DECISION OF MUNICIPAL TAX HEARING OFFICER

Decision Date: August 27, 2012
Decision: MTHO #'s 655,656, & 657
Taxpayers:
Tax Collectors: Cities of Bullhead City and Lake Havasu
Hearing Date: May 2, 2012

DISCUSSION

Introduction

From May 20, 2010 through May 18, 2011, letters of protest were filed by ***Bank #1*** (3 protests) and ***Bank #2*** (2 protests) (Collectively, ***Bank #1*** and ***Bank #2*** referred to as "Taxpayers")of tax assessments made by the Cities of Bullhead City ("Bullhead City") (4 assessments) and by the City of Lake Havasu ("Havasu") (1 assessment) (Collectively, Bullhead City and Lake Havasu referred to as "Cities"). A hearing was commenced on May 2, 2012 before the Municipal Tax Hearing Officer ("Hearing Officer"). Appearing for the Cities were ***their attorneys, an Auditor and a City Attorney***. Appearing for Taxpayers were ***their attorneys***. On July 31, 2012, the Hearing Officer indicated the record was closed and a written decision would be issued on or before September 14, 2012.

DECISION

On February 24, 2010, Bullhead City issued an assessment for ***Bank #1*** for additional taxes in the amount of $46,638.58, interest in the amount of $1,565.49, and penalties totaling $11,659.65. The assessment was for the period April 2009. On February 24, 2010, Bullhead City issued an assessment for ***Bank #2*** for additional taxes in the amount of $9,629.94, interest in the amount of $290.82, and penalties totaling $2,407.49. The assessment was for the period of June 2009. On August 25, 2010, Bullhead City issued an assessment for ***Bank #1*** for additional taxes in the amount of $1,437.31, interest in the amount of $43.27, and penalties totaling $359.33. The assessment was for the period of October 2009. On November 16, 2010, Bullhead City issued an assessment for ***Bank #1*** for additional taxes in the amount of $8,110.54, interest in the amount of $108.12, and penalties totaling $1,622.11. The assessment was for the period of June 2010. On April 1, 2011, Lake Havasu issued an assessment for ***Bank #2*** for additional taxes in the amount of $10,984.16, interest in the amount of $717.70, and penalties totaling $2,746.04. The assessment was for the period of November 2008 through June 2010.

For each of the assessments, there was speculative builder activity done pursuant to the Model City Tax Code Section 416 ("Section 416"). In each instance, the actual construction work was done by a speculative builder that did not pay the tax. In each case, Taxpayers loaned monies to the speculative builders who constructed various commercial condominiums and other structures. Taxpayers obtained the improved properties that were constructed by various trustee deeds or deeds in lieu of foreclosure. Section 416 imposes a tax on the gross income from the business activity upon every person engaging in business as a speculative builder. Model City Tax Code Section 100 ("Section 100") defines a "speculative builder" as an "owner-builder" who sells or contracts to sell improved real property. "Owner-builder" is defined in Section 100 as an owner of real property who constructs or has constructed any improvements to real property. While Taxpayers were not part of the actual construction activity, the Cities assessed them pursuant to Model City Tax Code Section 595c ("Section 595c"). Section 595c provides as follows: "Any person who purchases, or who acquires by foreclosure, by sale under trust deed or warranty deed on lieu of foreclosure, or by any other method, improved real property or a portion of improved real; 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 as provided in Section 416." In each case, the builders that had the improvements constructed did not pay any speculative builder tax.

Taxpayers argued that the successor liability assessment seeking to transfer and morph the unpaid tax of a entity actually engaged in the speculative building activity into a transferee liability of an entity not engaged in the speculative building business constitutes an unconstitutional attempt to impose taxes premised on the irrebuttable factual presumption that Taxpayers are something they are clearly not (See Hecla Mining Co. v. Arizona Department of Revenue, 130 Ariz. 83,85, 634 P.2d 10, 12 (App. 1981). Taxpayers asserted they were engaged in the personal and professional service activity of loaning money and providing financing for other entities which might be engaged in a taxable activity. Taxpayers presented evidence that they were federally chartered and Arizona Banking Department-regulated financial institutions whose charters precluded them from engaging in business as speculative builders. Taxpayers asserted there must be a business activity generating the underlying liability and there is no such thing as "engaging in the business activity of successor liability". According to Taxpayers, the core of the purported successor liability is that of doing business as a speculative builder. Taxpayers noted that Section 595c was recently amended and recognizes for periods after May 1, 2010 that any unpaid taxes will be postponed and deferred until after the property can be resold.

The Cities argued that Taxpayers were not being taxed as speculative builders who construct improvements to real property. The Cities acknowledged Taxpayers were not speculative builders. According to the Cities, Taxpayers were taxed for vicarious liability as liability for the conduct of the speculative builders. The Cities have made a policy decision that those that acquire property upon which speculative builder tax was not paid should be responsible for that obligation.

In response to the vicarious liability argument, Taxpayers asserted such theory cannot be applied upon the facts of this case. Taxpayers indicated the decisions relied upon by the Cities involve vicarious liability for negligence or other tortious conduct. According to Taxpayers, the failure to pay taxes is not a tort but is a statutory violation. Taxpayers argued that the assessments depend entirely upon the irrebuttable presumption that the banks are being treated as if they were speculative builders despite the reality that they are not and by their charters they are precluded from being speculative builders.

Taxpayers also argued that A.R.S. Section 33-811e ("Section 811e") precludes the assertion of the assessments as "successor liability" obligations against Taxpayers pursuant to Section 595c. Section 811e provides as follows: "The trustee's deed shall operate to covey to the purchaser the title, interest and claim of the trustee, the trustor, the beneficiary, their respective successors in interest and all persons claiming the trust property sold by or through them, including all interest or claim in the trust property acquired subsequent to the recording of the deed of trust and prior to delivery of the trustee's deed. That conveyance shall be absolute without right of redemption and clear of all liens, claims or interests that have a priority subordinate to the deed of trust and shall be subject to all liens, claims or interests that have a priority senior to the deed of trust." Taxpayers argued that since each of the parcels in question were the subject of a trustee's sale and deed of trust or deed in lieu procedure, any and all claims or interest has been extinguished by operation of law. Taxpayers asserted that the assessments at issue were issues well after the trustee sales and issuance of trust deeds. Each of the assessments was triggered by the recordation of documents by Taxpayers memorializing the subsequent sales transactions following the trust deed and/or deed in lieu of foreclosure proceedings. In Taxpayers opening post-hearing brief, they cited two recent appellate decisions, BT Capital and Madison in support of Taxpayers arguments that Section 811 extinguished any claims or interests for purported speculative builder successor liability taxes. Subsequently, the Cities filed a Motion to Strike ("Motion") any reference to the two cases. In reply, Taxpayers noted that the Hearing Officer had ordered the parties to brief the issue of whether or not Section 811 applies to the facts of this case. Accordingly, Taxpayers requested the Motion be denied.

The Cities argued that Section 811e is concerned with transferring real property which has been obtained in foreclosure, and the term "lien' is referring to objects that attached and became a legal encumbrance on real property obtained in foreclosure. The Cities asserted Section 811e does not sweep into coverage legal obligations unrelated to title in the property. The Cities argues that Section 811e has nothing to do with imposed legal status, like tax liability of the sellers of the property, which is unrelated to the property. As noted above, the Cities filed a Motion to strike any reference to BT Capital and Madison since these cases were never raised prior to or during the hearing. Alternatively, the Cities argued the cases cited by Taxpayers actually support the Cities arguments that the successor liability tax assessments are not extinguished by Section 811.

Taxpayers argued that Article 9, Section 24 of the Arizona Constitution ("Section 24") prohibits the taxes assessed in this matter. Section 24 provides as follows: "The state, any county, city, town, municipality or other political subdivision of the state, or any district

created by law with authority to impose any tax, fee, stamp requirement or other assessment, shall not impose any new tax, fee, stamp requirement or other assessment, direct or indirect, on the act or privilege of selling, purchasing, granting, assigning, transferring, receiving, or otherwise conveying any interest in real property. This section does not apply to any tax, fee, or other assessment in existence on December 31, 2007."Taxpayers asserted that the effect of allowing any municipal "speculative builder tax successor liability" to cloud title will constitute a violation of Section 24.

The Cities argued that Section 24 does not have anything to do with the tax in this case. The Cities asserted that Section 24 was enacted to prohibit real estate transfer taxes and the underlying speculative builder tax is not a real estate transfer tax. Further, the Cities argued that even if it was a real estate transfer tax it would be exempt pursuant to the last sentence since it was in effect prior to December 31, 2007.

For each assessment, the Cities assessed penalties pursuant to A.R.S. Section 1125 ("Section 1125") for failure to file reports and failure to timely pay taxes. Taxpayers asserted that the penalties cannot be sustained since Taxpayers had no way of knowing the taxes were due from the speculative builders and had no advance notice the taxes would be shifted to them.

There was no dispute that for each of the transactions in question that there was an original owner-builder pursuant to Section 100 that had improvements made to real property. In each case, Taxpayers loaned the owner-builder monies to construct the improvements and the owner-builders experienced financial difficulties resulting in the improved real properties being transferred to Taxpayers via deed of trust or deed in lieu procedure. The transfers to Taxpayers resulted in sales pursuant to Section 100. "Sale" is defined in Section 100 to mean any transfer of title or possession, or both in any manner or by any means whatsoever, including consignment transactions and auctions. We conclude that each of the transfers to Taxpayers were transfers resulting in taxable speculative builder sales pursuant to Section 416. There was no dispute that the speculative builders that made the improvements did not pay any taxes to the Cities on the transfers to Taxpayers. As a result, the Cities assessed Taxpayers pursuant to Section 595. Subsection "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. For all transactions assessed in this matter, Taxpayers acquired improved real property or a portion of improved real property by foreclosure, by sale under trust deed or warranty deed in lieu of foreclosure. Clearly, the first portion of Subsection "c" is met. The last part of the subsection tells us how the tax is to be imposed. The person who has acquired the improved real property for which the taxes have not been paid <u>shall be responsible for payment of such tax as a speculative builder as provided in Section 416.</u> The Cities have acknowledged Taxpayers were not speculative builders pursuant to Section 416 and have relied upon a vicarious liability argument to support the assessment. After review of the emphasized language of Subsection "c", we must

disagree with the conclusion of the Cities. Subsection c does not say the person acquiring the improved real property will be subject to tax as if they were speculative builders. It also doesn't say the person acquiring the improved real property will be assessed a speculative builder tax. It clearly states that persons acquiring the improved real property will be assessed as a speculative builder. We conclude the "plain and ordinary meaning" of Subsection c requires Taxpayers to be speculative builders in order to be assessed. By the Cities own admission, Taxpayers were not speculative builders. We further conclude that the recent change in Subsection "c" further supports that conclusion as the taxable event is based on the subsequent sale by the creditor. Based on all the above, we conclude the assessments were based on irrebutable presumptions that Taxpayers were speculative builders. Consistent with the Cities admission that Taxpayers were not speculative builders and the decision in Hecla, all assessments in this matter shall be abated. Accordingly, Taxpayers' protests should be granted consistent with the Discussion, Findings, and Conclusions, herein. The Cities July 16, 2012 Motion is hereby denied.

While we found in Taxpayers favor, we also conclude that the Cities position was substantially justified based on previous decisions. In this case, Taxpayers raised new arguments that had not been previously raised.

FINDINGS OF FACT

1. From May 20, 2010 through May 18, 2011, letters of protest were filed by ***Bank #1*** and ***Bank #2*** of five tax assessments made by the Cities.

2. On February 24, 2010, Bullhead City issued an assessment for ***Bank #1*** for additional taxes in the amount of $46,638.58, interest in the amount of $1,565.49, and penalties totaling $11,659.65.

3. The February 24, 2010 assessment by Bullhead City for ***Bank #1*** was for the period of April 2009.

4. On February 24, 2010, Bullhead City issued an assessment for ***Bank #2*** for additional taxes in the amount of $9,629.94, interest in the amount of $290.82, and penalties totaling $2,407.49.

5. The February 24, 2010 assessment by Bullhead City for ***Bank #2*** was for the period of June 2009.

6. On August 25, 2010, Bullhead City issued an assessment for ***Bank #1*** for additional taxes in the amount of $1,437.31, interest in the amount of $43.27, and penalties totaling $359.33.

7. The August 25, 2010 assessment was for the period of October 2009.

8. On November 16, 2010, Bullhead City issued an assessment for ***Bank #1*** for additional taxes in the amount of $8,110.54, interest in the amount of $108.12, and penalties totaling $1,622.11.

9. The November 16, 2010 assessment was for the period of June 2010.

10. On April 1, 2011, Lake Havasu issued an assessment for ***Bank #2*** for additional taxes in the amount of $10,984.16, interest in the amount of $717.70, and penalties totaling $2,746.04.

11. The April 1, 2011 assessment was for the period of November 2008 through June 2010.

12. For each of the transactions in question, there was an owner-builder that has improvements made to real property.

13. In each case, Taxpayers loaned the owner-builder monies to construct the improvements afterwhich the owner-builders experienced financial difficulties resulting in the improved real properties being transferred to Taxpayers via deed of trust or deed in lieu of procedure.

14. Taxpayers are engaged in the personal and professional service activity of loaning money and providing financing for other entities.

15. Taxpayers are federally chartered and Arizona Banking Department-regulated financial institutions whose charters preclude them from engaging in business as speculative builders.

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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 speculative building.

3. Pursuant to Section 100, the original builders were "owner-builders" for the improved properties in question.

4. The transfers of the improved real properties via deed of trust or deed in lieu of procedure to Taxpayers resulted in speculative builder sales pursuant to Section 416.

5. None of the original builders paid the speculative builder tax on the transfers of improved real property to Taxpayers.

6. The "plain and ordinary meaning" of Section 595c requires Taxpayers to be speculative builders in order to be assessed.

7. The unpaid speculative builder taxes on the transfers to Taxpayers were assessed against Taxpayers as if Taxpayers were speculative builders pursuant to Section 595c.

8. The Cities have acknowledged that Taxpayers were not speculative builders.

9. We conclude the assessments in this matter were based on the irrebutable presumption that Taxpayers were speculative builders.

10. Consistent with the Cities admission that Taxpayers were not speculative builders and the decision in Hecla, all assessments in this matter shall be abated.

11. Taxpayers' protests should be granted, consistent with the Discussion, Findings, and Conclusions, herein.

12. The Cities July 16, 2012 Motion is denied.

13. The parties have timely rights of appeal to the Arizona Tax Court pursuant to Model City Tax Code Section -575.

ORDER

It is therefore ordered that the May 20, 2010 through May 18, 2011, letters of protest filed in this matter by ***Bank #1*** and ***Bank #2*** of tax assessments made by the City of Bullhead City and the City of Lake Havasu should be granted consistent with the Discussion, Findings, and Conclusions, herein.

It is further ordered that the City of Bullhead City and the City of Lake Havasu shall abate all taxes, interest, and penalties assessed in these matters.

It is further ordered that this Decision is effective immediately.

Municipal Tax Hearing Officer