

DECISION OF MUNICIPAL TAX HEARING OFFICER

Decision Date: July 31, 2004

Decision: MTHO #176

Tax Collector: City of Peoria

Hearing Date: June 16, 2004

DISCUSSION

Introduction

On January 29, 2003, *Taxpayer* (“Taxpayer”) filed a protest of a tax assessment made by the City of Peoria (“City”). After review, the City concluded on February 3, 2004 that the protest was timely and in the proper form. On February 9, 2004, the Municipal Tax Hearing Officer (“Hearing Officer”) ordered the City to file a response on or before March 25, 2004. On March 15, 2004, the City filed a response. On March 18, 2004, the Hearing Officer ordered the Taxpayer to file any reply on or before April 8, 2004. On March 19, 2004, the City filed a Notice of Supplemental Authority (“Supplement”). The Taxpayer filed a reply on April 8, 2004. On April 14, 2004, a Notice of Tax Hearing (“Notice”) was filed setting the matter for hearing commencing on June 16, 2004. Both parties appeared and presented evidence at the June 16, 2004 hearing. On June 17, 2004, the Hearing Officer indicated the record was closed and a written decision would be issued on or before August 2, 2004.

The City conducted an audit of the Taxpayer for the period January 2003 through October 2003. The City assessed the Taxpayer as a speculative builder for the sale of a developed *ABC* Pharmacy located at *Location* within the City. The City assessed the Taxpayer for taxes due in the amount of \$21,750.31, penalties in the amount of \$559.60, and interest.

City Position

The City taxed the “total selling price” of the *ABC* pharmacy. City Code Section 12-416 (a) (“Section 416 (a)”) imposes a tax on the gross income of speculative builders within the City. Further, City Code Section 12-416(a) (1) (“Section 416(a) (1)”) includes in the taxable gross income of a speculative builder the “total selling price from the sale of improved real property...” The City asserted that A.R.S. Section 1-213 (“Section 213”) requires that non-technical words and phrases in legislative enactments must be construed “according to the common and approved use of the language, . . .”. The City argued that “total selling price” is just the kind of non-technical phrase referred to in Section 213. The City disagrees with the Taxpayer’s argument that the portion of the total selling price attributable to the value of the leasehold associated with the *ABC* pharmacy should be excluded from taxation. The City noted that while Section 416 contains several explicit exclusions, there is no exclusion for leaseholds or the portions of the total selling price attributable to the purchase of the leasehold interest.

Further, the City argued that because the property is not useful for any purpose other than to service the lease, the value of the improved property is defined by the leasehold. The City asserted that the Taxpayer's convoluted reading of the Code would eviscerate the capacity of the City to collect any tax at all under this portion of the Code. The City cited a City of Glendale's Hearing Officer decision in March 2000 as persuasive (but not mandatory) authority to support the City position herein. In the City of Glendale case, the Hearing Officer concluded there were no provisions in the Tax Code for the City of Glendale to authorize a speculative builder to have a deduction for the present value of a lease. Based on all the above, the City requested the tax assessment be upheld.

Taxpayer Position

The Taxpayer indicated they had developed an *ABC* pharmacy on land owned by the Taxpayer at *Location* in the City. Subsequently, the Taxpayer secured a long-term lease with *ABC* and then sold the property, with the *ABC* lease in place, to a third party buyer for \$3,859,745.00. According to the Taxpayer, the sales price was based on the tangible value of the improved real property plus the intangible value of the rental revenue stream from the long term *ABC* lease, which was in place at the time of sale. The Taxpayer argued that the starting point of the analysis is the long recognized rule that tax imposition statutes are to be strictly construed against the taxing jurisdiction. In this case, the Taxpayer asserts the speculative builder tax is on the total selling price from the sale of improved real property. The Taxpayer argued that the intangible value of the rental revenue stream from the *ABC* lease should not be included as part of the proceeds from the sale of "improved real property." The Taxpayer cited a 1999 decision by a City of Phoenix Hearing Officer to support its position. In that case, the City of Phoenix Hearing Officer concluded that "improved real property" did not include the intangible value of in-place leases if that value could be appropriately determined. The Taxpayer differentiated the City of Glendale case and the City of Phoenix case in that the City of Glendale focused on a claimed deduction while the City of Phoenix case focused on the scope of the tax. The Taxpayer argued that their claim in this case was the same claim supported by the City of Phoenix case. The Taxpayer presented evidence at the hearing that the sales price of the *ABC* pharmacy without a lease in place would have been \$3,480,248.23. The Taxpayer also provided evidence of three other sales similarly constructed and similarly located *ABC* pharmacies (without leases) were sold within a one-year period for sales prices ranging from \$3,262,421.38 to \$3,386,435.04.

ANALYSIS

There was no dispute that the sale of the *ABC* pharmacy at *Location* was subject to the speculative builder tax. The only dispute centered around the appropriate sales price and whether or not the value of a long-term lease in place at the time of sale should be included or deducted from the sales price. Both parties cited a hearing officer decision from a sister city to support their argument. Based on the 3 arguments presented in those two decisions, this Hearing Officer actually concurs with both. The argument in the City of Phoenix decision centered around whether a long-term lease was includable as part of the sales price of improved property while the City of Glendale decision centered around whether there was a deduction available from the sales price of improved property for a long-term lease.

The proper question in this case is whether the lease is includable or is the lease deductible? The initial question is whether the value of the lease should be included as part of the total selling price from the sale of improved real property. Consistent with the law that tax imposition statutes are to be strictly construed against the taxing jurisdiction, we find that the intangible value of the lease is not part of the selling price of the improved real property. As a result, we concur with the Taxpayer. As to the appropriate value for the lease, we find the Taxpayer's evidence as to what the pharmacy company would have paid for the improved real property without a lease to be reasonable. This was corroborated by comparables in the area. Accordingly, we approve the Taxpayer's recommended selling price for the improved real property in the amount of \$3,480,248.32. We do have some concerns that the sale with a lease was simply a method in which *ABC* paid the Taxpayer a bonus for doing a good job. However, based upon the testimony in this case, the Taxpayer was at risk that the sales price would go down with the lease in place. In future cases, if it is determined that the decision to sell with the lease in place is too close to the sales date, we could conclude that it was a bonus payment and thus part of the overall sales price of improved property.

FINDINGS OF FACT

1. On January 29, 2004, the Taxpayer filed a protest of a tax assessment made by the City.
2. After review, the City concluded on February 4, 2004 that the protest was timely and in proper form.
3. On February 9, 2004, the Hearing Officer ordered the City to file a response on or before March 25, 2004.
4. On March 15, 2004, the City filed a response.
5. On March 18, 2004, the Hearing Officer ordered the Taxpayer to file a reply on or before April 8, 2004.
6. On March 19, 2004, the City filed a Supplement.
7. The Taxpayer filed a reply on April 8, 2004.
8. On April 14, 2004, a Notice was filed setting the matter for hearing commencing on June 16, 2004.
9. Both parties appeared and presented evidence at the June 16, 2004 hearing.
10. On June 17, 2004, the Hearing Officer indicated the record was closed and a written decision would be issued on or before August 2, 2004.

11. The City conducted an audit of the Taxpayer for the period January 2003 through October 2003.
12. The City assessed the Taxpayer as a speculative builder for the sale of a developed *ABC* pharmacy located at *Location* within the City.
13. The City assessed the Taxpayer for taxes due in the amount of \$21,750.31, penalties in the amount of \$559.60, and interest.
14. Prior to selling the *ABC* pharmacy, the Taxpayer secured a long-term lease with *ABC*.
15. The Taxpayer sold the *ABC* pharmacy with the long-term lease in place to a third party buyer for \$3,859,745.00.
16. Based on the evidence, the Taxpayer could have sold the *ABC* pharmacy without the lease to the *ABC* Corporation for \$3,480,248.23.
17. The Taxpayer sold three other similarly constructed, similarly situated *ABC* pharmacies (without leases) within a year of the sale at *Location* for sales prices ranging from \$3,262,421.38 to \$3,386.435.04.

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 Taxpayer was a speculative builder on the sale of the *ABC* pharmacy at *Location* in the City.
4. Section 416(a) (1) includes in the taxable gross income of a speculative builder the “total selling price” from the sale of improved real property.
5. The intangible value of the rental stream from the *ABC* lease is not includable in the sales price of improved real property.
6. The Taxpayer has presented evidence that a reasonable value for the sales price of improved real property at *Location* was \$3,480,248.23.
7. The Taxpayer’s protest should be granted.

ORDER

It is therefore ordered that the January 29, 2003 protest by *Taxpayer* of a tax assessment made by the City of Peoria is hereby granted.

It is further ordered that the City of Peoria shall revise the sales price of the *ABC* pharmacy located at *Location* to \$3,480,248.23 and adjust the tax, penalties, and interest assessed to reflect the revised sales price.

It is further ordered that this Decision is effective immediately.

Jerry Rudibaugh
Municipal Tax Hearing Officer