

**Jerry Rudibaugh  
Municipal Tax Hearing Officer**

**DECISION OF MUNICIPAL TAX HEARING OFFICER**

Decision Date: November 13, 2002

Decision: MTHO #49

Tax Collector: City of Tempe

Hearing Date: September 10, 2002

**DISCUSSION**

**Introduction**

On May 31, 2002, *ABC, L.L.C.* ("Taxpayer") filed a protest of a tax assessment of the City of Tempe ("City"). After review, the City concluded on June 5, 2002 that the protest was timely and in proper form. On June 10, 2002, the Municipal Tax Hearing Officer ("Hearing Officer") ordered the City to file a response to the protest on or before July 25, 2002. The City filed its response on to the protest on July 25, 2002. On August 6, 2002, the Hearing Officer ordered the Taxpayer filed any reply on or before August 21, 2002. The matter was scheduled for hearing commencing on September 10, 2002. On August 20, 2002 the Taxpayer filed a request for an extension until September 5, 2002 in which to file its reply. On August 21, 2002, the Hearing Officer granted the extension request. The Taxpayer filed its reply on September 5, 2002. The Taxpayer and City both appeared and presented evidence at the September 10, 2002 hearing. On September 11, 2002, the Hearing Officer ordered the Taxpayer to file any response to the City's argument on statutory construction on or before September 17, 2002 and the City's reply was to be filed on or before September 24, 2002. On September 16, 2002 the Taxpayer filed a request for an extension until September 23, 2002. On September 17, 2002 the request was granted by the Hearing Officer and the City's reply deadline was extended until September 30, 2002. The Taxpayer filed its response on September 23, 2002 and the City filed its reply on September 30, 2002.

In February 1997, the Taxpayer purchased a parcel of vacant land at the corner of A Drive and B road ("E Property") in the City. On May 27, 1997 the Taxpayer took out a building permit for an office/warehouse building. On September 3, 1997, the Taxpayer entered into a contract with Contractor Construction Company, Inc. ("Contractor") for construction of a shell building. The total amount of the contract, including change orders, was \$4,328,055. The shell building was completed in November of 1997. Subsequently, the Taxpayer constructed tenant improvements totaling \$6,290,542, which was completed in July 2000. In December of 2001, the Taxpayer sold the E Property to Buyer, L.L.C. ("Buyer") for \$20,145,404.

On April 19, 2002, the City assessed a deficiency against the Taxpayer for underpayment of privilege tax due on the sale of the property under City Code Section 16-416 ("Section 416") as a speculative builder sale. The assessment was for \$116,683.39 of taxes plus applicable interest. The City also assessed a late payment penalty pursuant to City Code Section 16-540 (b)(2) ("Section 540") in the amount of \$11,668.34. At the request of the Taxpayer, the City subsequently waived the late payment penalty.

## **City Position**

The City argued that the Elliot property was sold before the expiration of 24 months after the improvements were substantially complete. According to the City, the shell building would not meet the substantially complete definition of the City Code Section 100 (“Section 100”). Section 100 defines substantially complete as:

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.”

The construction of the E Property was suspended after the final billing in February 1999. According to the City, the original building permit expired in September 1999 and a new building permit to reissue the expired permit was issued in May 2000. In addition, various other building permits were issued from May 2000 through March 2001 for the completion of the shell and the construction of tenant improvements totaling \$6,290,542. The City asserted that the shell building passed final inspection on July 21, 2000 and certificates of occupancy (“certificates”) were issued at various times thereafter through April 2001.

The City argued that the \$909,660 of construction costs for the completion of the shell building and the \$5,380,882 of construction costs for tenant improvements constituted improvements to real property and the 24-month period did not begin until completion of those improvements. The City further argued that for buildings constructed within the City, the issuance of a Certificate is the only appropriate measure of substantial completion under Section 100. Since the sale occurred in December 2001, the City concluded the sale was subject to the speculative builders tax under Section 416 since the last Certificate was issued in April of 2001. This was well within the 24-month period established by the Code.

## **Taxpayer Position**

The Taxpayer asserted that it entered into a contract with Contractor for construction of a “grey shell building”. According to the Taxpayer, a grey shell building does not include tenant improvements such as air conditioning since they are not incorporated into the tenant space until the tenants are known. The Taxpayer argued that the shell building was “compliance certificate” ready upon completion in November of 1998. The Taxpayer asserted that the City’s conclusion that the building was halted and then restarted is an erroneous conclusion. The Taxpayer argued that the shell building was completed in November of 1998 and subsequent improvements were the direct result of tenant improvements required as a result of leases entered into. The Taxpayer indicated that any delay that occurred between building completion and lease up was due to market saturation and the corresponding difficulty of finding tenants in the market place. As a result, the Taxpayer asserted that the shell building was substantially complete as defined by Section 100 in November 1998, which was more than three years prior to the sale of the building. Accordingly, the Taxpayer concluded the shell building is not subject to the speculative builder tax imposed by Section 416.

Alternatively, the Taxpayer argued that if there was a speculative builder tax imposed, it should be based on the subsequent tenant improvement contracts completed within the 24-month period prior to the sale. According to the Taxpayer, the value attributable to the land and shell building would have to be excluded from the sale value taxed.

### **ANALYSIS**

We concur with the Taxpayer that a shell building can be substantially complete pursuant to Section 100. We do not agree with the City that a Certificate of Occupancy must be issued to meet the substantially complete test. The third prong of Section 100 defines substantially complete as a building being ready for “immediate occupancy or use”.) Under certain facts, the Hearing Officer concludes a shell building could be ready for its intended use and not be ready for immediate occupancy.

However, under the facts of this case, the Hearing Officer does not find the shell building was substantially complete for its intended use until July of 2000. This conclusion was reached because of the re-issuance of the original building permit for almost \$1 million of additional construction on the shell building in May 2000. Since the sale of the E property occurred within 24-months of the Taxpayer’s completion of substantial improvements to the shell building, the sale was properly taxed as a speculative builder sale pursuant to Section 416. Accordingly, the Taxpayer’s protest is denied.

### **FINDINGS OF FACT**

1. On May 31, 2002, the Taxpayer filed a protest of a tax assessment of the City.
2. After review, the City concluded on June 5, 2002 that the protest was timely and in the proper form.
3. On June 10 2002, the Hearing Officer ordered the City to file a response to the protest on or before July 25, 2002.
4. The City filed its reply on July 25, 2002.
5. On August 6, 2002, the Hearing Officer ordered the Taxpayer to file any reply on or before August 21, 2002.
6. The matter was scheduled for hearing commencing on September 10, 2002.
7. On August 20, 2002, the Taxpayer filed a request for an extension until September 5, 2002 in which to file its reply.
8. On August 21, 2002, the Hearing Officer granted the extension request.

9. The Taxpayer filed its reply on September 5, 2002.
10. The Taxpayer and City both appeared and presented evidence at the September 10, 2002 hearing.
11. On September 11, 2002, the Hearing Officer ordered the Taxpayer to file any response to the City's arguments on statutory construction on or before September 17, 2002 and the City's reply was to be filed on or before September 24, 2002.
12. On September 16, 2002, the Taxpayer filed a request for an extension until September 23, 2002.
13. On September 17, 2002, the request was granted by the Hearing Officer and the City's reply deadline was extended until September 30, 2002.
14. The Taxpayer filed its response on September 23, 2002 and the City filed its reply on September 30, 2002.
15. On September 3, 1997, the Taxpayer entered into a contract with Contractor for construction of a shell building.
16. The total amount of the Contractor contract was \$4,328,055.
17. On May 10, 2000, the City re-issued the expired building permit on the shell building.
18. The Taxpayer entered into a second construction contract for an additional \$909,660 for improvements to the shell building.
19. The Taxpayer entered into a construction contract for tenant improvements totaling \$5,380,882.
20. The additional improvements to the shell building and the tenant improvements were completed in July 2000.
21. In December of 2001, the Taxpayer sold the E Property to Buyer for \$20,145,404.

### **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 taxes the gross income of speculative builders within the City.

3. Section 100 defines speculative builder as an owner-builder who sells or contracts to sell improved real property before the expiration of 24 months after the improvements of the real property sold are substantially complete.
4. Section 100 provides three alternative definitions of substantially complete.
5. The shell building was not ready for its intended use until July of 2000.
6. The sale of the E Property in December of 2001 was within 24-months of the improvements on the shell building being substantially completed.
7. The E Property sale was a speculative builder sale pursuant to Section 416.
8. The Taxpayer's protest should be denied.

**ORDER**

It is therefore ordered that the May 31, 2002 protest of *ABC, L.L.C.* of the City of Tempe tax assessment is hereby denied.

It is further ordered that this decision shall be effective immediately.

Jerry Rudibaugh  
Municipal Tax Hearing Officer