

**Jerry Rudibaugh**  
**Municipal Tax Hearing Officer**

**DECISION OF MUNICIPAL TAX HEARING OFFICER**

Decision Date: November 3, 2003  
Decision: MTHO #122  
Tax Collector: City of Tucson  
Hearing Date: August 7, 2003

**DISCUSSION**

**Introduction**

On April 29, 2003, *Taxpayer*, (“Taxpayer”) filed a protest of a tax assessment made by the City of Tucson (“City”). After review, the City concluded on May 7, 2003 that the protest was timely and in the proper form. On May 16, 2003, the Municipal Tax Hearing Officer (“Hearing Officer”) filed a letter requesting the Taxpayer clarify its protest petition on or before June 6, 2003. On June 3, 2003, the Taxpayer filed a letter clarifying its protest. On June 7, 2003, the Hearing Officer ordered the City to file a response to the protest on or before July 22, 2003. On July 9, 2003, the City filed its response. A Notice of Hearing (“Notice”) was issued setting the matter for hearing commencing on August 7, 2003. On July 12, 2003, the Hearing Officer ordered the Taxpayer to file any reply on or before August 4, 2003. Both the City and Taxpayer appeared and presented evidence at the August 7, 2003 hearing. On August 11, 2003, the Hearing Officer filed a letter indicating that the Taxpayer was to provide copies of contracts to the City by August 21, 2003, the City would file any comments/recommendations on or before September 4, 2003, and the Taxpayer would file any reply to the City on or before September 18, 2003. After review of the contracts, the City filed its comments/recommendations on September 2, 2003. On September 16, 2003, the Taxpayer filed its reply. On September 18, 2003, the Hearing Officer issued a letter indicating the record was closed and that a written decision would be issued on or before November 3, 2003.

The Taxpayer had *Construction LLC* (“*Construction*”) build a building at \_\_\_\_\_ (“*Property*”). Both the Taxpayer and *Construction* are owned by *Owner 1* and *Owner 2*. The City treated the Taxpayer as an owner-builder and conducted an audit for the period November 2000 through November 2002. It was determined during the audit that the Taxpayer also had rental income from the *Property*. The City assessed the Taxpayer for unreported contracting income pursuant to City Code Section 19-415 (“Section 415”) and unreported rental income pursuant to City Code Section 445(a) (“Section 445”) with additional taxes due of \$19,391.65 plus interest. The City also assessed the Taxpayer for penalties totaling \$4,836.11 for failing to timely file tax returns and for failing to timely pay taxes.

## City Position

The City argued that the Taxpayer is an owner-builder and, therefore, liable for tax under City Code Section 417 (“Section 417”). The City indicated that City Code Section 100 (“Section 100”) defines an owner-builder as an owner that constructs or has constructed any improvement to real property. Further, the City noted that Section 100 defines a speculative builder as an owner-builder who sells or contracts to sell improved real property. According to the City, the **Property** is still owned by the Taxpayer and thus they are owner-builders. The City asserted that Section 417 provides that twenty-four months after the improvements to a property have been complete that the owner-builder who is not a speculative builder has a tax liability. That liability is based on the gross income from the activity of construction contracting upon the real property which was realized by those construction contractors to whom the owner-builder provided written declaration that the contractors were not responsible for the taxes set forth in City Code Section 19-415(c)(2) (“Section 415”). According to the City, the Taxpayer failed to cooperate during the audit process and did not provide any documentation. As a result, it was unclear whether the Taxpayer provided a written declaration pursuant to Section 417. Consequently, the City was unable to determine if the Taxpayer or its construction contractor, **Construction**, was liable for the tax. For that reason, the City assessed both the Taxpayer and **Construction** for the construction gross income for the **Property**. Because of the lack of documentation, the City had to estimate the tax liability using building permits for the property. There were two building permits for the **Property** totaling \$1,199,370. Section 417 allows a taxpayer to take a tax credit for any taxes paid to material vendors or construction contractors. In this case, no documentation was provided by the Taxpayer and as a result no tax credits were given by the City.

In addition to the contracting income, the City determined that during the audit period the Taxpayer was renting the **Property** as a charter school. Section 445 provides for a tax on the business of renting real property within the City. Because the Taxpayer provided no records, the City had to estimate the amount of rental income. The City estimated the monthly rental to be one percent of the building value of \$1,200,000 or \$12,000 per month. Lastly, the City requested the penalties for failure to timely file reports and failure to timely pay taxes be upheld. According to the City, the Taxpayer has operated construction companies within the City limits for a number of years and should have been aware of the licensing and reporting requirements.

## Taxpayer Position

In its protest petition, the Taxpayer disputed the amount of construction income for the **Property**. At the hearing, the Taxpayer did not dispute the construction amount. The Taxpayer argued that the assessment should have been against **Construction** as the prime contractor. The Taxpayer agreed with the City’s assessment on the rental income. The Taxpayer requested the penalties be waived. According to the Taxpayer, the purpose of penalties is to encourage tax-filing compliance and the Taxpayer has agreed to comply in the future.

## ANALYSIS

Based on the evidence presented, the Taxpayer is an owner-builder. There was no disagreement

as to the amount of construction income for building the *Property*. While the Taxpayer argued that *Construction* should have been the taxpayer assessed, the Hearing Officer must disagree. Clearly, no tax was paid by either the Taxpayer or *Construction* and both are owned by the same people. We do not find the Taxpayer has provided sufficient documentation to demonstrate which entity was to be responsible for the tax. As a result, we find the City's assessment pursuant to Section 417 to be a reasonable approach and one that the Hearing Officer will approve. We do agree with the Taxpayer that both the Taxpayer and *Construction* should not be assessed for the same construction income. As to the rental income, the Hearing Officer concludes the Taxpayer has agreed with this portion of the assessment and it should also be approved.

The City was authorized pursuant to Section 540 to assess penalties for the Taxpayer's failure to timely file reports and failing to timely pay taxes. The Taxpayer failed to demonstrate reasonable cause for failing to file reports or failing to timely pay taxes. In fact, the Taxpayer aggravated the situation by failing to provide records during the audit process. Accordingly, the request to waive the penalties is denied.

#### **FINDINGS OF FACT**

1. On April 29, 2003, the Taxpayer filed a protest of a tax assessment made by the City.
2. After review, the City concluded on May 7, 2003 that the protest was timely and in proper form.
3. On May 16, 2003, the Hearing Officer filed a letter requesting the Taxpayer clarify its protest petition on or before June 6, 2003.
4. On June 3, 2003, the Taxpayer filed a letter clarifying its protest.
5. On June 7, 2003, the Hearing Officer ordered the City to file a response to the protest on or before July 22, 2003.
6. On July 9, 2003, the City filed its response.
7. A Notice was issued setting the matter for hearing commencing on August 7, 2003.
8. On July 12, 2003, the Hearing Officer ordered the Taxpayer to file any reply on or before August 4, 2003.
9. Both the City and Taxpayer appeared and presented evidence at the August 7, 2003 hearing.
10. On August 11, 2003, the Haring Officer filed a letter indicating that the Taxpayer was to provide copies of contracts to the City by August 21, 2003, the City would file any comments/recommendations on or before September 4, 2003, and the Taxpayer would

file any reply to the City on or before September 18, 2003.

11. After review of the contracts, the City filed its comments/recommendations on September 2, 2003.
12. On September 16, 2003, the Taxpayer filed its reply.
13. On September 18, 2003, the Hearing Officer issued a letter indicating the record was closed and that a written decision would be issued on or before November 3, 2003.
14. The Taxpayer had **Construction** build a building at the **Property**.
15. Both the Taxpayer and **Construction** are owned by **Owner 1** and Andrea J. **Owner 2**.
16. The City treated the Taxpayer as an owner-builder and conducted an audit for the period November 2000 through November 2002.
17. It was determined during the audit that the Taxpayer also had rental income from the **Property**.
18. The City assessed the Taxpayer for unreported contracting income pursuant to Section 415 and unreported rental income pursuant to Section 445 with additional taxes due of \$19,391.65 plus interest.
19. The City also assessed the Taxpayer for penalties totaling \$4,836.11 for failing to timely file tax returns and for failing to timely pay taxes.
20. The Taxpayer had improvements made on the **Property** and the Taxpayer still owns the **Property**.
21. The Taxpayer failed to cooperate during the audit process and did not provide any documentation.
22. The City was unable to determine if the Taxpayer or **Construction** was liable for the tax on construction income.
23. The City assessed both the Taxpayer and **Construction** for the same construction income.
24. Because of the lack of documentation, the City had to estimate the tax liability using building permits for the **Property**.
25. There were two building permits for the **Property** totaling \$1,199,370.
26. During the audit period, the Taxpayer was renting the **Property** as a charter school.

27. Because the Taxpayer provided no records, the City had to estimate the amount of rental income.
28. The City estimated the monthly rental to be one percent of the building value or \$12,000 per month.

### **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. Section 415 authorizes a tax on the gross income from the business activity of construction contracting.
3. The Taxpayer is an owner-builder pursuant to Section 100.
4. The Taxpayer did not provide sufficient documentation to determine which entity (between the Taxpayer and ***Construction***) was to be responsible for the tax on the contracting income.
5. The City's assessment for the contracting income on the Taxpayer was appropriate pursuant to Section 417.
6. The Taxpayer had unreported rental income pursuant to Section 445.
7. The Taxpayer failed to file tax returns or timely pay taxes for its business activity during the audit period.
8. The City is authorized to use estimates when the Taxpayer fails to maintain or provide necessary books and records.
9. The City's estimation method was made on a reasonable basis.
10. The Taxpayer has failed to demonstrate reasonable cause for waiving of penalties for failure to timely file or failing to timely pay.
11. The Taxpayer's protest should be denied.

### **ORDER**

It is therefore ordered that the April 29, 2003 protest of ***Taxpayer*** of a tax assessment made by the City of Tucson is hereby denied.

It is further ordered that this Decision shall be effective immediately.

Jerry Rudibaugh  
Municipal Tax Hearing Officer