

DECISION OF MUNICIPAL TAX HEARING OFFICER

Decision Date: January 31, 2008
Decision: MTHO #'s 379/380
Taxpayers: *Taxpayer Developer / Taxpayer Land Entity*
Tax Collector: City of Chandler
Hearing Date: January 7, 2008

DISCUSSION

Introduction

On February 21, 2007, *Taxpayer Developer* (“Taxpayer Development”) filed a protest of a tax assessment made by the City of Chandler (“City”). On February 23, 2007, Taxpayer Development filed an amended protest. On April 23, 2007, *Taxpayer Land Entity* (“Taxpayer Land”) filed a protest of a tax assessment made by the City. After review, the City concluded on August 14, 2007 that the protest by Taxpayer Development was timely and in the proper form. After review, the City concluded on August 14, 2007 that the protest by Taxpayer Land was timely and in the proper form. On September 4, 2007, the Municipal Tax Hearing Officer (“Hearing Officer”) ordered the City to file any responses to the protests on or before October 19, 2007. On October 23, 2007, the Hearing Officer extended the City’s deadline until November 6, 2007. On November 6, 2007, the City filed responses to the protests. On November 15, 2007, the Hearing Officer ordered Taxpayer Development and Taxpayer Land to file any replies to the City on or before December 6, 2007. On November 21, 2007, a Notice of Tax Hearing (“Notice”) scheduled the matters for hearing commencing on January 7, 2008. On December 4, 2007, Taxpayer Development filed a reply. On December 5, 2007, Taxpayer Land filed a reply. Each of the parties appeared at the January 7, 2008 hearing and presented evidence. On January 9, 2008, the Hearing Officer indicated the record was closed and a written decision on the matters would be issued on or before February 21, 2008.

City Position on Taxpayer Development

The City issued a Notice of Assessment (“Assessment”) on January 9, 2007 alleging that Taxpayer Development was liable for transaction privilege tax as a “speculative builder” on the sales of real property located in the City at *1234 Apple Place* (“*Apple Place*”) and *5678 East Orange Place* (“*Orange Place*”). The City assessed Taxpayer Development for taxes in the amount of \$2,541.55, interest up through January 2007 in the amount of \$388.29, and penalties in the amount of \$849.29.

The City disputed Taxpayer Development’s claim that it was entitled to a credit under City Code Section 62-416(c)(3)(A) and (B) (“Section 416(c). The City noted that the speculative builder (*House, LLC* (“*House*”)) from whom Taxpayer Development had

purchased the real property when it was only partially improved had not paid a tax pursuant to Section 416. As a result, the City asserted Taxpayer Development was responsible for payment of such tax as provided in City Code Section 62-595(c) (“Section 595(c)”) According to the City, Section 595(c) provides that any person who purchases, or who acquires by foreclosure, by 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 62-416 and 62-417. The City agreed that to the extent Taxpayer Development owed additional taxes, the failure to timely pay was due to reasonable cause and not willful neglect.

City Position on Taxpayer Land

The City issued a Notice of Revised Assessment (“Revised Assessment”) on March 6, 2007 alleging that Taxpayer Land was liable for transaction privilege tax as a speculative builder on the sales of real property located in the City at **4321 East Loin Place, 5678 South Mountain Drive, 9876 East Loin Place, and 4567 East Cat Place**. The City assessed Taxpayer Land for taxes in the amount of \$7,512.26.

The City disputed Taxpayer Land’s claim that it was entitled to a credit under Section 416(c). The City noted that the speculative builder **House** from whom Taxpayer Land had purchased the real property when it was only partially improved had not paid a tax pursuant to Section 416. According to the City, Taxpayer Land subsequently sold four of five parcels purchased from **House** without Taxpayer Land making any additional improvements to the parcels. The City assessed Taxpayer Land as a speculative builder on the sales prices of Taxpayer Land to third party buyers.

The City argued that if it is determined Taxpayer Land is not liable on its selling prices, then Taxpayer Land is liable to pay City tax on the sales by **House** to Taxpayer Land pursuant to Section 595(c).

Taxpayer Development Position

Taxpayer Development indicated it purchased **Preserve Lots 3 and 8** from **House** on May 19, 2003. According to Taxpayer Development, Lots **3** and **8** had been improved by **House** prior to purchase by Taxpayer Development. Subsequently, Taxpayer Development made additional improvements to Lots **3** and **8** which were then sold to third party buyers.

Taxpayer Development argued it was entitled to a credit pursuant to Section 416(c) for transaction privilege tax that **House** was responsible for paying the City. Taxpayer Development asserted that Section 416(b)(4) lists three conditions that must be satisfied in order for **House** to exclude the gross income from **House**’s sales. According to Taxpayer Development, none of those conditions were met by **House** and as a result **House** should have included the sales to Taxpayer Development as part of **House**’s

taxable gross income.

In reply to the City, Taxpayer Development argued Section 595(c) did not apply to this matter. Taxpayer Development asserted Section 595 deals with the succession and/or cessation of business. Taxpayer Development indicated it did not succeed *House* in business. According to Taxpayer Development, both properties in dispute were sold by November 2005 and the cessation of business by *House* did not occur until May 2006. Taxpayer Development noted that Section 595(b) reads that taxes imposed by this Chapter are a lien on the property of any person subject to this Chapter who sells his business or quits his business, if the person fails to make a final return and payment of the tax within fifteen (15) days after selling or quitting business. Taxpayer argued this section can only be applied to property still in the possession of the person going out of business or sold in the course of going out of business. Taxpayer asserted it could not possibly apply to property sold three years prior to the business cessation. Taxpayer Development argued that to the extent any taxes are found to be due, its failure to pay such taxes are due to reasonable cause and not willful neglect.

Taxpayer Land Position

Taxpayer Land indicated it purchased *Preserve Lots 10, 11, 12, 13, and 14* from *House* on May 19, 2003. According to Taxpayer Land, Lots *10, 11, 12, 13, and 14* had been partially improved by *House* prior to purchase by Taxpayer Land. Taxpayer Land asserted it made no improvements to the Lots between the time the Lots were purchased and the time they were sold. As a result, Taxpayer Land argued it was not an owner-builder that made or had made any improvements to real property.

In reply to the City's assertion that the sales from *House* were deemed to be an allowed exclusion pursuant to Section 416(b)(4), Taxpayer Land argued none of the three conditions were met by *House* and the gross sales should have been included in *House's* income. In reply to the City, Taxpayer Land asserted that Section 595(c) did not apply to this matter as there was no succession and/or cessation of business.

ANALYSIS

Taxpayer Development

Clearly, Taxpayer Development was a speculative builder for Lots *3* and *8*. Taxpayer Development made improvements to the real property which was then sold to third party buyers. Section 416 imposes the tax on the gross income from the sale. Next, we have the issue of whether or not Taxpayer Development was entitled to a tax credit pursuant to Section 416(c) for tax that Taxpayer Development argued should have been paid by *House* on the sale of Lots *3* and *8* to Taxpayer Development. We note that City Code Section 360 ("Section 360") provides that all credits are conditional upon adequate proof and documentation being provided by the taxpayer. As a result, we start with the requirement that the burden of proof is on Taxpayer Development to demonstrate it was entitled to a tax credit. Since there was no evidence of any taxes being paid to the City on

the *House* sales to Taxpayer Development, we conclude Taxpayer Development did not meet its burden of proof for a tax credit for taxes paid to the City. Section 416(c) also provides for a tax credit when it can be shown taxes were separately charged to a taxpayer. In this case, Taxpayer Development provided a copy of a lot purchase contract that indicated the total purchase price included sales tax. We don't find that evidence to be enough to demonstrate Taxpayer Development was separately charged a specified tax on the purchase of Lots 3 and 8. Accordingly, we conclude that Taxpayer Development failed to meet its burden of proof of demonstrating it was entitled to a tax credit for taxes separately charged by *House* on the sales to Taxpayer Development. Based on the above, Taxpayer Development's claim for a tax credit must be denied.

We conclude that any taxes not timely paid by Taxpayer Development in this matter were due to reasonable cause. A reasonably prudent businessperson would have relied on *House* to have paid taxes to the City under the circumstances set forth herein.

Taxpayer Land

Section 100 defines a "speculative builder" as an "owner-builder" that sells improved real property. "Owner-builder" is defined in Section 100 as an owner that has improvements constructed to real property. Taxpayer Land purchased and sold four parcels of real property. However, Taxpayer Land did not have improvements constructed nor did Taxpayer Land make any improvements on the real property. As a result, Taxpayer Land was not an owner-builder pursuant to Section 100 and thus not a speculative builder pursuant to Sections 100 and 416.

Next, we have the issue on whether or not Taxpayer Land is liable for tax on the sales from *House* to Taxpayer Land. We think not. *House* was liable for any taxes on those sales unless *House* could demonstrate it was entitled to an exclusion for the sale of partially improved residential real property pursuant to Section 416(b)(4). There was no evidence that *House* met the requirements set forth in Section 416(b)(4). Accordingly, we conclude that Taxpayer Land was not liable for any taxes on the sales by *House* to Taxpayer Land.

Lastly, we have the issue of whether or not Taxpayer Land was liable for taxes on the *House* sales pursuant to Section 595(c). Subsection 595(a) makes it clear that (b) through (d) may only be applied when there is a "succession in and/or cessation of business". At the time of the sales to Taxpayer Land, *House* was in the speculative builder business. Subsequently, *House* went out of that business. Clearly, there was no succession in and/or cessation of business at the time of the *House* sales to Taxpayer Land. Based on all the above, we conclude that Taxpayer Land's sale of the four parcels in question was not a taxable event. Accordingly, Taxpayer Land's protest is granted.

FINDINGS OF FACT

1. On February 21, 2007, Taxpayer Development filed a protest of a tax assessment made by the City.
2. On February 23, 2007, Taxpayer Development filed an amended protest.
3. On April 23, 2007, Taxpayer Land filed a protest of a tax assessment made by the City.
4. After review, the City concluded on August 14, 2007 that the protest by Taxpayer Development was timely and in the proper form.
5. After review, the City concluded on August 14, 2007 that the protest by Taxpayer Land was timely and in the proper form.
6. On September 4, 2007, the Hearing Officer ordered the City to file responses on the protests by Taxpayer Development and Taxpayer Land on or before October 19, 2007.
7. On October 23, 2007 the Hearing Officer extended the City's deadline until November 6, 2007.
8. On November 6, 2007, the City filed responses to the protests by Taxpayer Development and Taxpayer Land.
9. On November 15, 2007, the Hearing Officer ordered Taxpayer Development and Taxpayer Land to file replies to the City on or before December 6, 2007.
10. On November 21, 2007, a Notice scheduled the matters for a joint hearing commencing on January 7, 2008.
11. On December 4, 2007, Taxpayer Development filed a reply.
12. On December 5, 2007, Taxpayer Land filed a reply.
13. Both parties appeared and presented evidence at the January 7, 2008 hearing.
14. On January 9, 2008, the Hearing Officer indicated the records were closed and a written decision on the matters would be issued on or before February 21, 2008.
15. The City issued an Assessment on January 9, 2007 alleging that Taxpayer Development was liable for transaction privilege tax as a speculative builder on the sales of real property located in the City at *Apple Place* and *Orange Place*.
16. The City assessed Taxpayer Development for taxes in the amount of \$2,541.55, interest in the amount of \$388.29, and penalties in the amount of \$849.29.

17. Taxpayer Development purchased Lots **3** and **8** from **House** on May 19, 2003.
18. Lots **3** and **8** had been partially improved by **House** prior to purchase by Taxpayer Development.
19. Taxpayer Development made additional improvements to Lots **3** and **8** and then sold the Lots to third party buyers prior to November 2005.
20. **House** did not pay the City any taxes on the sales to made to Taxpayer Development.
21. Taxpayer Development did not provide any written declaration to **House** that Taxpayer Development was assuming the liability for and would pay all privilege taxes which would otherwise be due to the City on the sales of partially improved residential real property to Taxpayer Development.
22. The City issued a Revised Assessment on March 6, 2007 alleging that Taxpayer Land was liable for transaction privilege tax as a speculative builder on the sales of real property located in the City at **4321 East Loin Place, 5678 South Mountain Drive, 9876 East Loin Place, and 4567 East Cat Place.**
23. There was a cessation of business by **House** in May 2006.
24. The City assessed Taxpayer Land for taxes in the amount of \$7,512.26.
25. Prior to the sales to Taxpayer Land, **House** had partially improved the properties located at **4321 East Loin Place, 5678 South Mountain Drive, 9876 East Loin Place, and 4567 East Cat Place.**
26. Taxpayer Land did not make any additional improvements to the four properties in question prior to selling them to third party buyers.
27. **House** did not pay the City any taxes on the sales made to Taxpayer Land.
28. Taxpayer Land did not provide any written declaration to **House** that Taxpayer Land was assuming the liability for and would pay all privilege taxes which would otherwise be due to the City on the sales of partially improved residential real property to Taxpayer Land.

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 Development was a speculative builder for Lots 3 and 8 pursuant to Section 416.
3. Section 360 provides that all credits are conditional upon adequate proof and documentation being provided by the taxpayer.
4. Taxpayer Development did not meet its burden of proof for a tax credit pursuant to Section 416(c).
5. Taxpayer Development's claim for a tax credit is denied.
6. Taxpayer Development's failure to timely pay taxes was due to reasonable cause.
7. Section 100 defines a "speculative builder" as an "owner-builder" that sells improved real property.
8. Section 100 defines an "owner-builder" as an owner that has improvements constructed to real property.
9. Taxpayer Land was not an "owner-builder" pursuant to Section 100 and thus not a "speculative builder" pursuant to Sections 100 and 416.
10. *House* was liable for any taxes on sales to Taxpayer Land unless *House* could demonstrate it was entitled to an exclusion pursuant to Section 416(b)(4).
11. There was no evidence that *House* had met the requirements set forth in Section 416(b)(4).
12. Taxpayer Land was not liable for any taxes on the sales from *House* to Taxpayer Land.
13. Subsection 595(a) makes it clear that Subsections (b) through (d) may only be applied when there is a "succession in and/or cessation of business".
14. At the time of the sales to Taxpayer Land, *House* was in the speculative builder business.

15. There was no succession in and/or cessation of business at the time of the *House* sales to Taxpayer Land.
16. Taxpayer Land's sales of the four parcels in question were not taxable events pursuant to the City Code.
17. Taxpayer Land's protest should be granted.

ORDER

It is therefore ordered that the February 21, 2007 protest, as amended on February 23, 2007, by *Taxpayer Developer* of a tax assessment made by the City of Chandler is hereby partly granted and partly denied, consistent with the Discussion, Findings, and Conclusions, herein.

It is further ordered that the City of Chandler shall remove all penalties assessed on *Taxpayer Developer*.

It is further ordered that the April 23, 2007 protest by *Taxpayer Land Entity* of a tax assessment made by the City of Chandler is hereby granted.

It is further ordered that the City of Chandler shall remove all taxes assessed on *Taxpayer Land Entity* associated with the sale of real property located in the City at *4321 East Loin Place, 5678 South Mountain Drive, 9876 East Loin Place, and 4567 East Cat Place*.

It is further ordered that this Decision is effective immediately.

Jerry Rudibaugh
Municipal Tax Hearing Officer