deduction or exemption from tax. *See Ebasco Servs., Inc. v. Ariz. State Tax Comm'n*, 105 Ariz. 94, 99, 459 P.2d 719, 724 (1969).
23. There is a presumption that all gross income is subject to the tax until the contrary is established by the taxpayer. TCC § 16-400(c).
24. Taxpayer did not show that privilege taxes were paid to the City or were charged separately to Taxpayer in excess of the amounts allowed by the Tax Collector.

25. Taxpayer's sale of the property was subject to the privilege tax on speculative builders measured by the total selling price.
26. Under the administrative review process a taxpayer may contest the applicability or amount of the tax imposed on him. TCC § 16-570(b)(1).
27. Taxpayer's inability to pay is not relevant regarding the validity of the assessment.
28. The City's assessment against Taxpayer dated April 1, 2011 was proper.

Ruling

Taxpayer's protest of an assessment of privilege tax, interest, combined penalties and fees made by the City of Tempe for the period July 2010 is denied.

The Tax Collector's Notice of Assessment to Taxpayer dated April 1, 2011 for the period July 2010 is upheld.

Taxpayer has timely rights of appeal to the Arizona Tax Court pursuant to Model City Tax Code Section -575.

Sincerely,

Hearing Officer

HO/7100.doc/10/03

c: ***Tax Audit Supervisor***
Municipal Tax Hearing Office