

## DECISION OF MUNICIPAL TAX HEARING OFFICER

Decision Date: November 30, 2009

Decision: MTHO # 526

Taxpayer: *Taxpayer*

Tax Collector: City of Mesa

Hearing Date: October 22, 2009

### DISCUSSION

#### Introduction

On May 6, 2009, a letter of protest was filed by *Taxpayer* of a tax assessment made by the City of Mesa (“City”). A hearing was commenced before the Municipal Tax Hearing Officer (“Hearing Officer”) on October 22, 2009. Appearing for Taxpayer was *Taxpayer Representative*. Appearing for the City were *Assistant City Attorney, Tax Administrator, Tax Audit Supervisor*, and *Senior Tax Auditor*. At the conclusion of the October 22, 2009 hearing, the record was closed and the Hearing Officer indicated a written decision would be issued on or before December 7, 2009.

### DECISION

Taxpayer was the owner of commercial real property located at *Mesa Property* in the City. Taxpayer is an LLC consisting of two members, *Member One* and *Member Two*. The *Mesa Property* consisted of four buildings which each had seven suites for a total of twenty-eight suites. The City conducted an audit of Taxpayer for the period December 2006 through July 2008. The City concluded Taxpayer sold eighteen of the suites during the audit period. As a result, the City assessed Taxpayer for additional taxes in the amount of \$33,857.90, interest up through February 2009 in the amount of \$2,910.18, and penalties totaling \$6,546.95.

Prior to the construction of the suites, Taxpayer had entered into a loan agreement with *Bank*, a related entity to Taxpayer. The loan Deed of Trust provided that upon the sale of a suite, Taxpayer was obligated to pay *Bank* “not less than \$295,000 of the sale proceeds for the sale of said unit.” Taxpayer protested the sale of six suites included in the City’s assessment. Four of those suites (*23,27,33, & 39*) were transferred to a related entity, *Entity 123*. Taxpayer protested the inclusion of these four suites because there was a “unity of ownership” among the two entities involved. The four units were transferred from Taxpayer to *Entity 123* on August 1, 2007 by a Quit Claim Deed. With those transfers, *Entity 123* assumed the obligation to pay *Bank*. The primary issue on the transfer of these four units was whether or not there was a sale. While the same individuals may be owners of Taxpayer and *Entity 123*, City Code Section 5-10-100

("Section 100") defines "persons" to include corporations, partnerships, associations, and etc. that are separate and distinct entities for City Code purposes. As a result, we conclude all the entities involved in this matter are separate and distinct persons under the provisions of the City Code. There was no dispute that Taxpayer was a speculative builder during the audit period and thus the sale price of any sale is taxable pursuant to City Code Section 5-10-416 ("Section 416"). In order for there to be a sale, Section 100 requires there to be a transfer of title or possession for a consideration. There was no dispute that the four suites were transferred from Taxpayer to **Entity 123**. Based on the evidence presented, we conclude that **Entity 123** did assume Taxpayer's obligation to **Bank** which would constitute as consideration pursuant to City Code Section 5-10-200 ("Section 200"). Section 200 provides that gross income includes the reduction of or forgiveness of indebtedness. Accordingly, we conclude the four suites were sold from Taxpayer to **Entity 123**. There was also a dispute as to the amount of each sale. City Code Section 5-10-210 ("Section 210") provides that in transactions between affiliated companies or persons and the gross income is not indicative of the "market value" of the transaction the City shall determine the market value based on such transactions by non-related taxpayers under similar conditions and circumstances. Taxpayer's records indicate the four units were each transferred for \$10.00 each. Clearly, the \$10.00 amount does not reflect market value. The City utilized three sales (unit nos. **15, 17, & 19**) from Taxpayer to unrelated third parties during the months of July 2007 and May 2008 to determine a market value for the four units of \$137.4258 per square foot. We conclude that the City's use of sales to non-related entities near the same time frame as the transfer of the four units was a reasonable basis for determining a "market value". City Code Section 5-10-545 ("Section 545") places the burden on Taxpayer of proving the City's estimate was not reasonable. Taxpayer provided evidence of more recent sales that were at reduced values from those used by the City. Because there has been a declining real estate market, it is not surprising that more recent sales have been at reduced rates. The Code requires the market value to be based on similar conditions and circumstances. We conclude the sales used by the City were closer to the time frame of the transfers of the four units and thus would more represent the market value at that time. Accordingly, we conclude Taxpayer has failed to prove the City's estimates were unreasonable.

On May 25, 2007, Taxpayer sold suites **11** and **49** to **Member One** and **Member Two** for \$300,000.00 each. Taxpayer did not dispute these were taxable sales pursuant to Section 416. Taxpayer did dispute the City's use of an estimate for these sales. The City concluded the sale amounts were not indicative of the "market value" and pursuant to Section 210 the City determined the market value based on transactions by non-related taxpayers under similar conditions and circumstances. Suite **49** was sold with tenant improvements and faced **Mesa Road**. The City determined that the sales of suites **7** and **51** to non-related taxpayers were sold with tenant improvements and faced **Mesa Road**. The sale of suite **7** occurred in February 2007. The sale of suite **51** occurred in October 2007. The City calculated the average price per square foot of these sales to be \$168.2026. This average was utilized to calculate a market value for suite **49** to be \$494,011.04. We conclude the City's use of sales to non-related entities near the same time frame as the transfer of suite **49** was a reasonable basis for determining "market value". As we previously noted, Section 545 places the burden on Taxpayer of proving

the City's estimate was not reasonable. Taxpayer argued the \$300,000.00 amount was a fair amount for the time. To support its opinion, Taxpayer provided evidence of a similar sale that occurred on October 22, 2008 in the amount of \$333,375.00. As we previously noted, it is not surprising that a more recent sale has been at a reduced rate because of the declining real estate market. The Code requires the market value to be based on similar conditions and circumstances. We conclude the sales used by the City were closer to the time frame of the transfer of suite **49** and thus would more represent the market value at the time. Accordingly, we conclude Taxpayer has failed to prove the City's estimate was unreasonable.

Suite **11** was sold without tenant improvements and faced *Mesa Road*. The City determined that sales of suites **5, 9, 43** and **47** were sold to non-related entities without tenant improvements and faced *Mesa Road*. The sales occurred during the period of December 2006 through July 2008 with an average sale per square foot of \$140.7092. The City utilized the average sale price to determine the market value of the suite **11** sale to be \$407,353.13. We conclude the City's use of sales to non-related entities near the same time frame as the transfer of suite **11** was a reasonable basis for determining "market value". Section 545 placed the burden on Taxpayer of proving the City's estimate was not reasonable. Taxpayer argued the \$300,000.00 amount was a fair value for the time. Taxpayer asserted the sale that occurred on October 22, 2008 in the amount of \$333,375.00 provided evidence of the reasonableness of the \$300,000.00 amount. For the same reasons given for the transfer of suite **49**, we conclude Taxpayer has failed to prove the City's estimate was not reasonable.

The City assessed penalties pursuant to City Code Section 540 ("Section 540") for failure to file and failure to timely pay taxes. Those penalties may be waived for reasonable cause. Taxpayer presented evidence that the sales in question were reported based on advice from a tax expert. Accordingly, we conclude Taxpayer has demonstrated reasonable cause to have the penalties waived. Based on all the above, we conclude Taxpayer's protest should be denied with the exception of the penalties.

### **FINDINGS OF FACT**

1. On May 6, 2009, Taxpayer filed a protest of a tax assessment made by the City.
2. The City conducted an audit assessment of Taxpayer for the period of December 2006 through July 2008.
3. The City assessed Taxpayer for additional taxes in the amount of \$33,857.90, interest up through February 2009 in the amount of \$2,910.18, and penalties totaling \$6,546.95.
4. Taxpayer is the owner of the *Mesa Property* in the City.

5. Taxpayer is an LLC consisting of two members, *Member One* and *Member Two*.
6. The *Mesa Property* consisted of four buildings which each had seven suites for a total of twenty-eight suites.
7. The City assessed Taxpayer on the sale of eighteen suites during the audit period.
8. Prior to the construction of the four buildings, Taxpayer entered into a loan agreement with *Bank*, a related entity to Taxpayer.
9. The loan Deed of Trust provided that upon a sale of a suite, Taxpayer was obligated to pay *Bank* “not less than \$295,000 of the sale proceeds for the sale of said unit”.
10. Taxpayer transferred four suites (*23,27,33, & 39*) to a related entity, *Entity 123*, on August 1, 2007 by a Quit Claim Deed.
11. Taxpayer’s records indicate the four suites were transferred for \$10.00 each.
12. During the months of July 2007 and May 2008, Taxpayer sold suites *15, 17, & 19* to non-related entities.
13. The average sale price per square foot for suites *15, 17, & 19* was \$137.4258.
14. The real estate market has been declining since the transfer of suites *23, 27, 33, & 39* to *Entity 123*.
15. On May 25, 2007, Taxpayer sold suites *11* and *49* to *Member One* and *Member Two* for \$300,000.00 each.
16. Suite *49* was sold with tenant improvements and faced *Mesa Road*.
17. Suites *7* and *51* were sold to non-related entities by Taxpayer with tenant improvements and each faced *Mesa Road*.
18. The sale of suite *7* occurred in February 2007 and the sale of suite *51* occurred in October 2007.
19. The average sale price per square foot of suites *7* and *51* was \$168.2026.
20. Based on the \$168.2026 per square foot price, the market value of the sale of suite *49* was \$494,011.04.
21. Suite *11* was sold without tenant improvements and faced *Mesa Road*.
22. Suites *5, 9, 43, and 49* were sold by Taxpayer to non-related entities without tenant improvements and faced *Mesa Road*.

23. The sales of suites **5, 9, 43, and 49** occurred during the period of December 2006 through July 2008 with an average sale price per square foot of \$140.7092.
24. Based on the \$140.7092 per square foot price, the market value of the suite **11** sale was \$407,353.13.
25. Taxpayer sold a suite on October 22, 2008 in the amount of \$333,375.00
26. The real estate market has been declining since Taxpayer's sale of suites **11** and **49**.
27. Taxpayer relied upon a tax expert in reporting of the transfers of suites **23, 27, 33, 39, 11, and 49**.

#### 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. Taxpayer, **Bank, Entity 123, Member One, and Member Two** were all separate and distinct "persons" pursuant to Section 100.
4. When suites **23, 27, 33, and 39** were transferred from Taxpayer, **Entity 123** assumed the obligation to **Bank**.
5. The assumption by **Entity 123** of Taxpayer's obligation to pay **Bank** constituted consideration pursuant to Section 200.
6. Section 210 requires transactions between affiliated persons to be subject to tax based on market value.
7. The City used sales from Taxpayer to non-related entities during the same time frame as the transfers to **Entity 123** to determine the market value of the transfers of suites **23, 27, 33, and 39**.
8. The City's methodology for determining the market value of the transfers to **Entity 123** was reasonable.

9. Taxpayer failed to meet its burden of proving the City's estimate of market value for Taxpayer's transfers to *Entity 123* was not reasonable pursuant to Section 545.
10. The City used sales by Taxpayer to non-related entities during the same time frame as the transfers of suites *11* and *49* to determine the market value of the transfers of suites *11* and *49*.
11. The City's methodology of determining the market value of the transfers of suites *11* and *49* to *Member One* and *Member Two* was reasonable.
12. Taxpayer failed to meet its burden of proving the City's estimate of market values for Taxpayer's transfers to *Member One* and *Member Two* were not reasonable pursuant to Section 545.
13. The City was authorized pursuant to Section 540 to assess penalties for failure to file and failure to timely pay taxes.
14. Taxpayer has demonstrated reasonable cause to have all penalties waived.
15. 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 May 6, 2009 protest by *Taxpayer* of a tax assessment made by the City of Mesa is hereby partly denied and partly granted, consistent with the Discussion, Findings, and Conclusions, herein.

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

It is further ordered that this Decision is effective immediately.

Jerry Rudibaugh  
Municipal Tax Hearing Officer