

# Jerry Rudibaugh

## Municipal Tax Hearing Officer

### DECISION OF MUNICIPAL TAX HEARING OFFICER

Decision Date: September 12, 2002

Decision: MTHO #38

Tax Collector: City of Tucson

Hearing Date: June 12, 2002

### DISCUSSION

#### Introduction

On March 17, 2002, "Taxpayer" filed a protest of the City of Tucson ("City") tax assessment. After review of the protest, the City concluded the protest was timely and in proper form. On April 1, 2002, the Municipal Tax Hearing Officer ("Hearing Officer") ordered the City to file any response to the protest on or before May 16, 2002. The City filed its response on April 19, 2002. On April 26, 2002, the Hearing Officer ordered the Taxpayer to file any reply on or before May 10, 2002. On April 26, 2002, the Taxpayer filed a reply to the City. On May 2, 2002, the City filed comments to the April 26, 2002 letter of the Taxpayer. On May 6, 2002, the Taxpayer filed comments to the City's audit results. On May 21, 2002, the matter was set for hearing commencing on June 12, 2002. The City and Taxpayer both appeared at the hearing and presented evidence. On June 17, 2002, the Hearing Officer issued a letter ordering the City to file a post-hearing response on June 26, 2002. The Taxpayer would file a reply to the City on or before July 9, 2002, and the City would reply to the Taxpayer on or before July 23, 2002. The City filed a post-hearing response on June 19, 2002. The Taxpayer filed a reply to the City on June 28, 2002. On July 18, 2002, the City filed a reply to the Taxpayer. On July 29, 2002, the Taxpayer filed additional comments. On August 18, 2002, the Hearing Officer issued a letter indicating a written decision would be issued on or before September 12, 2002.

The Taxpayer is a corporation with "Mr. D") as President and Secretary. The Taxpayer took out a City building permit on March 18, 1997 to construct two triplexes for "Company B" with Mr. D as President and Claudia D ("Mrs. D") as Secretary. The Taxpayer took out a second building permit on December 15, 1999, to construct a guesthouse on the property of Mr. and Mrs. D. The Taxpayer reported \$42,600 of construction income and paid taxes to the City for the month of March 1998. The Taxpayer reported construction income of \$14,786 to the State of Arizona ("State") for the month of June 1998, but reported no income to the City. The audit period consisted of only the months in which there was income. Those months included January of 1998, March of 1998, June of 1998, and March of 2000. The City requested on several occasions for the Taxpayer to provide records, but none were provided. As a result, the City utilized the income reported on the tax returns and the amounts on the building permits to arrive at an audit result of \$4,046.12 of additional taxes due plus interest.

## **City Position**

The City disagrees with the Taxpayer's assertion that if the corporation is working for the President's family the corporation does not have contracting income. The City asserted that the Taxpayer, Company B, and Mr. and Mrs. D are separate legal entities. While the Taxpayer disagreed with the City's determination of contracting income, the Taxpayer failed prior to the hearing to provide any records to the contrary. The Taxpayer did provide some records subsequent to the hearing for the City to review. After review of the records, the City agreed that the loan for construction of the triplexes was \$200,000. The City argued that the Taxpayer should have paid taxes on construction income for the triplexes at the fair market value or at least on the cost plus a reasonable profit. The City utilized the amount of \$279,315 from the building permit as a fair estimate of fair market value. The City disputed the Taxpayer's request to utilize the Pima County ("County") tax valuation of \$156,000 as being representative of a fair market value. The City argued that the County's valuation is usually less than the actual fair market value of the property, often 20% to 25% less than the actual cost of construction.

As to the guesthouse, the City argued that the Taxpayer should be taxed as a general contractor on the fair market value based on the building permit value of \$41,762. The Taxpayer asserted that they had paid sales taxes on most of the materials utilized in constructing the guesthouse during the period of October 1999 through October 2000 and provided invoices at the hearing for the City to review. The City reviewed Company Z invoices and determined the Taxpayer had paid a tax of \$168.67 on receipts totaling \$2,576.23. The Taxpayer also provided Company R invoices for the City to review. The invoices provided were all dated in 2001 and the City concluded that none of the invoices reflected the job location of the guesthouse.

In an effort to determine the cost of the triplex project, The City reviewed bank statements provided by the Taxpayer at the hearing. The auditor found deposit items classified as sales such as a \$689.95 sale of cooler to brother. In addition, there was a sale of new grills for a house in the amount of \$462.25, and \$3,777.88 designated as a sale. As a result, the City requested the audit be extended to include these retail sales found in examining the bank statements.

The City argued that the two months in which contracting income was reported (March and June of 1998) should be taxed. According to the City, the Taxpayer would not have reported those for the construction of the triplex since the Taxpayer did not consider the project to be general contracting work.

## **Taxpayer Position**

The Taxpayer asserted that it never used the general contractor's license to build anything for anyone but itself. The Taxpayer considered work done for Company B and for Mr. and Mrs. D as being work done for the Taxpayer since they were all owned by the D's. Further, the Taxpayer asserted that taxes were paid on the purchases used for the construction of the two projects. The Taxpayer provided the City with bank statements and invoices to review after the hearing.

As to the triplexes, the Taxpayer provided documentation after conclusion of the hearing to demonstrate that the actual cost was approximately \$200,000. Further, the Taxpayer provided a recent County Tax Valuation of \$156,000 to be representative of the fair market value. While the Taxpayer acknowledged that the tax valuations from the County do not reflect the fair market value for existing housing, the Taxpayer asserted that values for new construction are current and do reflect the fair market value.

The Taxpayer indicated that the President is the only full-time employee and as a result the Taxpayer can only handle one job at a time. According to the Taxpayer, construction was being done on the triplexes up through June 16, 1998. The Taxpayer asserted that the amounts reported on tax returns for March and June of 1998 were part of contracting construction for the triplexes and as a result the City is counting those amounts twice. The Taxpayer argued that if there were other jobs there would have been building permits in addition to the two permits taken out by the Taxpayer.

## **ANALYSIS**

The City is authorized to tax contracting income pursuant to City Code Section 19-415 ("Section 415"). While the Taxpayer has argued that it only did work for itself, the Hearing Officer concurs with the City's argument that there were three separate legal entities. The Taxpayer acted as a general contractor for Company B in constructing the triplexes. The Taxpayer also acted as the general contractor in constructing the guesthouse for Mr. and Mrs. D. The Hearing Officer also concurs with the City that the appropriate contracting income amount should be based on fair market value. As to the triplexes, the evidence supports an actual cost of approximately \$200,000. As a result, the Hearing Officer does not find the Taxpayer's tax valuation

from the County of \$ 156,000 to be a reasonable estimate of fair market value. The only estimate presented that makes sense as a fair market value estimate is the City's use of the permit valuation of \$279,315. Accordingly, the Hearing Officer adopts the City's estimate of \$279,315 as the appropriate fair market value for the construction of the triplexes.

As far as the guesthouse, we reach a slightly different conclusion. Because the guesthouse would not have a separate market value from the primary residence, the Hearing Officer concludes that the building permit valuation would result in an excessive fair market valuation. At the same time, the Hearing Officer concludes that the actual cost would be too low for a fair market valuation. Based on the overall evidence, the best estimate of the fair market value is the average of the permit valuation and the actual cost (\$41,762 & \$20,000) ÷ 2 or \$30,881.

While the Taxpayer argued that the two months reported of March and June 1998 were already included in the amount for the triplexes, we do share the City's concern that the Taxpayer's argument contradicts the argument that the triplexes were not taxable. That concern must be balanced with the facts that the months of March and June 1998 were during the same timeframe of the construction of the triplexes, there was no evidence of any other building permit, and that the Taxpayer only had one employee. Based on the overall evidence, the Hearing Officer concludes that the income for the two months of March and June 1998 are already included within the fair market value of the triplexes.

Based on the City's review of the Home Depot invoices for the guesthouse, the Taxpayer should receive credit for taxes already paid in the amount of \$168.67. We also concur with the City's request to include retail sales in the amounts of \$689.95, \$462.25, and \$3,777.88 as part of the assessment. While the Taxpayer argued that taxes had already been paid on the cooler and grills, there were no invoices provided to support that argument. As to the \$3,777.88 amount, the Taxpayer's explanation was that they did not know why it was marked as a sale. We do not find that to be a satisfactory explanation and shall include the \$3,777.88 amount as a retail sale to be included as part of the assessment.

#### **FINDINGS OF FACT**

1. On March 17, 2002, the Taxpayer filed a protest of the City tax assessment.
2. After review of the protest, the City concluded the protest was timely and in the proper form.
3. On April 1, 2002, the Hearing Officer ordered the City to file any response to the protest on or before May 16, 2002.
4. The City filed its response on April 19, 2002.
5. On April 26, 2002, the Hearing Officer ordered the Taxpayer to file any reply on or before May 10, 2002.
6. On April 26, 2002, the Taxpayer filed a reply to the City.
7. On May 2, 2002, the City filed comments to the April 26, 2002 letter of the Taxpayer.
8. On May 6, 2002, the Taxpayer filed comments to the City's audit results.
9. On May 21, 2002, the matter was set for hearing commencing on June 12, 2002.
10. The City and Taxpayer both appeared at the hearing and presented evidence.
11. On June 17, 2002, the Hearing Officer issued a letter ordering the City to file a post-hearing response on June 26, 2002. The Taxpayer would file a reply to the City on or before July 9, 2002, and the City would reply to the Taxpayer on or before July 23, 2002.
12. The City filed a post-hearing response on June 19, 2002.
13. The Taxpayer filed a reply to the City on June 28, 2002.

14. On July 18, 2002, the City filed a reply to the Taxpayer.
15. On July 29, 2002, the Taxpayer filed additional comments.
16. On August 18, 2002, the Hearing Officer issued a letter indicating a written decision would be issued on or before September 12, 2002.
17. The Taxpayer is a corporation with Mr. D as President and Secretary.
18. Company B is a corporation with Mr. D as President and Mrs. D as Secretary.
19. The Taxpayer took out a building permit on March 18, 1997 to construct two triplexes for Company B.
20. The Taxpayer took out a second building permit on December 15, 1999, to construct a guesthouse on the property of Mr. and Mrs. D.
21. The Taxpayer reported \$42,600 of construction income and paid taxes to the City for the month of March 1998.
22. The Taxpayer reported construction income of \$14,786 to the State for the month of June 1998 but reported no income to the City
23. The City utilized the months of January 1998, March 1998, June 1998, and March of 2000 to encompass the construction of the triplexes and guesthouse and the two months in which the Taxpayer reported income.
24. The City utilized the income reported on the two tax returns and the amounts on the two building permits to arrive at an audit result of \$4,046.12 of additional taxes due plus interest.
25. Prior to the hearing, the Taxpayer failed to provide any records to the City.
26. The cost to build the triplexes was approximately \$200,000.
27. Based on the building permit, the fair market value of the triplexes was \$279,315.00.
28. The cost to construct the guesthouse on the principal residency of Mr. and Mrs. D was approximately \$20,000.00.
29. Based on the building permit, the fair market value of the guesthouse was \$41,762.
30. Based on the County Tax Valuation, the fair market value of the triplexes was \$156,000.
31. At the hearing, Mr. D testified that the guesthouse was completed by October 2000.
32. The City reviewed Home Depot invoices and determined that the Taxpayer paid a tax of \$168.67 on receipts totaling \$2,576.23 for the period October 1999 through October 2000.
33. The City reviewed Company R invoices provided by the Taxpayer that were all dated in 2001 and did not reflect the job location of the guesthouse.
34. The City reviewed bank statements provided by the Taxpayer and found deposit items classified as sales such as a sale of a cooler for \$689.95, a sale of new grills for a house for \$462.25, and a sale in the amount of \$3,777.88.
35. The Taxpayer only has one full-time employee.

36. The Taxpayer was constructing the triplexes during the months of March and June 1998.

37. There was no evidence of any building permits taken out by the Taxpayer other than the ones for constructing the triplexes and guesthouse.

### **CONCLUSIONS OF LAW**

1. Pursuant to ARS Section 42-605 6, the Municipal Tax Hearing Officer is to hear all reviews of petitions for hearing or redetermination under the Model City Tax Code.

2. The Taxpayer, Company B, and Mr. and Mrs. D are separate legal entities.

3. City Code Section 415 authorizes the City to tax contracting income.

4. The Taxpayer contracted to build two triplexes for Company B and a guesthouse for Mr. and Mrs. D.

5. In transactions between parties in which the gross income from the transaction is not indicative of the market value, it is reasonable for the City to determine a market value upon which the contracting tax shall be levied.

6. The building permit provided a reasonable market value for the triplexes.

7. An average of the cost and building permit value provided a reasonable market value for the guesthouse.

8. Based on the City's review of the Home Depot invoices, it is reasonable to allow the Taxpayer a credit for \$168.67 for taxes paid on the purchase of materials for the guesthouse.

9. Based on the City's review of the bank statements, it is reasonable to include retail sales totaling \$4,930.08 as part of the audit assessment.

10. The contracting income reported by the Taxpayer for the months of March and June 1998 are already included within the fair market value of the triplexes.

### **ORDER**

It is therefore ordered that the March 17, 2002 protest of Durable Construction Co., Inc. of the City of Tucson tax assessment is hereby denied in part and granted in part, consistent with the discussion contained herein.

It is further ordered that the City of Tucson shall revise its tax assessment to reflect contracting income from the construction of the guesthouse in the amount of \$30,881.00.

It is further ordered that the City of Tucson shall revise its tax assessment to reflect the contracting income for the months of March and June 1998 are already included as part of the contracting income for the triplexes.

It is further ordered that the City of Tucson shall revise its tax assessment to include a credit for taxes paid on the construction of the guesthouse in the amount of \$168.67.

It is further ordered that the City of Tucson shall revise its tax assessment to include retail sales totaling \$4,930.08.

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

Jerry Rudibaugh

Municipal Tax Hearing Officer