

## DECISION OF MUNICIPAL TAX HEARING OFFICER

September 22, 2011

*Taxpayer*  
*Taxpayer's Address*

*Taxpayer*  
MTHO # 640

Dear Ms. Smith:

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

### Taxpayer's Protest

Taxpayer was assessed City of Chandler privilege tax under the speculative builder classification for the sale of a building Taxpayer had constructed in the City. Taxpayer did not sell the property. The transaction was merely one partner buying out the other. Under the circumstances, any sales tax assessment on the transaction would be inappropriate.

### Tax Collector's Response

Taxpayer was the owner of record to improved real property. Taxpayer is a limited liability company and sold the property to another limited liability company. It does not matter that the purpose of the transaction was to transfer one partner's interest to the other or that the two companies may be related because they have a common member. Two separate and distinct legal entities were involved. A speculative builder is one who sells improved real property. A sale is defined as any transfer of title by any means whatsoever. Here Taxpayer transferred title to the property and filed an Affidavit of Value indicating a selling price of \$1,500,000. Taxpayer was a speculative builder. Therefore the sale of Taxpayer's improved real property is subject to the privilege tax.

### Discussion

Taxpayer purchased vacant land and contracted to have a commercial building built on the property. The building was substantially completed on August 13, 2008. Taxpayer transferred the property to **Great Big Company** on or about March 3, 2010. One of the members or Taxpayer was also a member of **Great Big Company**. An affidavit of value recorded for the sale showed the sale price as \$1,500,000.00. Taxpayer did not report the transaction or pay City privilege tax on the sale.

The Tax Collector contacted Taxpayer to inquire regarding the sale. Based on information submitted by Taxpayer, the Tax Collector issued an assessment to Taxpayer under the speculative builder classification for the sale of the building. The Tax Collector based the assessment on the sales price listed on the affidavit of value. Taxpayer timely protested the assessment indicating that Taxpayer did not believe the transaction was taxable.

The Chandler Tax Code (CTC) governs whether and to what extent a person is taxable. Taxpayer was assessed as a speculative builder. A speculative builder includes an owner-builder who sells improved commercial real property before the expiration of twenty-four months after the improvements of the real property sold are substantially complete. 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 had a commercial building constructed 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. Taxpayer transferred title to the property by special warranty deed to another limited liability company. The two limited liability companies were separate entities even if they had a common member. 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 under the speculative builder classification.

Taxpayer's objective to transfer interest in the property from one of the partners to the other does not enter into consideration in determining whether the transaction was subject to tax. Taxpayer's transaction fell within the code definition of a speculative builder. The code does not take Taxpayer's intent into consideration.

Taxpayer stated at the hearing that it transferred interest in other properties where the transfer did not generate a privilege tax liability. Taxpayers are free to use whatever form of business they choose, but in choosing a form they must accept its advantages and disadvantages. It is how the transaction was structured, not how it could have been structured, that determines taxability.

The proposed assessment included penalties for failure to file and failure to pay. Taxpayer protested the entire assessment. While Taxpayer's protest did not specifically make reference to the penalties imposed, the Hearing Officer concludes penalties were a part of the protest of the entire assessment. The circumstances of this case, where the Taxpayer's limited intent was to transfer an interest in the property from one partner to the other, as well as the Taxpayer's lack of knowledge that the form of the transaction would qualify as a sale by a speculative builder, demonstrates reasonable cause and not willful neglect by the Taxpayer. For those reasons, the penalties included in the assessment should be abated.

Based on all the above, we conclude Taxpayer's protest of the assessment of privilege tax and interest should be denied. The City's assessment of privilege tax and interest against Taxpayer was proper. The Tax Collector shall remove from the assessment the penalties in the amount of \$866.94.

#### Findings of Fact

1. Taxpayer is a limited liability company.
2. Taxpayer purchased vacant land and built a commercial building on the property.
3. Taxpayer hired a contractor to build the building.
4. The building was substantially completed on August 13, 2008.

5. Taxpayer testified that it built the building for a long-term project and had not planned on selling the property.
6. Because of economic conditions, one of the members of Taxpayer paid the outstanding bank loan on the property.
7. By paying the bank loan, the member paying the loan in essence purchased the interest of the other member.
8. Taxpayer sold the property to **Great Big Company**, another limited liability company, on or about March 3, 2010 by special warranty deed.
9. One of the members of Taxpayer was also a member of **Great Big Company**.
10. Taxpayer testified that the purpose of the sale was to transfer interest in the property from one partner (member) to another partner (the member who had paid the bank loan).
11. The sale of the property was within 24 months after substantial completion of the improvement.
12. The affidavit of value for the sale listed the sales price as \$1,500,000.00.
13. The Tax Collector conducted an audit assessment of Taxpayer for the period March 2010.
14. Taxpayer had cooperated with the Tax Collector in conducting the audit.
15. The Tax Collector issued an assessment for City privilege tax under the speculative builder classification in the amount of \$3,465.93, interest calculated through February 28, 2011 in the amount of \$98.59, penalties in the amount of \$866.48 and license fees in the amount of \$90.00.
16. The assessment was based on the sales price of \$1,500,000 listed in the recorded affidavit of value.
17. Taxpayer timely protested the assessment and requested a hearing.

#### Conclusions of Law

1. A speculative builder includes an owner-builder who sells improved commercial real property before the expiration of twenty-four months after the improvements of the real property sold are substantially complete. CTC § 62-100.
2. Improved real property includes any real property upon which a structure has been constructed. CTC § 62-416(a)(2)(A).
3. The property was improved real property.
4. 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. CTC § 62-100.
5. Taxpayer was the owner of the property and had an improvement constructed on the property by a contractor.
6. Taxpayer was an owner-builder.
7. Sale of improved real property includes any form of transaction which in substance is a transfer of title of improved real property. CTC § 62-416(a)(3).

8. Person means an individual, firm, partnership, joint venture, association, corporation, estate, trust, receiver, syndicate, broker, the Federal Government, this State, or any political subdivision or agency of this State. CTC § 62-100.
9. A member or manager of a limited liability company may transact business with the limited liability company and has the same rights and obligations with respect to those transactions as a person who is not a member or manager. A.R.S. § 29-608.
10. Taxpayers are free to use whatever form of business they choose, but in choosing a form they must accept its advantages and disadvantages. *Higgins v. Smith*, 308 U.S. 473, 60 S.Ct. 355 (1940).
11. A limited liability company and its members are separate persons.
12. Taxpayer and ***Great Big Company*** were properly treated as separate legal entities for City privilege tax purposes by the Tax Collector.
13. Taxpayer's transfer of title to the property to ***Great Big Company*** in March 2010 was a sale of the property.
14. Taxpayer was a speculative builder during the audit period.
15. Taxpayer's sale of the property was subject to the privilege tax on speculative builders.
16. The City Code imposes a penalty for failure to file a timely return and for failure to timely pay taxes unless Taxpayer shows that the failure is due to reasonable cause and not willful neglect.
17. Taxpayer was unaware that the transfer of the property in order to transfer the interest of one of the members of the limited liability company to another member would be subject to the City privilege tax.
18. Taxpayer's intention was to keep the property and not sell it.
19. The managing member of Taxpayer continued to have an interest in the property through his membership in the purchasing limited liability company.
20. Taxpayer has demonstrated reasonable cause for failing to timely file tax returns and for failing to timely pay taxes on the sale of the property.
21. Taxpayer's protest of the penalty portion of the assessment should be granted.
22. The City's assessment of privilege tax and interest against Taxpayer was proper.

### Ruling

Taxpayer's protest of an assessment of privilege tax and interest made by the City of Chandler for the period March 2010 is denied.

Taxpayer's protest of an assessment of penalties made by the City of Chandler for the period March 2010 is granted.

The Tax Collector's Notice of Assessment to Taxpayer for the period March 2010 is upheld with the exception of the assessment of penalties. The Tax Collector shall remove from the assessment the penalties in the amount of \$866.94.

Both parties have 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: ***Tax Audit Supervisor***  
Municipal Tax Hearing Office