

## DECISION OF MUNICIPAL TAX HEARING OFFICER

Decision Date: November 7, 2011

Decision: MTHO # 629

***Taxpayer:***

Tax Collector: City of Sedona

Hearing Date: October 10, 2011

### DISCUSSION

#### Introduction

On March 3, 2011, a letter of protest was filed by ***Taxpayer*** of a tax assessment made by the City of Sedona (“City”). A hearing was commenced before the Municipal Tax Hearing Officer (“Hearing Officer”) on October 10, 2011. Appearing in person for the City were ***representatives of a tax audit firm***. Taxpayer appeared telephonically on behalf of himself. On October 12, 2011, the Hearing Officer indicated the record was closed and a written decision would be issued on or before November 28, 2011.

### DECISION

On February 14, 2011, the City issued two separate audit assessments of Taxpayer. One assessment was for the audit period of March 2006. The assessment was for additional taxes in the amount of \$7,222.39, penalties for failure to file and failure to timely pay in the amount of \$1,805.60, and interest up through January 2011 in the amount of \$2,259.12. The second assessment was for the audit period of July 2008. The second assessment was for additional taxes in the amount of \$3,703.25, penalties for failure to file and failure to timely pay in the amount of \$925.81, and interest up through January 2011 in the amount of \$405.66.

The first assessment involved the sale of a single family residence located at ***123 CI*** in the City. Taxpayer had the home built and a final inspection was issued by the City on February 14, 2006. Subsequently, Taxpayer sold the home to a family member on March 27, 2006. The City assessed the sale as a speculative builder sale pursuant to City Code Section 8-416 (“Section 416”). Taxpayer argued that since the sale was to a family member, it should not be considered as a speculative builder sale.

The second assessment was for the sale of a single family residence located at ***456 CF*** in the City. The home was built to be a second home but due to financial difficulties of Taxpayer, the home was offered for sale commencing in November 2006. The home was

issued a final inspection by the City in January 2007. On July 9, 2008, the home was sold at a Trustee's sale at a bid price of \$807,000.00. Taxpayer argued the property was used as a second home upon completion in early 2007 until it was foreclosed on in July 2008. Secondly, Taxpayer argued the first mortgage amount of \$807,000.00 exceeded the market value. Taxpayer noted that a year later the home was sold for \$671,000.00. At the hearing, Taxpayer provided the City with additional information on the land value for the *CF* property. As a result, the City revised the assessment to reflect a land deduction of \$260,000.00. The revised assessment was for additional taxes in the amount of \$2,555.63, penalties of \$638.91, and interest up through October in the amount of \$357.62. The City also updated the interest on the *CI* of \$2,519.01 up through October 2011.

City Code Section 100 ("Section 100") defines "owner-builder" as an owner of real property who, by himself or by or through others constructs or has constructed any improvement to real property. In this case, Taxpayer had a single family residence built at *CF* and at *CI*. As a result, Taxpayer was an owner-builder pursuant to Section 100 for both lots. Section 100 defines "speculative builder" to mean an "owner-builder" who sells improved real property consisting of a custom, model or inventory home. Section 100 defines "sale" to mean any transfer of title or possession, or both, exchange, barter, conditional or otherwise, in any manner or by any means whatsoever, of property for a consideration. We conclude that the transfers of the improved *CI* and improved *CF* were sales pursuant to Section 100 and would have resulted in Taxpayer becoming a speculative builder pursuant to Section 100. Section 416 imposes a tax on the gross income from the business activity upon every person engaging in business as a speculative builder. Taxpayer was unable to provide any reference in the City Code to support its claim that a sale to a family member was an exempt sale. Accordingly, we must deny Taxpayer's protest of the *CI* sale.

As to the *CF* sale, we conclude that Taxpayer actually used the home as a principal place of residence prior to the sale. Unfortunately for Taxpayer the exemption set forth in City Regulation 416.1 for a "homeowner's bona fide non-business sale" requires that the principal place of residence to occur six months prior to the home being offered for sale. In this case, the *CF* property was offered for sale prior to it being completed. As a result, the exemption pursuant to Regulation 416.1 was not available. Taxpayer presented evidence that the *CF* property sold for less money approximately a year after the Trustee sale. In reviewing the evidence, we conclude that the City's use of the bid price for the Trustee sale was the best evidence of the market value at the time of the sale. With market values declining, it would not be surprising to find the market value was less one year after the Trustee sale. Accordingly, we conclude Taxpayer's protest of the sale price must be denied. Based on the additional information provided by Taxpayer at the hearing, we approve the City's revisions to the *CF* assessment.

Lastly, we have the matter of penalties. The City assessed Taxpayer for penalties pursuant to City Code Section 5-10-540 ("Section 540") for failure to file, and failure to timely pay. The penalties for failure to timely file and failure to timely pay may be waived for "reasonable cause". Reasonable cause is defined in Section 540 that a

taxpayer exercised ordinary business care and prudence, i.e., had a reasonable basis for believing that the tax did not apply to the business activity. While we did not approve Taxpayer's protest of the underlying taxes, we do conclude that Taxpayer exercised ordinary business care and prudence. As a result, we conclude Taxpayer has demonstrated reasonable cause to have all penalties waived. Based on all the above, we conclude that Taxpayer's protest should be partly, denied and partly granted, consistent with the Discussion, Findings, and Conclusions, herein.

### **FINDINGS OF FACT**

1. On March 3, 2011, Taxpayer filed a protest of tax assessments made by the City.
2. On February 14, 2011, the City issued two separate audit assessments of Taxpayer.
3. One assessment was for the period of March 2006.
4. The assessment was for additional taxes in the amount of \$7,222.39, interest up through January 2011 in the amount of \$2,259.12, and penalties totaling \$1,805.60.
5. The second assessment was for additional taxes in the amount of \$3,703.25, interest up through January 2011 in the amount of \$405.66, and penalties totaling \$925.81.
6. The second assessment was for the audit period of July 2008.
7. The first assessment involved the sale of a single family residence located at ***123 CI*** in the City.
8. Taxpayer had the home built and a final inspection was issued by the City on February 14, 2006.
9. Taxpayer sold the ***CI*** property to a family member on March 27, 2006.
10. The second assessment was for the sale of a single family residence located at ***456 CF*** in the City.
11. The home built at ***456 CF*** was to be a second home, but due to financial difficulties of Taxpayer, the home was offered for sale commencing in November 2006.
12. The ***CF*** home was issued a final inspection by the City in January 2007.
13. On July 9, 2008, the ***CF*** property was sold at a Trustee's sale at a bid price of \$807,000.00.

14. The *CF* property was sold a year later for \$671,000.00.
15. After completion of the *CF* home in January 2007, Taxpayer utilized it as a principal place of residence.
16. At the hearing, Taxpayer provided the City with additional information to demonstrate the land value for the *CF* property was \$260,000.00.
17. On October 11, 2011, the City revised the tax due on the *CF* sale to \$2,555.63, the penalties were reduced to \$638.91, and the interest was updated up through October 2011 to \$357.62.
18. On October 11, 2011, the City updated the interest on the *CI* assessment to \$2,519.01 up through October 2011.

### **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. Pursuant to Section 100, Taxpayer was an “owner-builder” for the *CI* home and the *CF* home.
3. The transfers of the improved *CI* and improved *CF* properties were sales pursuant to Section 100 and resulted in Taxpayer becoming a speculative builder pursuant to Section 100.
4. The sale of improved *CI* and *CF* were taxable speculative builder sales pursuant to Section 416.
5. Taxpayer’s sale of the *CF* property did not qualify for the exemption set forth in Regulation 416.1 as Taxpayer failed to live in the residence prior to it being offered for sale.
6. The City’s usage of the bid price for the Trustee sale of the *CF* property was the best evidence of the market price at the time of sale.
7. Taxpayer provided sufficient documentation to demonstrate that the land deduction for the *CF* property should be revised to \$260,000.00.

8. The City was authorized pursuant to Section 540 to assess penalties.
9. Taxpayer demonstrated reasonable cause to have the penalties waived for failing to timely file or timely pay taxes.
10. Taxpayer's March 3, 2011 protest should be partly granted and partly denied, consistent with the Discussion, Findings, and Conclusions, herein.
11. The parties have timely rights of appeal to the Arizona Tax Court pursuant to Model City Tax Code Section-575.

### **ORDER**

It is therefore ordered that the March 3, 2011 protest by *Taxpayer* of tax assessments made by the City of Sedona should be partly granted and partly denied consistent with the Discussion, Findings, and Conclusions, herein.

It is further ordered that the City of Sedona shall revise the assessments consistent with the City of Sedona's October 11, 2011 email.

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

It is further ordered that this Decision is effective immediately.

Municipal Tax Hearing Officer