DECISION OF MUNICIPAL TAX HEARING OFFICER

Decision Date: December 21, 2009
Decision: MTHO # 505
Taxpayer: ***Taxpayer***
Tax Collector: City of Peoria
Hearing Date: August 24, 2009

DISCUSSION

Introduction

On March 24, 2009, a letter of protest was filed by ***Taxpayer*** of a tax assessment made by the City of Peoria ("City"). A hearing was commenced before the Municipal Tax Hearing Officer ("Hearing Officer") on August 24, 2009. Appearing for Taxpayer was ***Taxpayer Representatives***. Appearing for the City were Assistant City Attorney, Tax and License Supervisor, Tax Auditor and Engineering Supervisor. At the conclusion of the August 24, 2009 hearing, the parties agreed on a briefing schedule. On November 6, 2009, the Hearing Officer closed the record and indicated a written decision would be issued on or before December 21, 2009.

DECISION

The City conducted an audit of Taxpayer for the period of April 2005 through September 2005. The City concluded that Taxpayer sold three improved lots that were subject to the speculative builder tax pursuant to City Code Section 12-416 ("Section 416"). Lot No. 16 was sold to ***Buyer A*** on September 19, 2005; Lot No. 22 was sold to ***Buyer B*** on September 22, 2005; and, Lot No. 25 was sold to ***Buyer C*** on August 12, 2005. As a result, the City assessed Taxpayer for additional taxes in the amount of $11,543.68, interest up through February 2009 in the amount of $2,998.73, and penalties totaling $2,885.92. Taxpayer protested the entire assessment as it argued the three lots were not "improved real property" pursuant to Section 416 when they were sold.

Taxpayer asserted that in Estancia Dev. Assocs. V. City of Scottsdale, 196 Ariz. 87 (App. 1999), the Arizona Court of Appeals held that the sale of improved land by a speculative builder is not subject to city sales tax. Real property is "improved real property" only if it satisfies at least one of the requirements of Section 416(a)(2): "Improved Real Property" means any real property: (A) upon which a structure has been constructed; or (B) where improvements have been made to land containing no structure (such as paving or landscaping); or (C) which has been reconstructed as provided by Regulation; or (D) where water, power, and streets have been constructed to the property line. The parties

were in agreement that the issue in this case was whether or not Subsection B applied: "where improvements have been made to land containing no structure (such as paving or landscaping)". Both parties cited a recent decision, City of Scottsdale v. Terrabrook Mirabel, LLC, Arizona Tax Court Case No. TX2006-050063 (July 31, 2008) in which the Tax Court concluded the crucial question under Subsection B is whether the construction work physically on the lots constitutes valuable additions or betterments to the lots.

There was no dispute that each of the three lots had a sewer line run into the interior of the lots. This would have required plans, a permit, trenching, placing of sewer pipes and backfilling the trenches. Taxpayer argued in its post-hearing brief that the installation of the non-working pipe was quick and cheap and added nothing to the value of the lot(s). The City argued that it was uncontested that the sewer line was a betterment to the lot. No matter what the cost or effort to install the sewer pipe into the lot, we conclude that it clearly benefits the lot home buyer and makes it easier for the lot purchaser to hook up to the sewer system. Is that enough to conclude the lot was "improved real property" pursuant to Section 416(a)(2)(B) where improvements have been made to land containing no structure (such as paving or landscaping). We conclude Section 416(a)(2)(B) contains no reference to any costs. Certainly, paving could be done quickly and cheaply. The Court in Terrabrook concluded the following: "Nor can the Court find a **de minimis** exception in the statute: it is immaterial that the value of the improvement is small compared to the total value of the lot" The Court further concluded: " There is also evidence that utility lines may in at least some cases have extended beyond the property line (to a distance sufficient to exclude a mere surveying or placement error), with the similar purpose of making connection to the ultimate homebuilder less destructive and costly. Either of these would seem to add value, constituting an improvement and subjecting Plaintiff to tax under subsection b." We find the Court's conclusion to be right on point to the utility sewer lines in this matter. Accordingly, we conclude the sale of Lot Nos. 16, 22, and 25 were sales of improved real property pursuant to Section 416(a)(2)(B) and thus subject to the speculative builder tax in Section 416.

There were also discussions regarding possible improvements from grading and from installation of water lines. The City argued there were water lines brought into the interior of the three lots. Taxpayer argued that any water lines into the property would have occurred after the sale of the lot and would have been done by the lot purchaser and not Taxpayer. In reviewing the inspection reports provided by the City, we note that on the August 15, 2005 report it refers to placing water services one and one-half feet from the property lines. It was undisputed that Taxpayer graded a road to each of the lots in question. The City has argued that there was some grading made to the lots to insure the lots drained properly. Taxpayer provided language from each of the lot sales which specified Taxpayer would not mass grade the project. From that language, Taxpayer concluded it must leave the lot(s) alone. The City concluded the additional language from those contracts ("Each lot will be left in as much of its natural state as possible during project construction.") contemplates improvements. It is unclear to the Hearing Officer if the grading was done strictly by the needs of the road builders and/or the mandates of the City. If we were clear that it was to smoothly connect the individual driveway, we would conclude it was an improvement to the lot pursuant to Section 416(a)(2)(B). Based on the

evidence, we are unclear whether or not the water lines or grading would have resulted in improvements. However, as we previously concluded, the installation of the sewer lines into the lots would have resulted in improvements to the lots pursuant to Section 416(a)(2)(B). Accordingly, Taxpayer's protest of the speculative builder tax should be denied.

Since Taxpayer failed to timely file reports or timely pay taxes, the City was authorized pursuant to City Code Section 12-540 ("Section 540") to impose penalties. Those penalties may be abated for reasonable cause. Since Terrabrook clarified Section 416(a)(2)(B) after the sale of the lots in question, we conclude Taxpayer has demonstrated reasonable cause to have all penalties waived in this matter.

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FINDINGS OF FACT

1. On March 24, 2009, Taxpayer filed a protest of a tax assessment made by the City.

2. The City conducted an audit of Taxpayer for the period of April 2005 through September 2005.

3. The City assessed Taxpayer for additional taxes in the amount of $11,543.68, interest up through February 2009 in the amount of $2,998.73, and penalties totaling $2,885.92.

4. Taxpayer sold Lot No. 16 to ***Buyer A*** on September 19, 2005; Lot No. 22 was sold to Mr. and Mrs. ***Buyer B*** on September 22, 2005; and, Lot No. 25 was sold to ***Buyer C*** on August 12, 2005.

5. Prior to the sale of Lot Nos. 16, 22, and 25, Taxpayer had a sewer line run into the interior of the three lots.

6. The installation of the sewer lines would have required plans, a permit, trenching, placing of sewer pipes and backfilling of the trenches.

7. The August 15, 2005 inspection report provided by the City refers to water services being located one and one-half feet from the property lines.

8. Taxpayer had a road graded in front of the properties of Lot Nos. 16, 22, and 25.

9. The contracts for the sale of Lot Nos.16, 22, and 25 included language that Taxpayer would not mass grade the project .

10. It is unclear if the grading in front of Lot Nos. 16, 22, and 25 was done strictly by the needs of the road builders and/or the mandates of the City.

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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. Taxpayer was a speculative builder during the audit period.

3. The sale of Lot Nos. 16, 22, and 25 were sales of improved real property pursuant to Section 416(a)(2)(B) and Terrabrook.

4. The sale of Lot Nos. 16, 22, and 25 were taxable speculative builder sales pursuant to Section 416.

5. The City was authorized to assess penalties for Taxpayer's failure to timely file tax reports and failure to timely pay taxes pursuant to Section 540.

6. Taxpayer has demonstrated reasonable cause to have all penalties waived.

7. Taxpayer's protest should be denied with the exception of the penalties, consistent with the Discussion, Findings, and Conclusions, herein.

ORDER

It is therefore ordered that the March 24, 2009 protest by ***Taxpayer*** of a tax assessment made by the City of Peoria is hereby partly denied and partly granted, consistent with the Discussion, Findings, and Conclusions, herein.

It is further ordered that the City of Peoria shall remove all penalties assessed in this matter.

It is further ordered that this Decision is effective immediately.

Jerry Rudibaugh
Municipal Tax Hearing Officer