

DECISION OF MUNICIPAL TAX HEARING OFFICER

Decision Date: November 30, 2009

Decision: MTHO # 520

Taxpayer: *Mr. & Mrs. Taxpayer*

Tax Collector: City of Mesa

Hearing Date: October 20, 2009

DISCUSSION

Introduction

On April 18, 2009, a letter of protest was filed by *Mr. & Mrs. Taxpayer* (“Taxpayers”) of a tax assessment made by the City of Mesa (“City”). A hearing was commenced before the Municipal Tax Hearing Officer (“Hearing Officer”) on October 20, 2009. Appearing for Taxpayers were *Mr. Taxpayer* and *Mrs. Taxpayer*. Appearing for the City were *Tax Administrator*, *Tax Audit Supervisor*, and *Senior Tax Auditor*. At the conclusion of the October 20, 2009 hearing, the record was closed and the Hearing Officer indicated a written decision would be issued on or before December 5, 2009.

DECISION

The City conducted a non-audit compliance review of Taxpayers for the periods of July 2002 through November 2004 and January 2006 through February 2009. As a result of that review, the City assessed Taxpayers for additional taxes in the amount of \$7,700.59, interest up through March 2009 in the amount of \$1,625.65, penalties totaling \$1,899.76, and a license fee of \$50.00. Subsequently, Taxpayers provided a schedule of gross income for the assessment periods. After review, the City revised the assessment for additional taxes of \$5,264.48, interest up through March 2009 of \$983.27, penalties of \$1,293.86, and a license fee of \$50.00.

During the assessment periods, Taxpayers owned seven residential rental properties at various times. City Code Section 5-10-445 (“Section 445”) imposes a tax on the gross income from the business activity upon each person engaging in the business of leasing or renting real property located within the City. Subsection 445(f) provided that a person who has less than three residential apartments or houses for rent is not deemed to be in the rental business. Effective October 1, 2008, the number of units was changed in Subsection 445(f) from three to two. City Code Section 5-10-100 (“Section 100”) defines a “person” as an individual, partnership, joint venture, etc. For each of the seven properties, Taxpayers recorded the deed in both their names. In their protest, Taxpayers asserted the deeds were recorded in both names due to legalities. Taxpayers argued both parties functioned as distinct and separate individuals pursuant to the definition of a

“person” set forth in Section 100. Taxpayers further argued that during the majority of the assessment period, two properties were rented by *Mrs. Taxpayer* and two were rented by *Mr. Taxpayer* which qualified Taxpayers for the exemption for having less than three rental units within the City.

While *Mrs. Taxpayer* and *Mr. Taxpayer* could each act as an individual pursuant to Section 100, they could also act jointly as an association pursuant to Section 100. In this case, we conclude Taxpayers acted jointly as an association. There was no dispute that each of the deeds for the rental properties listed Taxpayers as the joint owners. Taxpayers acknowledged that both *Mrs. Taxpayer* and *Mr. Taxpayer* are obligated on loans to their bank on the rental properties. Taxpayers also acknowledged that both *Mrs. Taxpayer* and *Mr. Taxpayer* would have to sign any agreements to sell any of the rental properties. Taxpayers have provided no evidence that any of the properties were purchased with separate monies and no evidence that the income from any of the properties were reported separately for federal income tax purposes. As a result, we conclude that Taxpayers have failed to prove any of the properties were owned and operated separately by either individual. We further conclude that during the period of July 2002 through November 2004, Taxpayers owned three residential rental properties. During the period of January 2006 through February 2009, Taxpayers owned at least three residential rental properties. Based on the above, Taxpayers were in the business of leasing or renting real property located within the City during those time periods.

Taxpayers also made an argument that they had numerous expenses for which the City did not allow as deductions. We don’t dispute that Taxpayers had numerous expenses that were not deducted. Unfortunately for Taxpayers, Section 445 imposes a tax on the gross income. Accordingly, the numerous expenses can not be deducted.

Since Taxpayers failed to file any reports during the assessment periods, the City was authorized pursuant to City Code Section 5-10-545 (“Section 545”) to estimate the taxable gross income. The burden is on Taxpayers pursuant to Section 545 to prove the City’s estimate was not reasonable. In this case, Taxpayers provided a schedule of gross income for the assessment periods. After review, the City agreed with Taxpayers schedule. Accordingly, it was proper for the City to revise the assessment to reflect the actual gross income.

Since Taxpayers failed to file reports or timely pay taxes, the City was authorized pursuant to City Code Section 5-10-540 (“Section 540”) to assess penalties. Those penalties may be waived when a taxpayer demonstrates reasonable cause. Taxpayers provided sworn testimony they were unaware of the tax on their rental properties until they received the City’s assessment. Taxpayers also provided sworn testimony that they did not intend to have so many residential properties but they were unable to sell them because of the downturn in the housing market. Based on the above, we conclude Taxpayers have demonstrated reasonable cause to have all penalties waived. Taxpayers protest should be denied, with the exception of the penalties, consistent with the Discussion, Findings, and Conclusions, herein.

FINDINGS OF FACT

1. On April 18, 2009, Taxpayers filed a protest of a tax assessment made by the City.
2. The City conducted a non-audit compliance review of Taxpayers for the periods of July 2002 through November 2004 and January 2006 through February 2009.
3. The City assessed Taxpayers for additional taxes in the amount of \$7,700.59, interest up through March 2009 in the amount of \$1,625.65, penalties totaling \$1,899.75, and a license fee of \$50.00.
4. Subsequently, the City reviewed additional documentation from Taxpayers and recommended the assessment be revised to additional taxes in the amount of \$5,264.48, interest up through March 2009 in the amount of \$983.27, and penalties totaling \$1,293.86, and a license fee of \$50.00.
5. During the assessment periods, Taxpayers owned seven residential rental properties at various times.
6. For each of the seven properties, Taxpayers recorded the deed in both their names.
7. Taxpayers have provided no evidence that the properties were purchased with separate monies and no evidence that the income from any of the properties were reported separately.
8. Taxpayers acknowledged that both *Mrs. Taxpayer* and *Mr. Taxpayer* are obligated on loans to their bank on the rental properties.
9. Taxpayers also acknowledged that both *Mrs. Taxpayer* and *Mr. Taxpayer* would have to sign any agreements to sell the rental properties.
10. During the period of July 2002 through November 2004, Taxpayers owned three residential rental properties.
11. During the period of January 2006 through February 2009, Taxpayers owned at least three residential rental properties.
12. Taxpayers were unaware of the tax on their rental properties until they received the City's assessment.
13. Taxpayers were unable to sell any of the residential properties because of the downturn in the housing market.

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 445 imposes a tax on the gross income from the business of renting real property for a consideration.
3. Subsection 445(f) provided that a person engaging in the business of leasing or renting real properties who has less than three apartments or houses for rent is not deemed to be in the rental business.
4. Effective October 1, 2008, Subsection 445(f) was changed from three units to two units.
5. Section 100 defines a person as an individual, partnership, association, joint venture, etc.
6. During the assessment periods, Taxpayers acted jointly as an association.
7. Taxpayers have failed to prove any of the rental properties were owned and operated separately by either *Mrs. Taxpayer* or *Mr. Taxpayer*.
8. During the assessment periods, Taxpayers were in the business of leasing or renting real properties within the City.
9. Since Taxpayers failed to file reports, the City was authorized pursuant to Section 545 to estimate Taxpayer's taxable income.
10. It was proper for the City to revise the assessment after review of additional information provided by Taxpayers.
11. Since Taxpayer failed to timely file reports or timely pay taxes, the City was authorized pursuant to Section 540 to assess penalties.
12. Taxpayer has demonstrated reasonable cause for failing to file and failing to timely pay taxes.
13. All the penalties in this matter should be waived.

14. Taxpayer's protest should be denied, except for the penalties, consistent with the Discussion, Findings, and Conclusions, herein.

ORDER

It is therefore ordered that the April 19, 2009 protest by *Mr. Taxpayer & Mrs. Taxpayer* of a tax assessment made by the City of Mesa is hereby partly denied and partly granted, consistent with the Discussion, Findings, and Conclusions, herein.

It is further ordered that the City of Mesa shall remove all penalties assessed in this matter.

It is further ordered that this Decision is effective immediately.

Jerry Rudibaugh
Municipal Tax Hearing Officer