

Jerry Rudibaugh
Municipal Tax Hearing Officer
DECISION OF MUNICIPAL TAX HEARING OFFICER

Decision Date: November 6, 2002
Decision: MTHO #48
Tax Collector: City of Scottsdale
Hearing Date: September 24, 2002

DISCUSSION

Introduction

On May 22, 2002, *ABC, L.P.* (“ABC ” or “Taxpayer”) filed a protest of a tax assessment of the City of Scottsdale (“City”). After review, the City concluded on May 29, 2002 that the protest was timely and in proper form. On June 3, 2002, the Municipal Tax Hearing Officer (“Hearing Officer”) ordered the City to file a response to the protest on or before July 18, 2002. The City filed its response on to the protest on July 15, 2002. On July 18, 2002, the Hearing Officer ordered the Taxpayer filed any reply on or before August 1, 2002. The Taxpayer filed a reply on July 26, 2002. On August 12, 2002, the matter was scheduled for hearing commencing on September 12, 2002. At the request of the Taxpayer, the hearing was rescheduled for September 24, 2002. The Taxpayer and City both appeared and presented evidence at the hearing.

The Taxpayer was a partnership formed for the purpose of purchasing land, constructing, and operating a commercial rental building within the City. On April 15, 1998, the Taxpayer was issued a City building permit for a commercial shell at _____ (“Location”). During construction the Taxpayer was classified as an “owner builder” and paid taxes to the subcontractors. The building was leased in August 2000. The final site inspection for the building was approved on March 8, 2001. The improved property was sold on August 3, 2001 to Buyer Corporation (“Buyer”) for \$4.9 million. Subsequently, the City performed an audit of the Taxpayer and concluded the Buyer sale was a taxable sale as a speculative builder sale pursuant to City Code section 416 (“Section 416”). As a result, the City issued an assessment on April 11, 2002 for privilege tax in the amount of \$43,541.59 plus associated interest.

City Position

The City argued that the Location property was sold before the expiration of 24 months after the improvements were substantially complete. According to the City, the shell building would not meet the substantially complete definition of the City Code Section 100 (“Section 100”). Section 100 defines substantially complete as:

The “construction contracting or reconstruction contracting:

- 1) Has passed final inspection or its equivalent; **or**
- 2) Certificate of occupancy or its equivalent has been issued; **or**
- 3) Is ready for immediate occupancy or use.”

The City asserted that the final inspection of Location property occurred on March 9, 2001. According to the City, the Taxpayer had previously requested final site inspections on October 27 and 30, 2000 and February 1 and 6, 2001 and they were all rejected. The City indicated that a Certificate of Occupancy is issued when a structure is completed and deemed safe to occupy by the City. In this case, a Temporary Certificate of Occupancy was issued on March 9, 2001 after the final inspection. Further, the City argued that the Location property was not substantially complete as of August 27, 1999 because it was entered on the property tax roll as only 65 percent complete because it had no interior finish at that time. The City asserted that additional evidence that the property was not substantially complete in August 1999 was the fact that a building permit was issued on November 30, 2000 for \$278,037 of tenant improvements for the Location property. Lastly, the City asserted the Location property had no running water until February 2001. Based on the above, the City argued the Location property was not substantially complete until March 8, 2001 and thus the sale to Buyer on August 3, 2001 was within 24 months of the completion date. Accordingly, the City requested the tax assessment of the speculative builder sale be upheld.

Taxpayer Position

The Taxpayer asserted that on April 15, 1998 it pulled a building permit for the building of a shell building. According to the Taxpayer, a shell is approximately 65 percent complete compared to a totally built-out building. The Taxpayer indicated this was done because they did not know whether the building would be leased to a single tenant or multiple tenants. The Taxpayer argued that the shell building was completed on January 25, 1999. In support of its argument, the Taxpayer provided a Certificate of Substantial Completion (“Certificate”) from its architect dated January 25, 1999 as well as a letter from an independent architect of the lender indicating the shell portion of the project was 100 percent complete. After completion of the shell, the Taxpayer attempted to lease the building. On May 1, 1999, the Taxpayer entered into an agreement with JKL Real Estate Group, Inc. (“JKL”) which granted JKL the exclusive right to negotiate a lease for the shell property. JKL was unable to lease the property and on February 7, 2000 the Taxpayer entered into an agreement with DEF Commercial Real Estate Services Company (“DEF”), which granted DEF the exclusive right to negotiate a lease for, the shell property. DEF was successful in negotiating a lease with TENANT Corporation (“TENANT”). On July 28, 2000, TENANT took possession and control of the finished shell building. Subsequently, TENANT’s contractor Contractor Construction Co. (“Contractor”) pulled a permit on November 30, 2000 to build out the interior of the building shell. On March 8, 2001, the tenant improvement was completed and the City approved a Certificate of Occupancy. On August 3, 2001, the Taxpayer sold the building to Buyer. Based on the above, the Taxpayer argued that the speculative builder tax does not apply since there was over 24 months between the time the shell building was substantially complete and the sale of the building to Buyer.

ANALYSIS

Based on the evidence, the Hearing Officer concludes that the Taxpayer intended to build a shell building and lease it out. This conclusion is reached because the building permit specified it was for a shell building, the Taxpayer attempted to lease the shell building commencing on May 1,

1999, and the Taxpayer actually leased the shell building commencing on July 28, 2000. The primary issue presented in this case is whether or not a shell building can ever be substantially complete pursuant to Section 100. The improvements are substantially complete if one of the three prongs of Section 100 is met. Clearly, prong No. 2 could not be met by completion of the shell building because the City does not issue a Certificate of Occupancy until the interior is completed. By definition, the shell building interior is not completed. Also, prong No. 1 did not appear to be met, as there was no final inspection until March 12, 2001. That only leaves prong No. 3 on whether or not the shell building was ready for “immediate occupancy or use.” Generally, the City equated occupancy and use. Under the City’s argument, a shell building could never pass the test of being “substantially complete”. The Hearing Officer is unable to conclude that “immediate occupancy” and “use” are equivalent. We must conclude the drafters of the language had a purpose in their inclusion of “use” as well as occupancy. The evidence supports the Taxpayer’s assertion that the shell building was being built as their end product, which was then to be leased out to a third party to make whatever interior improvements they so desired.

Based on the evidence, we conclude that the shell building was substantially complete for its intended use on January 25, 1999 based on the Certificate from the Taxpayer’s architect and the corroboration from the independent architect of the lender. At that point, the Taxpayer had completed its end project and attempted to lease the shell building as is without completion of the interior. The Taxpayer was ultimately successful in negotiating a lease with TENANT who took possession of the shell building and began to make lease payments on the shell building. The Taxpayer made no improvements to the shell building either prior to entering the lease agreement or afterwards. The tenant, TENANT, made substantial improvements to the interior for its own use. Based on all the above, the Hearing Officer concludes that the Taxpayer constructed a ‘shell building on the Location property, which was substantially completed for its intended use on January 25, 1999. The Taxpayer made no additional improvements for the building to be leased out. As a result, the sale of the improved property on August 3, 2001 was after 24 months had expired since the Taxpayer substantially completed their improvements. Accordingly, the Taxpayer’s protest is granted as there was no speculative builder sale pursuant to Section 416.

FINDINGS OF FACT

1. On May 22, 2002, the Taxpayer filed a protest of a tax assessment of the City.
2. After review, the City concluded on May 29, 2002 that the protest was timely and in the proper form.
3. On June 3, 2002, the Hearing Officer ordered the City to file a response to the protest on or before July 18, 2002.
4. The City filed its reply on July 15, 2002.
5. On July 18, 2002, the Hearing Officer ordered the Taxpayer to file any reply on or before

August 1, 2002.

6. The Taxpayer filed a reply on July 26, 2002.
7. A hearing was held on September 24, 2002.
8. The Taxpayer was a partnership formed for the purpose of purchasing land, constructing, and operating a commercial rental building within the City.
9. On April 15, 1998, the Taxpayer was issued a City building permit for a commercial shell at Location.
10. During construction, the Taxpayer was classified as an “owner builder” and paid taxes to the subcontractors.
11. The Location property was sold to Buyer on August 3, 2001.
12. On April 11, 2002, the City assessed the Taxpayer as a speculative builder on the sale to Buyer for privilege tax in the amount of \$43,541.59.
13. A building shell is approximately 65 percent complete compared to a totally built-out building.
14. The Taxpayer provided a Certificate from its architect and a letter from an independent architect of the lender that the shell building was 100 percent complete on January 25, 1999.
15. On May 1, 1999, the Taxpayer entered into an agreement, which granted JKL the exclusive right to negotiate a lease for the shell building..
16. JKL was unable to lease the building and on February 7, 2000, the Taxpayer entered into an agreement, which granted DEF the exclusive right to negotiate a lease for the shell building.
17. On July 28, 2000, the Taxpayer entered into a lease agreement with TENANT and TENANT took possession of the shell building and began making lease payments to the Taxpayer.
18. Subsequently, TENANT’s contractor pulled a permit on November 30, 2000 to build out the interior of the building.
19. On March 8, 2001, the tenant improvement was completed and the City approved a Certificate of Occupancy.
20. A Certificate of Occupancy will not be issued for a shell building because the interior is not completed.

21. The Taxpayer intended to build a shell building and lease it out.
22. After completion of the shell building on January 25, 1999, the Taxpayer made no additional substantial improvements.
23. The Taxpayer leased out the shell building to TENANT as is without completion of the interior.

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. Section 416 taxes the gross income of speculative builders within the City.
3. Section 100 defines speculative builder as an owner-builder who sells or contracts to sell improved real property before the expiration of 24 months after the improvements of the real property sold are substantially complete.
4. Section 100 provides three alternative definitions of substantially complete.
5. The shell building was ready for its intended use on January 25, 1999.
6. The sale of the Location property on August 3, 2001, was after 24 months had expired since the Taxpayer had substantially completed their improvements of the real property.
7. The Location sale was not a speculative builder sale.
8. The Taxpayer's protest should be granted.

ORDER

It is therefore ordered that the May 22, 2002 protest filed by *ABC, L.P.* of a tax assessment of the City of Scottsdale is hereby granted.

It is further ordered that the City of Scottsdale shall revise its tax assessment by removal of the speculative builder assessment on the sale of the Location property.

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

Jerry Rudibaugh
Municipal Tax Hearing Officer