

DECISION OF MUNICIPAL TAX HEARING OFFICER

Decision Date: March 23, 2012

Decision: MTHO # 651

Taxpayer:

Tax Collector: City of Scottsdale

Hearing Date: November 30, 2011

DISCUSSION

Introduction

On May 31, 2011, a letter of protest was filed by ***Taxpayer*** of a denial by the City of Scottsdale (“City”) of a tax refund request. A hearing was commenced before the Municipal Tax Hearing Officer (“Hearing Officer”) on November 30, 2011. Appearing for the City were the ***Assistant City Attorney***, the ***Tax Audit Supervisor***, and a ***Senior Tax Auditor***. Appearing for Taxpayer were ***his representatives***. The parties filed post hearing briefs. On February 13, 2012, the Hearing Officer indicated the record was closed and a written decision would be issued on or before March 29, 2012.

DECISION

On March 17, 2011, the City received a refund request from Taxpayer in the amount of \$59,076.21. On April 25, 2011, the City issued a denial of the refund request. Subsequently, Taxpayer filed its May 31, 2011 protest.

Taxpayer constructed two adjacent commercial office buildings in ***Scottsdale*** referred to as ***Building No. I (“B1”)*** and ***Building No. II (“B2”)***. ***Permit # ABCD*** was issued on October 14, 2005 for the construction of ***B1***. The project was completed on August 24, 2006. Permitted A/C Square Feet was 133,201. Total Lot Square Footage was 313,040. Prior to the sale of ***B1***, Taxpayer secured leases with three tenants: ***T-One***; ***T-Two***; and, ***T-Three***. ***B1*** was sold on February 5, 2007 for \$35,086,155.00. Taxpayer paid the City speculative builder tax on the sale pursuant to City Code Section 416 (“Section 416”).

Permit # LMNOP was issued on May 23, 2006 for the construction of ***B2***. The project was completed on May 7, 2007. Permitted A/C Square Feet was 133,021. Total Lot Square Footage was 306,397. ***B2*** was sold on May 31, 2007 for \$29,518,797.00. Taxpayer paid the City speculative builder tax on the sale pursuant to Section 416. ***B2*** was vacant at the time of the sale.

On July 20, 2006, there was an agreement set forth in Declaration of Covenants, Conditions and Restrictions (“Declaration”) whereby **B1** and **B2** were to have equal use of all common areas, including the parking structure. On January 31, 2007, there was a First Amendment to the Declaration whereby **B1** was to have the right to utilize 366 parking spaces and **B2** was to have the right to 394 parking spaces.

Taxpayer has requested a refund of tax in the amount of \$59,076.21 based on the inclusion in Taxpayer’s speculative builder tax of the non-taxable value of in-place leases. Taxpayer offered two methods of valuing the in-place leases. First, there was the difference in selling price for **B1** and **B2**. While **B1** had more of the parking structure on its parcel, Taxpayer asserted there was no difference in the areas for **B1** and **B2** since **B2** had an easement over fifty percent of the parking spaces. Second, Taxpayer calculated a present value of the lease income stream using a rate of seven percent interest per year.

The City argued that Section 416 imposes a tax on the “selling price from the sale of improved real property”. According to the City, the selling price would include any value the leases may have. While the City acknowledged that an in-place lease may increase the selling price of improved real property, the City asserted there are no provisions in Section 416 for any deduction or exclusion for an in-place tenant lease. For that reason, the City argued any refund request must be denied.

Even if an in-place lease could be excluded from the selling price, the City asserted that Taxpayer has failed to substantiate the amount of refund request. The City argued that since this is a denial of a refund claim, there is a higher standard than for a protest of a tax assessment. According to the City, there are other possible reasons for **B1** having a higher sales price than **B2**. The City indicated that **B1** had frontage to the freeway and **B2** did not. Additionally the **B1** parcel had approximately 7,000 more square feet than the **B2** parcel.

There was no dispute that the sale of **B1** was subject to the speculative builder tax. The only dispute centered on the selling price and whether or not the value of a long term lease in place at the time of sale should be included or deducted from the sales price. The initial question was whether the value of the lease should be included as part of the total selling price from the sale of improved real property. Consistent with the law that tax imposition statutes are to be strictly construed against the taxing jurisdiction, we conclude that the intangible value of the lease is not part of the selling price of the improved real property. This is consistent with our Decision MTHO # 176. The fact that this involves a refund request instead of a protest of a tax assessment (MTHO # 176) does not change our analysis. As a result, we concur with Taxpayer. We concur with the City that the burden is on Taxpayer to substantiate the amount of refund. In this case, Taxpayer’s primary calculation of the refund amount was based on comparing the sale prices of **B1** and **B2**. Since they were sold within four months of each other, we conclude the time frame was comparable. Both parcels had commercial buildings constructed on them with approximately 133,000 square feet. The parcels were adjacent to each other. There was not sufficient evidence to demonstrate any premium value attributable to the

B1 parcel because it may have fronted the freeway while **B2** has a freeway view but does not have frontage. The one area of concern for comparable purposes was the fact that the **B1** parcel had approximately 7,000 square feet of additional parking area than the **B2** parcel. However, that concern is erased due to the fact that **B2** has an irrevocable easement to over fifty percent of the parking spaces within the parking structure. Based on all the above, we conclude the only discernible difference in the **B1** and **B2** parcels at the time of sale was the fact that **B1** had the in-place leases. As a result, we conclude Taxpayer's use of the difference in the selling price to be a reasonable estimate of the value of the in-place leases. We further conclude that the selling price of the improved real property for **B1** was the same as the selling price of **B2** or \$29,518,000.00.

FINDINGS OF FACT

1. On March 17, 2011, Taxpayer filed a request with the City for a refund of taxes paid in the amount of \$59,076.21.
2. On April 25, 2011, the City issued a denial of the refund request.
3. On May 31, 2011, Taxpayer filed a letter of protest of a denial by the City of a tax refund request.
4. Taxpayer constructed two adjacent commercial office buildings in the city of *Scottsdale* referred to as **B1** and **B2**.
5. *Permit # ABCD* was issued on October 14, 2005 for the construction of **B1**.
6. The **B1** project was completed on August 24, 2006.
7. The **B1** project had permitted A/C square feet of 133,201 and total lot square footage of 313,040.
8. Prior to the sale of **B1**, Taxpayer secured leases with three tenants: *T-One* ; *T-Two*; and, *T-Three*.
9. The **B1** project was sold on February 5, 2007 for \$35,086,155.00.
10. Taxpayer paid the City speculative builder tax on the sale of **B1**.
11. *Permit # LMNOP* was issued on May 23, 2006 for the construction of **B2**.

12. The **B2** project was completed on May 7, 2007
13. The **B2** project had permitted A/C square footage of 133,201 and total lot square footage of 306,397.
14. The **B2** project was sold on May 31, 2007 for \$29,518,797.00.
15. *The* B2 project was vacant at the time of sale.
16. On July 20, 2006, there was an agreement set forth in the Declaration whereby **B1** and **B2** were to have equal use of all common areas, including the parking structure.
17. On January 31, 2007, there was a First Amendment to the Declaration whereby **B1** was to have the right to utilize 366 parking spaces and **B2** was to have the right to utilize 394 parking spaces.

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 from the business activity of engaging in the business as a speculative builder.
3. Taxpayer was a speculative builder on the sale of **B1** and **B2**.
4. Section 416(a)(1) includes in the taxable income of a speculative builder the “total selling price” from the sale of improved real property.
5. Consistent with the law that tax imposition statutes are to be strictly construed against the taxing jurisdiction, the intangible value of the rental stream from the three secured leases in place at the time of sale of **B1** is not includable in the selling price of improved real property.
6. The fact that this case involves a refund request instead of a protest of a tax assessment (MTHO# 176) does not change our analysis.
7. The only discernible difference in the **B1** and **B2** parcels at the time of sale was the fact that **B1** had three in-place leases.

8. Taxpayer has presented evidence that a reasonable value for the selling price of improved real property for the **BI** project was \$29,518,797.00.
9. Taxpayer's May 31, 2011 protest should be approved, consistent with the Discussion, Findings, and Conclusions, herein.

ORDER

It is therefore ordered that the May 31, 2011 protest by **Taxpayer** of a denial by the City of Scottsdale of a tax refund request should be approved consistent with the Discussion, Findings, and Conclusions, herein.

It is further ordered that the City of Scottsdale shall issue a tax refund to **Taxpayer** based on a selling price for the **BI** project of \$29,518,797.00

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

It is further ordered that this Decision is effective immediately.

Municipal Tax Hearing Officer