

**Jerry Rudibaugh  
Municipal Tax Hearing Officer**

**DECISION OF MUNICIPAL TAX HEARING OFFICER**

Decision Date: December 30, 2002

Decision: MTHO #42

Tax Collector: City of Tempe

Hearing Date: August 19, 2002

**DISCUSSION**

**Introduction**

On April 12, 2002, the Owner ("Taxpayer") filed a Petition for Hearing ("Petition") in response to an audit assessment issued by the City of Tempe ("City"). After review, the City concluded on April 24, 2002 that the petition was timely and in proper form. On April 30, 2002, the Municipal Tax Hearing Officer (Hearing Officer") ordered the City to file a response to the Petition on or before June 14, 2002. On June 14, 2002, the City filed a request for an extension until June 21, 2002. On June 18, 2002, the Hearing Officer granted the City's request. The City filed its response on June 21, 2002. On June 25, 2002 the Hearing Officer ordered the Taxpayer to file any reply on or before July 9, 2002. On July 2, 2002, the Taxpayer requested an extension until July 23, 2002. On July 8, 2002, the Hearing Officer granted the Taxpayer an extension until August 5, 2002, on which to file a reply. The Taxpayer filed its reply on August 5, 2002. The matter was set for hearing commencing on August 19, 2002. The City and Taxpayer both appeared and submitted evidence at the August 19, 2002 hearing. On October 10, 2002, the Taxpayer filed a post hearing brief. On October 24, 2002, the City filed a response brief. On November 7, 2002, the Taxpayer filed a reply brief. On November 22, 2002, the City filed an additional response to which the Taxpayer filed an additional reply on December 5, 2002.

In 1996, Taxpayer purchased property at 2016 S. \_\_\_\_\_ ("Property") located in the City. The Taxpayer planned to build single family units on the property which initially would be rental properties. There was room for eleven lots. The Taxpayer did not have the finances to do the entire development. The development was named Development. The Taxpayer contacted people to invest in the development. The First Contributors contributed \$66,000 for a 2/11 interest in the development. The Second Contributors contributed \$99,000 for a 3/11 interest in the development. The Taxpayer contributed the land for a 6/11 interest in the development. From July 1999 through September 2000, eleven single-family residential units were constructed on the Property. At the time of construction, title to two of the units were in the name of the First Contributor. Three of the units were in the name of the Second Contributors and six of the units were in the name of the wife of the Taxpayer. Each of the individuals secured their own construction financing with respect to the lots they owned.

The total construction cost of the eleven units was \$1,342,495. On March 19, 2002, the City issued an assessment against the Taxpayer for the period of September 2000 to December

2001 for unreported construction contracting pursuant to City code Section 16-415 (“Section 415”). The City issued an assessment for additional tax in the amount of \$14,153.81 plus penalties and interest. Subsequently, the penalty for late payment was waived.

### **City Position**

The City asserted there was no partnership agreement or other documentation to indicate a partnership was formed. Additionally, the City asserted that there was no capital contribution to the partnership. The City indicated that the First Contributor and the Second Contributor purchased two lots and three lots respectively from the Taxpayer. According to the City, the money from the purchases went to the Taxpayer. The City indicated that title to the lots remained at all times in the names of the individual owners and all loans and loan documentation remain in the names of the individual owners. The City also noted that the Taxpayer and his wife reported these properties and related income as individually owned, not partnership properties, on their Federal income tax return. The City asserted that each individual owner is licensed with the City for privilege tax purposes. According to the City, the wife of the Taxpayer sold unit #102 and retained all of the proceeds.

Based on all the above, the City argued that the Taxpayer cannot be an Owner-Builder acting on behalf of the “partnership” since no partnership existed. Further, the City asserted that the Taxpayer could not be an Owner-Builder because he had no ownership interest in any of the properties at the time of construction.

According to the City, the Taxpayer acted as the contractor and was compensated as the contractor. The City disputed the Taxpayer’s argument that ABC Homes Inc. (“ABC”) was contracted to perform contracting services. The City asserted that the agreement with ABC limited the scope of work to “project management only”. ABC was paid \$33,000 for its services. The Taxpayer, on the other hand, entered into written contracts with subcontractors and suppliers and signed all checks in payment for the subcontractors and suppliers. According to the City, the Taxpayer received payments totaling approximately \$115,000 for supervision and reimbursement of costs incurred. In at least one case, the Taxpayer and/or his management company (XYZ Management) entered into a written contract with a subcontractor (JKL Concrete Inc.) indicating XYZ Management was the contractor.

### **Taxpayer Position**

The Taxpayer argued that a partnership was formed to construct and operate a rental complex. Further, because the taxpayer was a partner in the partnership, he is not taxable as a construction contractor based on the rule laid out in *Indigo Co. v. City of Tucson*, 166 Ariz. 596,804P.2d129 (“Ct.App. 1991). During 1996, the Taxpayer purchased the Property. According to the Taxpayer, a partnership was formed with the Second Contributors and the First Contributor for development of the properties. The Second Contributors and First Contributors contributed \$99,000 and \$66,000 respectively, for a 3/11 interest and a 2/11 interest, respectively. The Taxpayer asserted that in order to obtain “clean” financing for the construction of his property, the partners deeded record ownerships of the properties to the individuals best able to obtain financing. According to the Taxpayer, The Taxpayer acted as the managing partner

in overseeing construction and providing progress payments during the construction process. The Taxpayer asserts that The Taxpayer had no tax license number as a construction contractor and provided no tax license number to any contractors to obtain tax exempt goods or services. The Taxpayer argued that the partnership hired Mr. John Smith of ABC Homes (“ABC”) to provide construction contracting services and utilized ABC’s tax license during the course of the project. The Taxpayer asserted that the partners pooled their interests in construction costs and when the construction was completed the partners divided the rent based on their interest in the partnership.

Based on the above, the Taxpayer argued the parties intended to enter into a partnership. According to the Taxpayer, a partnership is formed upon the agreement of “two or more persons to carry on as co-owners of a business for profit”. The Taxpayer asserted that the most important factor in determining the existence of a partnership is the intention of the parties. The Taxpayer argued that The Taxpayer was a partner overseeing construction on partnership land and would have been an owner-builder and not a construction contractor. The Taxpayer understood that he was the non-taxable owner and paid sales tax on all purchases and payments to the trade contractors and suppliers. While the Taxpayer believes he was not a taxable construction contractor, in the alternative, the Taxpayer argues that the City must give him credit for taxes paid. The taxpayer attempted to obtain Assignment and Waiver forms from all suppliers and trade contractors in order to get credit for taxes paid.

According to the Taxpayer, the Taxpayer and his wife purchased six lots and held the lots as community property. Subsequently, in order to allow the Taxpayer's wife to more easily obtain financing for the construction on the lots, The Taxpayer quit claimed the six lots to his wife. The Taxpayer asserted that The Taxpayer did not intend to, and did not, transfer his community property interest with the quit claim deal. As a result, the Taxpayer argued that The Taxpayer was an owner of the property and thus not taxable under the City contracting classification.

The Taxpayer also argued that the Taxpayer's actions could be described as those of a construction manager or agent. The Taxpayer as the owner’s representative paid the subcontractors from the funds received from the owner. As a result, the Taxpayer was not the “prime contractor” but rather the various subcontractors will be treated as the taxable prime contractor.

Based on the above, the Taxpayer requests the tax, interest and penalties be abated. Further, the Taxpayer argued that even if the tax is not abated the penalties should be waived because the Taxpayer had reasonable cause to believe he was not taxable as a construction contractor.

### **ANALYSIS**

The primary issue put forward in this case is whether or not the Taxpayer is a taxable construction contractor for the construction on the Property. The Taxpayer’s core argument is that a partnership was formed to construct and operate a rental complex. While we concur with

the Taxpayer that a lack of partnership documentation is not the critical factor, we disagree with the Taxpayer that the facts and circumstances and intention of the parties in this case would conclude a partnership was formed. Clearly the parties intended some type of joint venture in construction and renting the eleven homes at Development. We do not conclude it was a partnership for the following reasons. (1) The individuals had separate loans for their respective lots and any foreclosure would be specific to the individual loan foreclosed on; (2) Title to the lots remain in the names of the individual owners; (3) The proceeds from the sale of any of the units would all go to the specific owner of that unit and would not be shared with the other owners; and (4) The various owners reported the properties and related income as individually owned, not partnership properties.

The Hearing Officer also disagrees with the Taxpayer's argument that The Taxpayer was an Owner-Builder. The Taxpayer deeded over his ownership share of the six lots to his wife so that she could obtain a loan by herself at an interest rate less than could be obtained with The Taxpayer as part owner. The Hearing Officer concludes that the Taxpayer cannot have it both ways. The property cannot be individually owned for loan purposes and jointly owned for construction purposes. In this case, the choice was made by The Taxpayer to deed over his ownership so that a lower interest rate could be obtained.

We must also disagree with the Taxpayer that The Taxpayer was acting as an agent of the owner and is not a taxable contractor. At a minimum, there would need to be evidence that The Taxpayer informed the various subcontractors that he was acting as an agent for the owners and thus the subcontractors would be liable for the tax. There was no such evidence presented. In fact, there was evidence that The Taxpayer on occasion represented himself as the general contractor for the project.

Based on the above, as well as the overall evidence presented, the Hearing Officer concludes that the Taxpayer was the taxable construction contractor for the Development project. Accordingly, the Taxpayer's protest of the City assessment is denied. We also conclude that the Taxpayer has provided reasonable cause for failing to timely pay his taxes and a waiver of the penalties is justified. Based on the Assignment form RST Hardware, it is appropriate for the Taxpayer to receive credit for taxes paid in the amount of \$3,024. As to the Assignment from DE Masonry, it appears as the Taxpayer may also be due an additional credit of \$1,562. We note that the City has opposed such a credit because the Assignment was for taxes paid to the City of Phoenix. We want to make it clear that if there is a dispute between the two Cities over taxes paid on the Development construction, the Taxpayer should not be part of that dispute pursuant to Model City Tax Code Section 565. In other words, if the taxes paid by DE Masonry to the City of Phoenix were for construction on Development, then the Taxpayer should receive credit for those taxes.

### **FINDINGS OF FACTS**

1. On April 12, 2002, the Taxpayer filed a Petition in response to an audit assessment issued by the City.

2. After review, the Hearing Officer ordered the City to file a response to the Petition on or before June 14, 2002.
3. On June 14, 2002, the City filed a request for an extension until June 21, 2002.
4. On June 18, 2002 the Hearing Officer granted the City's request.
5. The City filed its response on June 21, 2002.
6. On June 25, 2002, the Hearing Officer ordered the Taxpayer to file any reply on or before July 9, 2002.
7. On July 2, 2002, the Taxpayer requested an extension until July 23, 2002.
8. On July 8, 2002, the Hearing Officer granted the Taxpayer an extension until August 5, 2002.
9. The Taxpayer filed its reply on August 5, 2002.
10. The matter was set for hearing commencing on August 19, 2002.
11. The City and Taxpayer both appeared and presented evidence at the August 19, 2002 hearing.
12. On October 10, 2002, the Taxpayer filed a post-hearing brief.
13. On October 24, 2002, the City filed a response brief.
14. On November 7, 2002, the City filed a reply brief.
15. On November 22, 2002, the City filed an additional response.
16. On December 5, 2002, the Taxpayer filed an additional reply.
17. In 1996, the Taxpayers purchased the Property located in the City.
18. The Taxpayers planned to build single family units on the Property which initially would be rental units.
19. There was room for eleven lots on the Property.
20. The Taxpayers did not have the finances to do the entire development.
21. The development was named Development.

22. The Taxpayers contacted people to invest in Development.
23. The First Contributors contributed \$66,000 for a 2/11 interest in Development.
24. The Second Contributors contributed \$99,000 for a 3/11 interest in Development.
25. The Taxpayers contributed the land for a 6/11 interest in Development.
26. From July 1999 through September 2000, eleven single-family residential units were constructed on the Property.
27. At the time of construction, title to two of the units were in the name for the First Contributor.
28. Three of the units were in the name of the Second Contributors.
29. Six of the units were in the name of the Taxpayer's wife.
30. Each of the individuals secured their own construction financing with respect to the lots they owned.
31. The total construction cost of the eleven units was \$1,342,495.
32. On March 19, 2002, the City issued an assessment against the Taxpayer for the period of September 2000 to December 2001 for unreported construction contracting pursuant to Section 415.
33. The City issued an assessment for additional tax in the amount of \$14,152.81 plus penalties and interests.
34. Subsequently, the penalty for late payment was waived.
35. Prior to construction of the eleven units, The Taxpayer transferred his interest in six units to his wife.
36. The Taxpayer had no tax license number as a construction contractor and provided no tax license number to any contractors to obtain exempt goods or services.
37. The Taxpayer and his wife reported the Development properties and related income as individually owned, not partnership properties on the Federal income tax returns.
38. The Taxpayer's wife sold unit # 102 and retained all of the proceeds without sharing with the other "partners".
39. The Taxpayer quit claimed all of his interest to the six lots to his wife.

40. XYZ Management was the Taxpayer's management company.
41. The Taxpayer and/or XYZ Management entered into contracts with subcontractors and suppliers, purchased materials, signed all checks in payment of subcontractors and suppliers, and also supervised construction.
42. The Taxpayer and/or XYZ Management entered into a contract with JKL Concrete Inc., with XYZ Management designated as the contractor and JKL as the subcontractor.
43. The Taxpayer did not hold himself out as the agent of the owner in dealing with the various subcontractors.
44. The debt service on the outstanding mortgages remained an individual obligation.
45. The Taxpayer and/or XYZ Management received compensation as the contractor.

### **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 415 taxes construction contracting income.
3. The Taxpayer had no ownership in any of the lots at the time of the construction of Development.
4. Based on the evidence submitted, the Taxpayer was a taxable construction contractor on the improvements made on the Property.
5. The Taxpayer should receive credit for taxes paid to subcontractors/suppliers in connection with the construction on the Property where applicable Assignment and Waiver forms have been provided.
6. The Taxpayer's protest should be denied.

### **ORDER**

It is therefore ordered that the April 12, 2002 Petition for Hearing filed by the Taxpayer of a tax assessment issued by the City of Tempe is hereby denied consistent with the following ordering paragraphs.

It is further ordered that the City of Tempe shall waive all penalties.

It is further ordered that the City of Tempe shall credit the Taxpayer for taxes in the amount of \$3,024 paid by RST Hardware.

It is further ordered that the City of Tempe shall credit the Taxpayer for taxes in the amount of \$1,562 paid by DE Masonry if those taxes were paid to the City of Phoenix for construction of Development.

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

Jerry Rudibaugh  
Municipal Tax Hearing Officer