

DECISION OF MUNICIPAL TAX HEARING OFFICER

Decision Date: August 31, 2012

Decision: MTHO # 712

Taxpayers:

Tax Collector: City of Chandler

Hearing Date: August 2, 2012

DISCUSSION

Introduction

On April 12, 2012, ***Taxpayers*** filed a letter of protest for a tax assessment made by the City of Chandler (“City”). A hearing was commenced before the Municipal Tax Hearing Officer (“Hearing Officer”) on August 2, 2012. Appearing for Taxpayers ***were their representative and one of the taxpayers.*** Appearing for the City were a ***Senior Auditor and two other Auditors.*** On August 3, 2012, the Hearing Officer closed the record and indicated a written decision would be issued on or before September 17, 2012.

DECISION

On August 16, 2011, the City issued an assessment to Taxpayers for additional taxes in the amount of \$20,542.83, interest up through August 2011 in the amount of \$10,060.94, penalties in the amount of \$5,135.71, and license fees in the amount of \$52.50. Subsequently, the City reviewed additional documentation provided by Taxpayers resulting in an amended assessment. The January 11, 2012 amended assessment included additional taxes due in the amount of \$9,226.69, interest up through January 2012 in the amount of \$4,734.21, penalties totaling \$2,306.67, and license fees in the amount of \$52.50. The assessment was based on two speculative builder sales pursuant to City Code Section 62-416 (“Section 416”).

On or about March 14, 2003, Taxpayers purchased vacant land located at ***1234 N. Chandler (Property #1)*** located in the City. Taxpayers hired a construction contractor to build a residential custom home on ***Property #1.*** The structure was substantially completed on July 16, 2004 as evidenced when the final inspection was completed. Based on the Affidavit of Property Value (“Affidavit”), the improved ***Property #1*** was sold to ***Buyer #1*** in July 2004 for \$1,027,500.00. On or about July 9, 2003, Taxpayers purchased vacant land located at ***5678 N. Chandler (Property #2)*** located in the City. Taxpayers hired a construction contractor to build a residential custom home on ***Property #2.*** The structure was substantially completed on April 21, 2005 as evidenced when the final

inspection was completed. Based on the Affidavit, the improved **Property #2** was sold to **Buyer #2** in November 2004 for \$1,100,000.00. The City assessed Taxpayers as speculative builders pursuant to Section 416 on both the sale of the improved **Property #1** and the sale of the improved **Property #2**.

Taxpayers argued that the City Tax Code provides that taxes may only be assessed within four years of tax returns being filed. Taxpayers asserted that **Unique Custom Homes (“Unique”)** acted as Taxpayers agent and filed monthly returns. Since both sales in question occurred in 2004 and Taxpayers did not receive the assessment until 2011, Taxpayers argued the assessment is barred by the four year statute of limitations (“SOL”).

In response, the City argued that since Taxpayers failed to file any returns reporting the sales there is no SOL to bar the assessment. The City indicated that **Unique** was not responsible for paying the speculative builder tax as that liability falls on Taxpayers. Based on information provided, the City allowed a credit for City tax paid by **Unique** in the amount of \$4,089.62 and a deduction for State/County tax paid of \$17,176.43.

As to **Property #2**, Taxpayers asserted they only received \$181,070.03 in gross income from the sale and that should be the amount upon which to base the assessment. According to Taxpayers, the sale recorded on the Affidavit was actually a financing arrangement between **Most Popular Bank (“Bank”)** and the purchaser so as not to necessitate a second construction loan. Taxpayers indicated they had only taken the second construction draw and there were several more draws left to take. Taxpayers asserted that it was unreasonable for the City to argue that where the funds go is irrelevant. As a result, Taxpayers argued they should only be taxed on the \$183,070.03 amount. Based on Taxpayers calculations, they are due a refund of \$5,302.63 for overpayments of tax.

The City noted that 34 of the 43 inspections on the improvements to **Property #2** had taken place by the time of escrow for **Property #2**. As a result, the City indicated there were definite improvements made to **Property #2** at the time of sale. The City asserted that the transaction privilege tax was based on the gross receipts and not the gross income of Taxpayers. Based on the Affidavit, the City concluded the gross amount was \$1,100,000.00. As to Taxpayers request for a tax refund, the City noted Taxpayers have not filed or paid any taxes.

City Code Section 62-100 (“Section 100”) defines a speculative builder as an owner-builder who sells or contracts to sell improved real property consisting of custom, model, or inventory homes. An owner-builder is defined in Section 100 as an owner that had improvements constructed to real property. In this case, Taxpayers had custom homes constructed on **Property #1 and Property #2**. As a result, Taxpayers were owner-builders for both **Property #1 and Property #2**. Since Taxpayers were owner-builders who contracted to sell improved real property consisting of custom homes, Taxpayers were speculative builders pursuant to Section 100. As a result, both **#1 and #2 Properties** were taxable sales pursuant to Section 416. The activity of the contractor would have been

taxed as construction contracting pursuant to City Code Section 62-415 (“Section 415”). The general SOL set forth in City Code Section 62-550 (“Section 550”) is four years after the date on which the return is required to be filed, or within four years after the date on which the return is filed, whichever period expires later. While Taxpayers have argued the contractor filed tax reports as agents for Taxpayers, we must disagree. The contractor filed tax returns for the business activity of contracting pursuant to Section 415 which is distinct from the business activity of speculative building taxed pursuant to Section 416. Since Taxpayers never filed any tax returns as a speculative builder, the SOL of four years has not run.

Section 416 imposes the speculative builder tax on the sales price of improved real property. The sales price listed on the Affidavit for **Property #2** is \$1,100,000.00 on which the City based the assessment. Taxpayers have argued to use what appears to be the profit on the sale of \$181,070.43. Clearly, the amount of profit does not equate to the sales price. What complicates the matter is the Bank has used the Affidavit as a financing arrangement in order to close on the sale with only one escrow. After review of the settlement statement, we conclude the \$1,100,000.00 amount listed as the contract price is the price for a completed home. However, the house was not completed at the time of the sale as Taxpayers had not taken all the construction draws and at least nine inspections had not been performed at the time of sale. We conclude that Line 506 of the settlement statement represents the amount of unfinished construction that was included in the \$1,100,000.00 amount. We further conclude the actual sales price would be the difference between Line 420 and Line 506 of the settlement statement or \$1,142,180.60 less \$636,354.00 or \$505,826.66. Accordingly, we shall require the City to recalculate the assessment utilizing this reduced amount.

The City assessed Taxpayers for penalties for failure to timely file or timely pay taxes pursuant to City Code Section 62-540 (“Section 540”). Those penalties can be waived for reasonable cause. Based on the evidence, we conclude that Taxpayers reasonably believed the contractor was paying all the taxes. We conclude that Taxpayers have demonstrated reasonable cause to have all penalties waived. Taxpayers protest should be partly denied and partly granted, consistent with the Discussion, Findings, and Conclusions, herein.

FINDINGS OF FACT

1. On April 12, 2012, Taxpayers filed a letter of protest for a tax assessment made by the City.

2. On August 16 2011, the City issued an assessment to Taxpayer for additional taxes in the amount of \$20,542.83, interest up through August 2011 in the amount of \$10,060.94, penalties in the amount of \$5,135.71, and license fees in the amount of \$52.50.
3. Subsequently, the City reviewed additional documentation provided by Taxpayers resulting in an amended assessment.
4. The January 11, 2012 amended assessment included additional taxes in the amount of \$9,226.69, interest up through January 2012 in the amount of \$4,734.21, penalties totaling \$2,306.67, and license fees in the amount of \$52.50.
5. On or about March 14, 2003, Taxpayers purchased **Property #1** in the City.
6. Taxpayers hired a construction contractor to build a custom home on **Property #1**.
7. The structure was substantially completed on July 16, 2004 as evidenced when the final inspection was completed.
8. Based on the Affidavit, the improved **Property #1** was sold to **Buyer #1** in July 2004 for \$1,027,500.00.
9. On or about July 9, 2003, Taxpayers purchased **Property #2**.
10. Taxpayers hired a construction contractor to build a custom home on **Property #2**.
11. The structure was substantially completed on April 21, 2005 as evidenced when a final inspection was completed.
12. Based on the Affidavit, the improved **Property #2** was sold to **Buyer #2** in November 2004 for \$1,100,000.00.
13. At the time of sale, 34 of the 43 inspections on the improvements to **Property #2** had taken place.
14. Taxpayers never filed any tax reports or paid any taxes on either the **Property #1** sale or the **Property #2 sale**.
15. The construction contractor had filed tax reports for construction contracting pursuant to Section 415.
16. Taxpayers believed the contractor was paying all the taxes.

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. City Code Section 416 imposes a tax on the selling price from the sale of improved real property in the City.
3. Taxpayers were owner-builders for both ***Property #1*** and ***Property #2*** pursuant to Section 100.
4. Since Taxpayers were owner-builders who contracted to sell improved real property consisting of custom homes, Taxpayers were speculative builders pursuant to Section 100.
5. The sale of both ***Property #1*** and ***Property #2*** were taxable speculative builder sales pursuant to Section 416.
6. The sale price for the ***Property #2*** should be amended to \$505,826.66 to remove unfinished construction from the listed sale price.
7. Because no tax forms were ever filed by Taxpayers, the four year SOL does not apply to the assessment in this matter.
8. Because no tax forms were filed or taxes paid, the City was authorized to assess penalties pursuant to Section 540.
9. Taxpayers have demonstrated reasonable cause to have all penalties waived in this matter.
10. Taxpayers protest should be partly granted and partly denied, consistent with the Discussion, Findings, and Conclusions, herein.
11. The parties have timely appeal rights pursuant to Model City Tax Code Section 575.

ORDER

It is therefore ordered that the April 12, 2012 protest by *Taxpayers* of a tax assessment made by the City of Chandler is hereby partly denied and partly granted, consistent with the Discussion, Findings, and Conclusions, herein.

It is further ordered that the City of Chandler shall revise the assessment on *Property #2* to reflect a sale price of \$505,826.66.

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

It is further ordered that this Decision is effective immediately.

Municipal Tax Hearing Officer