

**Jerry Rudibaugh  
Municipal Tax Hearing Officer**

**DECISION OF MUNICIPAL TAX HEARING OFFICER**

Decision Date: October 23, 2003  
Decision: MTHO #125  
Tax Collector: City of Scottsdale  
Hearing Date: August 26, 2003

**DISCUSSION**

**Introduction**

On May 16, 2003, *Taxpayer* (“Taxpayer”) filed a protest of a tax assessment made by the City of Scottsdale (“City”) and a request for hearing. After review, on June 4, 2003, the City concluded the protest was timely and in the proper form. On June 6, 2003, the Municipal Tax Hearing Officer (“Hearing Officer”) ordered the City to file a response to the protest on or before July 21, 2003. On July 15, 2003, the City filed a response to the protest. On July 25, 2003, the Hearing Officer ordered the Taxpayer to file any reply on or before August 15, 2003. On July 28, 2003, a Notice of Hearing (“Notice”) was issued setting the matter for hearing on August 26, 2003. On August 14, 2003, the Taxpayer filed its reply. Both the Taxpayer and City appeared and presented evidence at the August 26, 2003 hearing. On August 27, 2003, the Hearing Officer issued a letter ordering the City to file any post-hearing brief on or before September 2, 2003 and the Taxpayer to file any reply brief on or before September 9, 2003. The City filed its brief on August 28, 2003 and the Taxpayer filed its reply brief on September 5, 2003. On September 26, 2003, the Hearing Officer issued a letter indicating the record was closed and a written decision would be issued on or before October 27, 2003.

The Taxpayer made a construction loan to *Customers* (“*Customers*”) to build the *Customers* primary residence. The *Customers* contracted with *Customers* Homes, Ltd. to perform the construction. The *Customers* defaulted on the loan and the Taxpayer acquired the real property at issue through a trustee’s sale on June 27, 2001. Subsequently, the City assessed the Taxpayer on the gross receipts of \$1,119,003, which was the purchase price at the trustee sale. The City assessed the Taxpayer for a tax of \$10,091.10 for understated contracting income plus interest and penalties. The City subsequently waived the penalties.

**City Position**

The Taxpayer was assessed a tax on the gross receipts from the trustee’s sale of the *Customers*’ property in June of 2001 as a speculative builder in the City pursuant to City Code Section 416 (“Section 416”). According to the City; a building permit was issued to the *Customers* in May of 1999 to build a custom, single family residence in the City. The City asserted that City Code

Section 100 (“Section 100”) defines a speculative builder as an owner-builder who sells or contracts to sell improved real property consisting of a custom home regardless of the stage of completion of such home. Further, Section 100 defines an owner-builder as an owner of real property who by himself or through others constructs or has constructed any improvement to real property. The City asserted that City Code Section 595 (“Section 595”) provides for a collection of taxes when there is a successor to a speculative builder and the tax has not been paid. Section 595 provides as follows:

“Any person who purchases, or who acquires by foreclosure, by sale under trust deed or warranty deed in lieu of foreclosure, or by any other method, improved real property or a portion of improved real property for which the Privilege Tax imposed by this Chapter has not been paid shall be responsible for payment of such tax as a speculative builder or owner-builder, as provided in Sections 416 and 417.”

Based on the facts and arguments set forth above, the City argued that there was a speculative builder sale when the Taxpayer obtained the improved real property from the **Customers** at the trustee sale. The City asserted that since the **Customers** never paid the tax, the Taxpayer was liable as a successor in interest.

In response to the Taxpayer’s argument that the tax is premature pursuant to City Code Section 417 (“Section 417”), the City argued that Section 417 does not apply. According to the City, Section 417 only applies to improved property that has not been sold or transferred by a speculative builder. The City asserted that the Taxpayer’s claim that the sale should be exempt pursuant to City Regulation 416.1 (“Regulation 416.1”) is not valid. According to the City, Regulation 416.1 lists specific criteria for the sale to be considered exempt. The first criteria listed is that the property must have actually been used as a principal place of family residence. In this case, the City asserts the improved property was never occupied. The City argued that the Taxpayer’s assertion that the transaction should be exempt pursuant to City Code Section 270 (“Section 270”) is erroneous. According to the City, Section 270 only applies to persons not required to be licensed and the Taxpayer is engaged in business and required to have a license. Lastly, the City asserts the Taxpayer’s argument that equity requires the City to pursue collection from the prior owner is also erroneous. According to the City, they apply Section 595 consistently to all businesses in the City and it would be unfair to competitors to treat the Taxpayer differently. Based on all the above, the City requested the assessment be upheld.

### **Taxpayer Position**

The Taxpayer argued that the imposition of a tax was premature pursuant to City Code Section 417 (“Section 417”) which requires the expiration of 24 months after all improvement to the property has been substantially completed. According to the Taxpayer, the improvements were not substantially completed at the time of Taxpayer acquired the property. Secondly, the Taxpayer argued that the transaction would be exempt pursuant to City Regulation 416.1 (“Regulation 416.1”) as a homeowner’s bona fide non-business sale. Thirdly, the Taxpayer argued the transaction would be exempt pursuant to City Code Section 270(a)(3) & (b) as a non-licensed business. Fourth, the Taxpayer argued that the City should be required to make a reasonable effort to collect the tax from the **Customers** prior to assessing the Taxpayer. Lastly,

the Taxpayer argued that the transaction in question was exempt from taxation pursuant to Section 416(b)(4), which provides for certain exclusions of gross income from the sale of partially improved residential real property. The Taxpayer asserted that if an owner built a home for himself that somehow rises to the level of a speculative builder, he should be given the benefit of the doubt and allowed the protection of Section 416(a)(4) and Section 416(b)(4). Based on the above, the Taxpayer requested the City's assessment be denied.

### **ANALYSIS**

Clearly, the *Customers* were owner-builders pursuant to Section 100. The *Customers* were in the process of building a custom home for their own use when it was transferred to the Taxpayer pursuant to a Deed of Trust. Such a transfer was a sale under the City Code. As a result, the *Customers* were subject to a tax on the sale pursuant to Section 416. While the improved property was not fully completed, Section 100 provides that the sale of a custom home by an owner-builder is a taxable speculative builder sale regardless of the stage of completion of such home. While the Taxpayer argued that the partially improved residential real property definition applies to the transfer in this case, the Hearing Officer must disagree. The definition in Section 416(a)(4) applies to property being developed for sale to individual homeowners. That was not the case for the *Customers'* property. Section 416(b)(4) refers to partially improved residential real property as defined in Section 416(a)(4). As we previously concluded Section 416(a)(4) does not apply and as a result Section 416(b)(4) does not apply either. Based on all the above, the *Customers* had a taxable sale from the transfer of their improved property to the Taxpayer. Further, since the *Customers* did not pay the taxes and the Taxpayer was the successor in interest pursuant to Section 595 and thus responsible for the payment of the tax. Accordingly, the protest of the Taxpayer should be denied.

### **FINDINGS OF FACT**

1. On May 16, 2003, the Taxpayer filed a protest of a tax assessment made by the City and a request for a hearing.
2. After review, the City concluded on June 4, 2003 that the protest was timely and in proper form.
3. On June 6, 2003, the Hearing Officer ordered the City to file a response to the protest on or before July 21, 2003.
4. On July 15, 2003, the City filed a response to the protest.
5. On July 25, 2003, the Hearing Officer ordered the Taxpayer to file any reply on or before August 15, 2003.
6. On July 28, 2003, a Notice was issued setting the matter for hearing on August 26, 2003.

7. On August 14, 2003, the Taxpayer filed its reply.
8. Both the Taxpayer and City appeared and presented evidence at the August 26, 2003 hearing.
9. On August 27, 2003, the Hearing Officer issued a letter ordering the City to file any post-hearing brief on or before September 2, 2003 and the Taxpayer to file any reply brief on or before September 9, 2003.
10. The City filed its brief on August 28, 2003 and the Taxpayer filed its reply brief on September 5, 2003.
11. On September 26, 2003, the Hearing Officer issued a letter indicating the record was closed and a written decision would be issued on or before October 27, 2003.
12. The Taxpayer made a construction loan to the *Customers* to build the *Customers'* primary residence.
13. The *Customers* contracted with *Customers* Homes, Ltd. to perform the construction.
14. The *Customers* defaulted on the loan and the Taxpayer acquired the real property at issue through a trustee's sale on June 27, 2001.
15. Subsequently, the City assessed the Taxpayer on the gross receipts of \$1,119,003 which was the purchase price at the trustee sale.
16. The City assessed the Taxpayer for a tax of \$10,091.10 for understated contracting income plus interest and penalties.
17. The City subsequently waived the penalties.
18. A building permit was issued to the *Customers* in May of 1999 to build a custom, single family residence in the City.
19. The *Customers'* home was partially completed when the property was transferred to the Taxpayer.

### **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 416 authorizes a tax on the gross income from the business activity of engaging in the business as a speculative builder.

3. The *Customers* were owner-builders pursuant to Section 100.
4. Section 100 provides that the sale of a custom home by an owner-builder is a taxable speculative builder sale regardless of the stage of completion of such home.
5. Section-416(a)(4) does not apply to the *Customers'* sale.
6. Section 416(b)(4) does not apply to the *Customers'* sale..
7. As a result of the trustee sale of the *Customers'* improved property to the Taxpayer, the *Customers* had taxable contracting income pursuant to Section 416.
8. The Taxpayer was a successor in interest to the *Customers'* improved property for which a privilege tax was imposed pursuant to Section 416.
9. As a successor in interest to the *Customers'* property, the Taxpayer is responsible for payment of the tax pursuant to Section 595.
10. The protest of the Taxpayer should be denied.

### **ORDER**

It is therefore ordered that the May 16, 2003 protest of *Taxpayer* of a tax assessment made by the City of Scottsdale is hereby denied.

It is further ordered that this Decision is effective immediately.

Jerry Rudibaugh  
Municipal Tax Hearing Officer