

Jerry Rudibaugh

Municipal Tax Hearing Officer

DECISION OF MUNICIPAL TAX HEARING OFFICER

Decision Date: March 18, 2002

Decision: MTHO #32

Taxpayer:

Tax Collector: City of Phoenix

Hearing Date: None

DISCUSSION

Introduction

On December 20, 2001, Taxpayer ("Taxpayer") filed a protest of the City of Phoenix ("City") tax assessment. After-review of the protest, the City determined that the protest was timely but not in the proper form. On January 17, 2002, the Tax Hearing Officer instructed the Taxpayer to respond. On January 18, 2002, the Taxpayer filed its amended protest. The amended protest was in the proper form and the city was ordered to file a response on or before March 7, 2002. In addition, the protest was processed as a hearing. On January 22, 2002, the Taxpayer requested the protest be processed as a redetermination. The City filed its response on January 31, 2002. The Tax Hearing Officer ordered the Taxpayer to file its reply by March 7, 2002. The Taxpayer filed its reply on February 5, 2002,

On January 21, 1999, Taxpayer and the Company A entered into an agreement entitled "Agreement to Form Joint Venture, and Purchase and Sell Real Property" ("Formation Agreement"). The joint company was known as Company B. The Formation Agreement required that Taxpayer sell developed and undeveloped land ("Property") to Company B for the lesser of \$15,250,000 or the development costs of the property. The Property was comprised of Buildings C, D, R and parcels of vacant land. On July 14, 2000, Taxpayer sold the Property to Company B for the development cost of \$11,671,720. However, Stewart Title & Trust of Phoenix, Inc. ("Stewart Title"), originally filed an Affidavit of Property Value ("Affidavit") erroneously stating that the development cost of the Property was \$13,594,518.

On January 19, 2001, Company B sold Building H to Company C for \$5,643,600. On August 22, 2001, Company B entered into two separate agreements to sell Buildings C and D to Company D and Company E for \$1,486,710 and \$1,613,940, respectively. The sales were completed on November 6, 2001. None of the purchasing entities were related to Company B.

City Position

On May 5, 2001, the City contacted the Taxpayer regarding a possible speculative builder sale. The City had made a routine search of Maricopa County ("County") sales records and based on Affidavit it appeared that the Taxpayer had sold improved real property in the amount of \$13,594,518 on July 14, 2000.

The City received other documentation from the Taxpayer that showed a sales price of \$11,674,660 and total development costs after adjustments of \$11,671,720. The City contacted the Taxpayer regarding the \$1,922,799 difference in the sales price provided by the Taxpayer (\$11,671,720) and the amount recorded by the County. The City concluded that while Company B may have funded the sale at cost this did not, appear to be a market price. Since the County utilizes the Affidavit

in determining the property value to base the assessment of property taxes, the City considered that as a reliable estimate of the property. Subsequently, the Taxpayer's title company corrected the Affidavit to show a revised sale price of \$11,671,720. The City's final assessment used the gross amount due to the seller, as adjusted for lease payments resulting in an amount of \$11,727,641.05.

Although the sale was to a related entity, the City believes the estimate applied to the sale by the Taxpayer was a reasonable market value. The City then reduced that amount by \$1,809,670.00 for the sales price of the vacant property. The adjusted sales price of \$9,917,971.05 was further adjusted for deductions and credits to compute the tax due of \$27,089.02. While the properties were subsequently sold to non-related entities, the City did not believe those sales were a reasonable estimate of the market price, at the time of closing of escrow or transfer of title to Company B since they occurred over one year later.

Taxpayer Position

The Taxpayer protested the assessment in the amount of \$9,392.97 plus applicable interest. The Taxpayer asserted that the City in arriving at its assessment amount failed to take into account Phoenix City Code Section 14-210 ("Section 210") in order to determine taxable gross proceeds under the speculative builder tax classification. According to the Taxpayer, Section 210 requires the City in arriving at its assessment to determine the "market value" of transactions between affiliated entities. Further, the Taxpayer asserted that the City invoked Section 210 when it issued its preliminary assessment against Taxpayer by utilizing the "market value" rather than basing the liability on the development costs. In this case, the Taxpayer argued that the most accurate measurement of market value was the sale of buildings C, D, and H to non-related entities Company D, Company E, and Company C, respectively. Those sales total \$8,744,250 and, according to the Taxpayer, should be used by the City in calculating its- assessment.

ANALYSIS

The parties were in agreement that the Taxpayer's sale of the Property to Company B was a taxable transaction pursuant to Phoenix City Code Section 416 ("Section 416") which provides that "the gross income of a speculative builder considered taxable shall include the total selling price from the sale of improved real property at the time of closing of escrow or transfer of title."

The parties were also in agreement that the sale price of the parcels of vacant land should not be included as part of the speculative builder assessment. Lastly, the parties were in agreement that Section 210 requires the City to determine the "market value" of the transactions between affiliated entities. The parties differed on the methodology of determining the market value and the issue was brought to the Tax Hearing Officer for resolution.

Section 210 provides as follows: In transactions between affiliated companies or persons, or in other circumstances where the relationship between the parties is such that the gross income from the transaction is not indicative of the market value of the subject matter of the transaction, the Tax Collector shall determine the "market value" upon which the City Privilege and Use Taxes shall be levied. "Market value" shall correspond as nearly as possible to the gross income from similar transactions of like quality or character by other taxpayers where no common interest exists between the parties, but otherwise under similar circumstances and conditions.

It is clear from Section 210 that the Tax Collector "shall" determine the "market value" when the transactions are between affiliated companies. It is also clear from the facts of this case that the transaction in question was between affiliated companies. Section 210 also requires "market value" to correspond as nearly as possible from similar transactions of like quality where the companies are not affiliated.

Based on the above, the issue before the Hearing Officer is which party's position best reflects "market value" under Section 210. We note that the sale of Building H occurred approximately six months after the initial sale and Buildings C and D were sold approximately one year after the initial sale.

Normally, we would expect the sales price to increase over time. In this case, the sales price to the non-related entities was actually below the development costs. The Hearing Officer concludes that fact actually adds credibility that the subsequent sales were a reasonable estimate of the market price at the time of closing of the initial sale. The Hearing Officer also concludes that the subsequent sales are similar transactions under similar circumstances as the initial sale. Based on all the above, the Hearing Officer grants the Taxpayer's request to reduce the total sales amount to \$8,744,250.

FINDINGS OF FACT

1. On November 21, 2001, the City issued a Notice of Tax Assessment to Taxpayer which included a speculative builder tax in the amount of \$27,089.12
2. On December 20, 2001, Taxpayer filed a protest of the City tax assessment.
3. On January 21, 1999, Taxpayer and the Company A entered into the Formation Agreement.
4. Pursuant to the Formation Agreement, a joint company known as Company B was formed.
5. The Formation Agreement required that Taxpayer sell the Property to Company B for \$15,250,000 or the development costs of the property.
6. The Property was comprised of Buildings C, D, H, and parcels of vacant land.
7. On July 14, 2000, Taxpayer sold the Property to Company B for the development cost of \$11,671,720.
8. Stewart Title filed an Affidavit stating the development cost of the Property was \$13,594,518.
9. On January 19, 2001, Company B sold Building H to Company C for \$5,643,600.
10. On May 5, 2001, the City contacted the Taxpayer regarding a possible speculative builder sale.
11. Based on the Affidavit to the County, the City concluded the Taxpayer had sold improved real property in the amount of \$13,594,518.
12. Subsequently, Stewart Title corrected the Affidavit to show a sales price of \$11,671,720.
13. The City concluded that while Company B may have funded the sale-at cost, this did not appear to be a market price.
14. On August 22, 2001, Company B entered into two separate agreements to sell Buildings C and D to Company D and Company E for \$1,486,710 and \$1,613,940, respectively.
15. Company C, Company D, and Company E were not related to Company B.
16. The City's final assessment utilized the development costs for Buildings C, D, and H as adjusted for lease payments resulting in an adjusted sales amount of \$11,727,641.05.
17. The City believed the sales to Company C, Company D, and Company E were not a reasonable estimate of the market price of the original transfer to KPPIC because the final sale occurred over one year after the closing of escrow on the transfer to Company B.
18. Taxpayer believed the most accurate measurement of market value of the original transfer to Company B were the sales of Buildings C, D, and H to non-related entities totaling \$8,774,250.

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 requires that the total selling price from the improved real property at the time of closing of escrow or transfer of title to be taxable gross income of a speculative builder.
3. Section 100 defines a speculative builder as an owner-builder who sells improve real property with 24 months after the improvements are substantially complete.

4. Section 210 requires the City to utilize the market value when transactions are between affiliated companies.

5. The sales of Building C, D, and H to Company E, Company D, and Company C were similar transactions under similar circumstances as the transfer from the Taxpayer to Company B and were a reasonable estimate of the-market price at the time of closing of the transfer to Company B.

6. Taxpayer's protest should be granted.

ORDER

It is therefore ordered that the December 20, 2001, as amended on January 14, 2002, protest request of Taxpayer is hereby granted.

It is further ordered that the City of Phoenix shall revise its tax assessment issued to Taxpayer to reflect a speculative builder sale in the amount of \$8,774,250.

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

Dated: March 18, 2002

Jerry Rudibaugh

Municipal Tax Hearing Officer