

DECISION OF MUNICIPAL TAX HEARING OFFICER

September 30, 2011

Taxpayer
Taxpayer's address

Taxpayer
MTHO # 637

Dear *Taxpayer*:

We have reviewed the evidence submitted for redetermination by *Taxpayer* and the City of Flagstaff (Tax Collector or City).¹ The review period covered was March 1, 2005 through April 30, 2010. Taxpayer's protest, Tax Collector's response, and our findings and ruling follow.

Taxpayer's Protest

Taxpayer was assessed City of Flagstaff privilege tax under the speculative builder classification for the sale of newly constructed homes Taxpayer had constructed in the City. Most of the properties were lost to foreclosure. The properties were not transferred from company ownership by formal sale; it was a paper transfer for financing purposes. The assessment creates a hardship for the company and may cause Taxpayer to go into bankruptcy. The company did not benefit by the transfers of the property.

Tax Collector's Response

Taxpayer was the owner of record to improved real property. The properties were sold by warranty deed. A speculative builder is one who sells improved real property. A sale is defined as any transfer of title by any means whatsoever. The sales met the definition for sales by a speculative builder and are subject to the City's privilege tax. The assessment also included unreported revenue from a remodeling project at the home of Taxpayer's president.

Discussion

The Tax Collector audited Taxpayer for the period March 1, 2005 through April 30, 2010. Taxpayer had reported zero tax liability during a portion of that period. The Tax Collector determined that Taxpayer had constructed and sold new homes in the City during the audit period and had conducted a remodeling project at the home of its president.

The Tax Collector issued an assessment to Taxpayer for the sale of the new homes that were not reported and also for the remodeling project. The Tax Collector based the assessment for the sale of the new homes on settlement statements and worksheets in Taxpayer's records. Taxpayer timely protested the assessment stating that:

1. Most of the properties were lost to foreclosure,

¹ Taxpayer did not submit a Reply Memorandum.

2. The properties were never transferred from company ownership by formal sale and the transactions were just paper transfers for financing purposes,
3. The assessment creates a hardship on the company and could cause Taxpayer to go into bankruptcy,
4. The company never benefited by the transfer of the property.

Taxpayer did not protest the assessment attributable to the remodeling project.

Properties were lost to foreclosure

Taxpayer did not provide any detail or documentation regarding this argument and has not cited any authority supporting the argument that a foreclosure of the property after Taxpayer's sale would exempt the sales at issue from privilege tax.

The properties were not transferred

The Tax Collector submitted evidence that its assessment was based on Taxpayer's records and recorded deeds and affidavits of value for the homes included in the assessment. Taxpayer has not submitted any evidence that the properties included in the assessment were not sold.

Taxpayer was assessed as a speculative builder. A speculative builder includes an owner-builder who sells or contracts to sell improved real property. To be a speculative builder, a person has to be an owner-builder and the property sold has to be improved real property.

An owner-builder is defined as an owner or lessor of real property who, by himself or by or through others, constructs or has constructed or reconstructs any improvement to real property. Improved real property includes any real property upon which a structure has been constructed. Taxpayer owned real property and built homes on the property. Taxpayer was an owner-builder and the property was improved real property.

Sale of improved real property includes any form of transaction which in substance is a transfer of title of improved real property. The record before the Hearing Office indicates that Taxpayer transferred title to the homes at issue by deed. Taxpayer thus sold improved real property when it transferred title. Taxpayer met the definition of a speculative builder and is liable for the City privilege tax on its sales under the speculative builder classification.

The assessment creates a hardship on the company

Taxpayer stated that the assessment creates a hardship on the company. The purpose of the protest and hearing process is to determine whether the assessment was valid under the City code. *See*, Flagstaff Tax Code (FTC) § 3-5-570(b)(1). Whether the assessment creates a hardship does not bear on the validity of the assessment and is not a question to be considered by the Hearing Office.

The company did not benefit by the transfer of the property

The Tax Collector stated in its response to the protest that the settlement statements show that Taxpayer received the sale price or benefit of the sales price. Taxpayer did not submit a reply and did not show that it did not receive a benefit from the sales.

Based on all the above, we conclude Taxpayer's protest of the assessment should be denied. The City's assessment of privilege tax, interest and combined penalties against Taxpayer was proper.

Findings of Fact

1. Taxpayer is an Arizona Corporation.
2. Taxpayer has been engaged in business in the City as a construction contractor and speculative builder since February 1994.
3. For January 2007 Taxpayer began to file zero tax liability returns with the City.
4. Building permits and occupancy certificates issued by the City listed Taxpayer as owner/builder of numerous new homes.
5. Coconino County records listed Taxpayer as the seller of the newly constructed homes.
6. The Tax Collector conducted an audit assessment of Taxpayer for the period March 1, 2005 through April 30, 2010.
7. Based on Taxpayer's records that included settlement statements and worksheets with settlement dates, the Tax Collector determined that Taxpayer sold new homes during the audit period that were not reported.
8. The Tax Collector also determined that Taxpayer conducted a remodeling project at the home of Taxpayer's president that was not reported.
9. The Tax Collector issued an assessment for City privilege tax in the amount of \$109,434.37, interest calculated through March 31, 2011 in the amount of \$20,946.02 and penalties in the amount of \$17,146.92.
10. The assessment for the sale of the new homes was based on the sales price listed in the settlement statements and worksheets.
11. The settlement statements for the sales of the homes showed the gross amount due the seller (Taxpayer) and the reductions to the amount due seller.
12. Taxpayer did not provide revenue records for the remodeling project.
13. The assessment for the remodeling project at the home of Taxpayer's president was estimated based on the construction value listed on the City building permit plus 50% of that amount.
14. Taxpayer timely protested the assessment contending:
 - a. Most of the properties were lost to foreclosure,
 - b. The properties were never transferred from company ownership by formal sale and the transactions were just paper transfers for financing purposes,
 - c. The assessment creates a hardship on the company and could cause Taxpayer to go into bankruptcy,
 - d. The company never benefited by the transfer of the property.
15. Taxpayer did not protest the assessment attributable to the remodeling project or the assessment of the penalties.
16. Taxpayer did not submit any documentation in support of its protest.
17. Taxpayer did not submit a reply to the Tax Collector's response to Taxpayer's protest.

Conclusions of Law

1. FTC § 3-5-416(a) imposes a privilege tax on persons engaging in business as a speculative builder within the City.
2. The tax is measured by the taxpayer's gross income from the business. FTC § 3-5-416(a).
3. The gross income of a speculative builder considered taxable includes the total selling price from the sale of improved real property at the time of closing of escrow or transfer of title. FTC § 3-5-416(a)(1).
4. A speculative builder includes an owner-builder who sells or contracts to sell improved real property. FTC § 3-5-100.
5. Improved real property includes any real property upon which a structure has been constructed. FTC § 3-5-416(a)(2)(A).
6. The properties were improved real property.
7. An owner-builder is defined as an owner or lessor of real property who, by himself or by or through others, constructs or has constructed or reconstructs any improvement to real property. FTC § 3-5-100.
8. Taxpayer was the owner of the properties and constructed improvements on the properties.
9. Taxpayer was an owner-builder.
10. Sale of improved real property includes any form of transaction which in substance is a transfer of title of improved real property. FTC § 3-5-416(a)(3).
11. Taxpayer's transfers of title to the properties to the purchasers listed in the deeds and settlement statements were sales of the properties.
12. Taxpayer was a speculative builder during the audit period.
13. The record before the Hearing Office indicates that Taxpayer received the sale price or benefit of the sales price.
14. Taxpayer's sales of the properties were subject to the privilege tax on speculative builders measured by the total selling price.
15. The City imposes a privilege tax on construction contractors measured by their gross income from construction contracting within the City. FTC § 3-5-415.
16. A construction contractor means a person who undertakes to or offers to undertake to or does himself or by or through others, construct, alter, repair, add to, subtract from, improve, move, wreck, or demolish any building, highway, road, railroad, excavation, or other structure, project, development, or improvement to real property, or to do any part thereof. FTC § 3-5-100.
17. Taxpayer was a construction contractor when it conducted a remodeling project at the home of its president.
18. Taxpayer did not protest the assessment attributable to the remodeling project.
19. The Tax Collector's assessment attributable to the remodeling project was proper.

20. Under the administrative review process a taxpayer may contest the applicability or amount of the tax imposed on him. FTC § 3-5-570(b)(1).
21. Taxpayer's inability to pay is not relevant regarding the validity of the assessment.
22. FTC § 19-540(b) imposes penalties for failure to timely file and to timely pay tax.
23. The penalties may be waived if the taxpayer demonstrates reasonable cause for its failure to file a return or pay the tax. FTC § 19-540.
24. Taxpayer has not demonstrated reasonable cause for its failure to file a return and to pay the tax.
25. The City's assessment against Taxpayer was proper.

Ruling

Taxpayer's protest of an assessment of privilege tax and interest made by the City of Flagstaff for the period March 1, 2005 through April 30, 2010 is denied.

The Tax Collector's Notice of Assessment to Taxpayer for the period March 1, 2005 through April 30, 2010 is upheld.

Taxpayer has timely rights of appeal to the Arizona Tax Court pursuant to Model City Tax Code Section -575.

Sincerely,

Hearing Officer

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c: ***Licensing and Revenue Administrator***
Municipal Tax Hearing Office