

DECISION OF MUNICIPAL TAX HEARING OFFICER

Decision Date: November 19, 2004

Decision: MTHO #192

Tax Collector: City of Tucson

Hearing Date: October 18, 2004

DISCUSSION

Introduction

On July 18, 2004, *Taxpayer* (“Taxpayer”) filed a protest of a tax assessment made by the City of Tucson (“City”). After review, the City concluded the protest was timely and in the proper form. On July 23, 2004, the Municipal Tax Hearing Officer (“Hearing Officer”) ordered the City to file a response to the protest on or before September 6, 2004. On August 24, 2004, the City filed a response to the protest. On August 30, 2004, the Hearing Officer ordered the Taxpayer to file any reply on or before September 20, 2004. On September 7, 2004, a Notice of Hearing (“Notice”) was issued setting the matter for hearing commencing on September 17, 2004. On September 8, 2004, the Taxpayer requested the hearing be continued. On September 10, 2004, a Notice was issued rescheduling the hearing commencing on October 18, 2004. On September 11, 2004, the Taxpayer sent an email requesting the reply deadline be extended to September 30, 2004. On September 17, 2004, the Hearing Officer extended the reply deadline to September 30, 2004. On September 27, 2004, the Taxpayer filed a reply. Both parties appeared and presented evidence at the October 18, 2004 hearing. On October 19, 2004, the Hearing Officer indicated the record was closed and a written decision would be issued on or before December 3, 2004.

City Position

The City conducted an audit of the Taxpayer for the period February 2000 through January 2004. During the audit period, the Taxpayer was a speculative homebuilder of single-family tract homes. The City concluded that the Taxpayer had underreported contracting income and over reported deductions resulting in an assessment for additional taxes due of \$24,554.60, plus interest \$4,318.69 up through April of 2004, and penalties totaling \$4,910.98. Subsequently, the City waived the penalties.

The City asserted the cost of land is defined in City Code Section 416 (b)(2) (“Section 416”) as “... the seller’s original purchase price of the land which is included in the real property sold, when a charge for such land is included in the total selling price of the real property sold.” The City does not consider closing and related costs, including broker fees, to be part of the actual price paid to the seller for the land.

The City did not consider the amounts paid to outside contractors for the infrastructure phase of each project to be part of the original purchase price of the land. Accordingly, the City disallowed the Taxpayer's request to claim these costs as part of the original cost of land. Pursuant to City Code Section 19-416 (c)(3) ("Section 416 (c)(3)") the City did allow the Taxpayer tax credit for City taxes paid to the outside contractors. The City only allowed tax credits for City taxes already paid and did not allow credits for taxes that may be paid in the future.

The City did not include approximately \$1.3 million in "labor only" services accrued during the development phase as part of the allowable land deduction. According to the City, these costs were not part of the original purchase price of the land. Further, the City argued that "labor only" services are not a valid deduction under the contracting activity.

The City argued that lot premiums paid by buyers of houses are part of the total selling price of improved property and should be included in gross income. The fact the premiums are paid based on the location and view from lots and no materials are involved does not exclude the amount from the total selling price.

Taxpayer Position

The Taxpayer asserted that in the 1980's, the sales tax burden shifted from subcontractors to builders on single family homebuilders. According to the Taxpayer, the goal of all state and local jurisdictions was to provide a reasonable basis for taxing the material in the homes so provided by the builder. The Taxpayer argued that the City has slowly changed the process over time so that the taxable base has now grown to unreasonably estimate material costs.

The Taxpayer argued that closing costs (and related HUD costs) are not part of the material costs. The Taxpayer asserted the City's position is contrary to both GAP accounting and federal tax law, where these costs are capitalized or included as part of initial basis. Further, there is no clear language in the City Code to exclude them.

The Taxpayer argued that all development cost should constitute land cost and thus be deducted from the sales price of the house. The Taxpayer asserted the tax credit should be reasonably calculated based on estimates and bids at the beginning of each project. This method would eliminate the constant need of review and revision necessary under the City's cash method. According to the Taxpayer, the City also missed sales tax paid during the audit.

The Taxpayer argued that all labor contractors should be allowed as a deduction from the taxable sales price since there is no material component to their bill. According to the Taxpayer, there were \$1.3 million of all labor development contractors in their two largest projects during the audit period.

The Taxpayer charges a lot premium to some home buyers. The Taxpayer argued these lot premiums should be excluded from the taxable sales price since there are not materials included in the lot premium.

ANALYSIS

Clearly Section 416 (b)(2) allows a deduction for the seller's original purchase price of the land. Although there are several issues set forth in this matter, most revolve around whether certain costs are part of the original purchase price of the land. We do find the Taxpayer's reliance on GAAP accounting and federal tax laws to include closing and related costs, including broker fees to be reasonable. Accordingly, we shall order the City to allow these costs as part of the original purchase price. The remaining costs such as amounts paid for the infrastructure and "labor only" services during the development phase occurred well after the original land purchase and would not be includable as part of the original land cost. Further, the Taxpayer has failed to provide reference to any other City Code Section that would allow these costs as deductions. As a result, we must conclude the Taxpayer has failed to meet their burden of proof of demonstrating these are allowable deductions.

As to the tax credits, the Taxpayer has failed to provide any reference to a City Code Section that would allow such credits based on estimates and bids instead of the actual sales tax paid during the audit period. As to the argument that the City missed sales tax paid during the audit, we shall require the City to adjust the tax assessment for any such missed tax for which the Taxpayer provided post-hearing supporting documentation.

We concur with the City's argument on the lot premium costs. These costs were an integral part of the overall selling price of the house. There simply could not be a sale of house and a sale of a lot premium. As a result, we find the lot premium costs were a part of the overall selling price of the improved property and the Taxpayer has failed to provide any reference to any City Code Section that would allow a deduction for the lot premium costs.

FINDINGS OF FACT

1. On July 8, 2004, the Taxpayer filed a protest of a tax assessment made by the City.
2. After review, the City concluded that the protest was timely and in proper form.
3. On July 23, 2004, the Hearing Officer ordered the City to file a response to the protest on or before September 6, 2004.
4. On August 24, 2004, the City filed a response to the protest.
5. On August 30, 2004, the Hearing Officer ordered the Taxpayer to file any reply on or before September 20, 2004.
6. On September 7, 2004, a Notice was issued setting the matter for hearing commencing on September 17, 2004.
7. On September 8, 2004, the Taxpayer requested the hearing be continued.

8. On September 10, 2004, a Notice was issued rescheduling the hearing commencing on October 18, 2004.
9. On September 11, 2004, the Taxpayer sent an email requesting the reply deadline be extended to September 30, 2004.
10. On September 17, 2004, the Hearing Officer extended the reply deadline to September 30, 2004.
11. On September 27, 2004, the Taxpayer filed a reply.
12. Both parties appeared and presented evidence at the October 18, 2004 hearing.
13. On October 19, 2004, the Hearing Officer indicated the record was closed and a written decision would be issued on or before December 3, 2004.
14. The City conducted an audit of the Taxpayer for the period February 2000 through January 2004.
15. During the audit period, the Taxpayer was a speculative builder of single-family tract homes.
16. The City concluded the Taxpayer had under reported contracting income and over reported deductions resulting in an assessment for additional taxes due in the amount \$24,554.60, plus interest of \$4,318.69 up through April of 2004, and penalties totaling \$4,910.98.
17. Subsequently, the City waived the penalties.
18. The City disallowed closing and related costs, including broker fees, from the original purchase price of land.
19. The City disallowed the Taxpayer's claimed deductions for amounts paid to outside contractors for the infrastructure phase of each project to be part of the original purchase price of land.
20. The City disallowed claimed tax credits by the Taxpayer for taxes that may be paid in the future.
21. The City disallowed approximately \$1.3 million in "labor only" services accrual during the development phase as part of the original purchase price of land.
22. The Taxpayer charged a lot premium to some house buyers that was included in the total selling price of the house.

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. During the audit period, the Taxpayer had under reported contracting income and over reported deductions.
3. The closing and related costs, including broker fees are part of the original purchase price of the land.
4. The Taxpayer has failed to meet its burden of proof that the amounts paid for the infrastructure and “labor only” services during the development phase were part of the original land purchase cost.
5. The Taxpayer has failed to meet its burden of proof that tax credits can be based on estimates and bids instead of the actual sales tax paid during the audit period.
6. Lot premium costs were an integral part of the overall selling price of the house.
7. The Taxpayer’s protest should be denied in part and granted in part consistent with the Discussion, Findings, and Conclusions, herein.

ORDER

It is therefore ordered that the July 8, 2004 protest of *Taxpayer* of a tax assessment made by the City of Tucson is hereby granted in part, and denied in part, consistent with the Discussion, Findings, and Conclusions, herein.

It is further ordered that the City of Tucson shall revise the assessment to include closing and related costs, including broker fees as part of the original purchase price of the land.

It is further ordered that the City of Tucson shall revise its assessment to reflect any missed tax credits for which the Taxpayer provided post-hearing supporting documentation.

It is further ordered that this Decision is effective immediately.

Jerry Rudibaugh
Municipal Tax Hearing Officer