

Jerry Rudibaugh

Municipal Tax Hearing Officer

DECISION OF MUNICIPAL TAX HEARING OFFICER

Decision Date: April 15, 2002

Decision: MTHO #21

Taxpayer: Taxpayer

Tax Collector: City of Scottsdale

Hearing Date: None

DISCUSSION

Introduction

On November 14, 2001, Taxpayer ("Taxpayer") filed a protest of the City of Scottsdale ("City") tax assessment. In its protest letter, the Taxpayer requested a hearing to present evidence and arguments. After review, the City filed its November 26, 2001 finding that the protest was timely and in the proper form. On November 28, 2001, the Taxpayer filed a request to change from a hearing to a redetermination. On December 6, 2001, the Municipal Tax Hearing Officer ("Hearing Officer") ordered the City to file its response to the protest on or before January 22, 2002. On January 16, 2002, the City filed its response. On January 21, 2002, the Hearing Officer ordered the Taxpayer to file its reply on or before February 20, 2002. Subsequently, the Taxpayer was granted a request for an extension of time to file its reply until February 26, 2002. The Taxpayer filed its reply on February 26, 2002.

Taxpayer was formed on October 23, 1995 as a limited partnership. Taxpayer was formed to purchase, develop, own and operate multifamily apartment communities. Taxpayer Housing was also formed on October 23, 1995 as a limited partnership. As a result of various inter-related ownership interests, Taxpayer has a direct ownership of 99.999% of Taxpayer Financing. Taxpayer Housing was formed for purposes of segregating certain properties belonging to Taxpayer for a cross-collateralized financial package. Lenders required the property be segregated from Taxpayer's other holdings into Taxpayer Financing so that loans could be secured. For federal tax purposes, the conveyance of the Taxpayer controlled properties is accounted for as a contribution of assets under Section 721 of the Internal Revenue Code, and as such, the assets and liabilities are reflected at historical cost. There are no federal tax consequences as a result of such transfer. The Taxpayer owned property at ... ("Property") and constructed an apartment complex on it. The earliest building permit was completed on October 17, 1996. In July of 1998, the Property was transferred by the Taxpayer to Taxpayer Financing. While the property had a market value of \$20,694,954.00, it was transferred from Taxpayer to Taxpayer Financing "for ten dollars (\$10.00) and other good and valuable consideration".

City Position

The Taxpayer sold improved real property before the expiration of twenty-four (24) months after the improvements were substantially complete and as a result was assessed tax as a speculative builder pursuant to Scottsdale City Code Section 416 ("Section 416"). A "sale" is defined in Scottsdale City Code Section 100 ("Section 100") as "any transfer of title in possession, or both, exchange, barter, conditional or otherwise, in any manner or by any means whatsoever, of property for a consideration". In addition, Scottsdale City Code Section 210 ("Section 210") requires the City to determine the market value of a transaction between affiliated companies where the "gross income from the transaction is not indicative of the market value of the subject matter of the transaction". As a result, the City utilized an arms-length sale of a similar property that occurred in June of 1998 to arrive at an estimated market value for the sale of \$22,435,438.60. Subsequently, the City

reduced the estimated market value to \$20,694,954.00 based on additional information provided by the Taxpayer.

While the Taxpayer argued that the transfer was not one "for a consideration" and thus no sale took place, the City disputed that argument. The City asserted that the Taxpayer signed and filed a Warranty Deed on July 17, 1998 which stated the following: "Taxpayer Housing Limited Partnership... for Ten Dollars (\$10.00) and other good and valuable consideration, in hand paid, hereby sells and conveys to Taxpayer Financing Limited Partnership ... the real property in the County of Maricopa and State of Arizona that is legally described...". According to the City, the code does not required consideration to be equal to the property received, just that it be present. The Warranty Deed signed by the Taxpayer clearly states that there was consideration present. As a result, the City asserts the Taxpayer's transfer to a related entity is taxable.

Taxpayer Position

The Taxpayer requested the audit assessment be vacated because there was no "sale". According to the Taxpayer, there was simply a transfer for title purposes only with nominal consideration stated so that the deed could not be later challenged as invalid. The Taxpayer argued that the City's response ignores the realities of the action in question and seeks to impose a tax because a deed was filed which contained the general boilerplate language that \$10 dollars and other good and valuable consideration was paid for the property. According to the Taxpayer, the Property was contributed by Taxpayer to Taxpayer Financing solely to collateralize a loan for financing purposes. The Affidavit of Value submitted with the deed indicated that the contribution of the property was between related parties and the "sale price" was \$0.00. Further, the Taxpayer asserted that because Taxpayer owned such a significant and substantial percentage of Taxpayer Financing, Taxpayer remained in control of the Property and continued to treat it exactly the same after the transfer. The Taxpayer argued that the financing technique used for this transaction was not designed to avoid tax but was required in order for lenders to secure their rights. Lastly, the Taxpayer asserts that to tax such a transaction is contrary to the commonly understood scope of the speculative builder tax and will cause serious problems in the construction financing industry.

ANALYSIS

The sole issue in this matter is whether or not there was a sale pursuant to Section 100 of the City code. If there was a sale, then it is clear the transaction would be taxable pursuant to Section 416. It is also clear that in order to have a sale pursuant to Section 100 there must be consideration for the Property. The Property valued at over \$20 million was transferred to Taxpayer Financing solely for financing purposes for \$10.00. The same people owned and operated the Property after the transfer. While the City as argued that nominal consideration is sufficient under the Section 100 in order to have a sale, the Hearing Officer does not reach the same conclusion. If the City intended nominal consideration to be sufficient pursuant to Section 100, the Hearing Officer concludes the City would have clearly stated that in Section 100. In addition to the lack of consideration, the Hearing Officer also finds it important that the Taxpayer had a legitimate purpose for the transfer other than avoidance of taxes. The Hearing Officer concludes, under the circumstances herein, there was not consideration given for the Property, as a result, there was no sale pursuant to Section 100. The protest of the Taxpayer is granted.

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 imposes a tax on speculative builders on the selling price of improved property.
3. Section 100 requires there to be consideration given in exchange for improved property in order for there to be a sale.
4. There was not consideration given for the Property when it was transferred from Taxpayer to Taxpayer Financing.
5. The Taxpayer's protest should be granted.

FINDINGS OF FACT

1. On November 14, 2001, Taxpayer filed a protest of the City's tax assessment.
2. On November 26, 2001, the City filed a finding that the protest was timely and in the proper form.

3. In its protest letter, the Taxpayer had requested a hearing be scheduled.
4. On November 28, 2001, the Taxpayer filed a request to change from a hearing to a redetermination.
5. On December 6, 2001, the Hearing Officer ordered the City to file its response to the protest on or before January 22, 2002.
6. On January 16, 2002, the City filed its response.
7. On January 21, 2002, the Hearing Officer ordered the Taxpayer to file its reply on or before February 20, 2002.
8. The Taxpayer was granted a request for an extension of time until February 26, 2002.
9. The Taxpayer filed its reply on February 26, 2002.
10. Taxpayer was formed on October 23, 1995 as a limited partnership.
11. Taxpayer was formed to purchase, develop, own and operate multifamily apartment communities.
12. Taxpayer Housing was formed on October 23, 1995 as a limited partnership.
13. Taxpayer has a direct ownership of 99.999% of Taxpayer Financing.
14. Taxpayer Housing was formed for the purpose of segregating certain properties belonging to Taxpayer for a cross-collateralized financial package.
15. For federal tax purposes, the conveyance of the Taxpayer properties to Taxpayer Financing is accounted for as a contribution and there are no federal tax consequences as a result of such transfer.
16. The Taxpayer owned Property and constructed an apartment complex on it.
17. The earliest building permit was completed on October 17, 1996.
18. In July of 1998, the Property, which had a market value of \$20,694,954.00, was transferred from Taxpayer to Taxpayer Housing for ten dollars (\$10.00) and other good and valuable consideration.
19. The Affidavit of Value submitted with the deed indicated the contribution of the property was between related parties and the sale price was \$0.00.

ORDER

It is therefore ordered that the November 14, 2001, protest of Taxpayer shall be granted.

It is further ordered that the City of Scottsdale shall vacate its audit assessment of the transfer from Taxpayer Housing to Taxpayer Financing.

It is further ordered that this decision is effective immediately.

Dated: April 15, 2002

Jerry Rudibaugh

Municipal Tax Hearing Officer