

DECISION OF MUNICIPAL TAX HEARING OFFICER

July 5, 2011

Taxpayer's Representative's name
Address of Taxpayer's representative

Taxpayer
MTHO # 600

Dear Taxpayer Representative:

We have reviewed the evidence and arguments presented by *Taxpayer* and the City of Mesa (Tax Collector or City) at the hearing on May 25, 2011. The review period covered was October 2003 through September 2009. Taxpayer's protest, Tax Collector's response, and our findings and ruling follow.

Taxpayer's Protest

Taxpayer owns real property in the City of Mesa and leases the property to *Company A* for the operation of an assisted living facility. Taxpayer was assessed City privilege tax under the real property rental classification for its lease of the property to *Company A*.

The City privilege tax is imposed on the person leasing or licensing real property to the tenant in actual possession. *Company A* is not the tenant in actual possession. *Company A* leases apartment units to its tenants who reside at the facility. *Company A* is in the business of leasing or licensing the property to the tenant in actual possession. Taxpayer's lease to *Company A* is a non-taxable lease for re-lease.

Tax Collector's Response

Company A is an assisted living center licensed by the Arizona Department of Health Services to provide personal care services. *Company A* uses the property in its business of providing room and personal care services to its residents. Because *Company A* uses the property in its business, it is not in the business of re-leasing the property to the residents. Taxpayer's lease to *Company A* is a lease to the tenant in actual possession and is therefore taxable.

In the alternative, even if *Company A* were considered to be leasing the rooms to the residents, it is only leasing the rooms and not the related common areas or kitchen facilities, administrative offices and other areas used by *Company A*. *Company A* is in possession of those areas. The lease of those areas by Taxpayer is a taxable lease to the tenant in actual possession.

Discussion

Taxpayer owns real property in the City and leases the property to *Company A*. *Company A* operates an assisted living facility (Facility) on the property. The Facility is comprised of 112

apartment units, common areas (such as a lounge, swimming pool, restaurant, hallways and elevator space) and areas that do not appear to be accessible to the residents (such as the kitchens, a front desk, maintenance room, janitor's area and storage areas.)

The residents of *Company A* occupy individual apartment units under an agreement called "*Company A* Assisted Living Month To Month Rental Agreement." Under the terms of the Agreement, *Company A* provides living accommodations to each resident in a designated apartment with elevator service where necessary, security, central cable TV hookup and utilities other than telephone. The apartment units have an electric range (which may be disconnected), refrigerator/freezer, carpeting or tile and vertical blinds.

Company A also provides three meals per day served in the restaurant, weekly housekeeping service, a program of recreational, educational and cultural opportunities designed to enhance the physical and social well being of the residents, scheduled transportation within a five mile radius and an emergency call system in each unit. *Company A* will coordinate emergency responses when called upon to do so and provide general health observations of the resident to the extent of making a reasonable effort to be aware of any change in the health needs of the resident.

Company A is licensed by the Arizona Department of Health Services to provide personal care services to the residents. Personal care services are defined as assistance with activities of daily living that can be performed by persons without professional skills or professional training and includes the coordination or provision of intermittent nursing services and the administration of medications and treatments by a licensed nurse.

Mesa Tax Code (MTC) § 5-10-445 imposes the City privilege tax on the business activity of renting, leasing or licensing for use real property located in the City to the tenant in actual possession or to the final licensee for a consideration. The Tax Collector conducted an audit assessment of Taxpayer for the period October 2003 through September 2009 and assessed Taxpayer city privilege tax for the lease of its property to *Company A*. The Tax Collector considered Taxpayer's lease to be to the tenant in actual possession of the property because *Company A* is a licensed assisted living center. *Company A* uses the property in its business of providing personal care services to its residents. Therefore Taxpayer's lease to *Company A* is to the tenant in actual possession and is taxable.

Taxpayer timely protested the assessment contending that its lease is not taxable because *Company A*, Taxpayer's tenant, leases the property to its residents, who are the tenants in actual possession. Therefore Taxpayer's lease is not to the tenant in actual possession and is not taxable. Taxpayer also argues that even if it were taxable, the penalty that was assessed should be abated.

In response to Taxpayer's protest, the Tax Collector argues in the alternative that, even if *Company A* were considered to be leasing the rooms to its residents, it is only leasing the rooms and not the related common areas, kitchen facilities and administrative offices. *Company A* is in possession of those areas. The lease of those areas to *Company A* by Taxpayer is a taxable lease to the tenant in actual possession.

***Company A* is Leasing the Apartment Units to the Residents.**

Whether Taxpayer is leasing the property to the tenant in actual possession depends on the nature of *Company A's* arrangement with its residents. Assisted living facilities occupy a middle position on a continuum extending from apartment buildings at one end and nursing homes on the other. We will take notice that in a typical lease of an apartment unit, little if any personal service is provided by the landlord. Nursing homes provide care for the individual, who is more a patient than a resident. "Nursing care institution" is defined in A.R.S. § 36-401.A.31. as a health care institution that provides inpatient beds or resident beds and nursing services to persons who need continuous nursing services but who do not require hospital care or direct daily care from a physician.

The question presented is whether *Company A's* arrangement with its residents is more analogous to the rental of an apartment or providing nursing services at a nursing care institution. Based on the record before us, we must conclude that in this case the arrangement between *Company A* and its residents is more analogous to the rental of an apartment that includes certain personal services. *Company A's* residents live in the apartment units. They do not need continuous nursing services, only some intermittent services at most. In fact, the resident must be physically and mentally capable of evacuating the Facility unassisted in the case of an emergency. *Company A* is not designed as a lock-down facility and residents may leave the premises.

The Agreement provides that the apartment shall be used and occupied by the resident as a private residence. The apartment units have central cable TV hookup available, utilities other than telephone and a kitchen. Residents may keep small domestic household pets (for an additional pet fee) provided they can take care of the pet. Parking for resident's automobile is available on a first come, first serve basis. Scheduled transportation within a five-mile radius is provided.

The apartment units have locking doors. A resident can exclude other residents and their guests from his apartment. *Company A* may enter a resident's apartment but only at reasonable times for inspection, pest control or maintenance or at any time in the case of an emergency. While certain personal care services may be provided, the primary purpose of the apartment unit is to serve as the home of the resident. Because the apartment units are leased by *Company A* to its residents, Taxpayer is not leasing the area occupied by the apartment units to the tenant in actual possession.

Taxpayer leased the Areas Other than the Apartment Units to the Tenant in Actual Possession.

The Tax Collector contends in the alternative that even if *Company A* considered to be leasing the apartment units to the residents, *Company A* is only leasing the units and not the common areas, kitchen facilities, administrative offices and other such areas. *Company A* is in possession of those areas and the lease of those areas by Taxpayer is a lease to the tenant in actual possession. Taxpayer argues that the common areas are for the use of the residents and therefore are a part of *Company A's* lease to the tenant in actual possession.

There are two areas that are not a part of the apartment units:

- other areas that would not appear to be accessible to the residents, such as the kitchens, storage and maintenance areas, the front desk and any administrative areas.
- the common areas that are accessible to the residents such as hallways, elevators, the restaurant and lounge.

The lease of areas that are not accessible to the residents is a lease to *Company A* for its use and is taxable.

Taxpayer's lease of the common areas to *Company A* is also taxable. While common areas are accessible to the residents, they remain under *Company A's* control. The Agreement does not address the common areas or give the residents any control of those areas. Generally, common areas are defined as those parts of the premises that are used by all the tenants, but the landlord retains control and is responsible to maintain in a reasonably safe condition; for example, an elevator, hallway, or stairway. The record does not indicate that *Company A* has given the residents control over the common areas. Therefore *Company A* is the tenant in possession of the common areas.

The record before the Hearing Office shows information regarding the area of the buildings.¹ The total square footage of the Facility is 78,587 square feet. The total square footage for all of the apartment units is 56,350 square feet. The square footage of the apartment units represents 71.70% of the total square footage. Therefore during the review period we have determined that 71.70% of Taxpayer's receipts are not from leasing to the tenant in actual possession and 28.30% of Taxpayer's receipts are taxable as leases to the tenant in actual possession.²

Other Arguments

The Tax Collector contends that *Company A* is prohibited from giving up actual possession of any portion of the facility under administrative rules promulgated by the Arizona Department of Health. A.A.C. R9-10-105.A.2., relating to initial license applications for health a care institution license, requires a copy of the lease for leased premises "... showing the rights and responsibilities of the parties and exclusive rights of possession of the leased facility.

The rule relates to the agreement between the health care institution and its landlord (*Company A* and Taxpayer here). The rule does not discuss the arrangement between the health care institution and its residents. In fact, the Health Department provisions contemplate the use of private apartments. See, A.R.S. § 36-401.A.38. The Department of Health rules require that a residential unit have an individually keyed entry door and that a key be provided to the resident or the resident's representative. R9-10-720.C.1.b.³ Therefore, the Department of Health rules do not preclude *Company A* from leasing the apartment units to its residents.

¹ The exhibits did not indicate the square footage of the entire property.

² This allocation may differ in subsequent periods if the area of the total property is considered.

³ The rule does provide that an employee will have a key and access to the unit at all times. However, the rule does not allow the unit to be accessed at any time for no reason.

The Tax Collector argued that *Tempe Life Care Village, Inc., v. City Of Tempe*, 148 Ariz. 264, 714 P.2d 434 (App. 1985) is not applicable because it was decided before the enactment of the Model City Tax Code and the case primarily involved the question whether Tempe Life Care was in business. While the question whether Tempe Life Care was engaged in business was the first issue addressed, the court also considered whether Tempe Life Care was leasing housing to its residents. *See*, 148 Ariz. at 270, 714 P.2d at 440.

Even though *Tempe Life Care* was decided before the Model City Tax Code, both the Model City Tax Code and the Tempe code at the time *Tempe Life Care* was decided taxed the business of renting or leasing real property for a consideration. Therefore *Tempe Life Care* is instructive.

The Tax Collector also cited *Marwood Rest Home, Inc. v. City of Philadelphia Tax Review Board*, 112 Pa.Cmwth. 240, 535 A.2d 281 (1987) arguing that a lease to a nursing home was taxable. The tax in *Marwood* was a use and occupancy tax imposed on the use or occupancy of real estate for the purpose of carrying on a business. The tax is imposed on the user or occupier of real estate. An exemption was provided for real estate used or occupied as the dwelling or principal place of residence of the user or occupier.

The court held that the exemption for using the property as a residence applied to the person subject to the tax. To illustrate the scope of the tax and the exemption, the court gave the example of a piano teacher who gives lessons in his home. The teacher is using real estate for the purpose of conducting a business or occupation, and thus becomes subject to the tax. The exemption applies, however, to the portion of the real estate that the teacher uses as his dwelling or principle place of residence. *Marwood* was not using any of the property for its residential purposes. It was using the property for a business purpose and was therefore taxable.

The court also discussed that the patients in *Marwood* had limited control over their living quarters. *Marwood* employees provided meals and laundry service, changed beds, gave baths, administered medication, etc. Most of the rooms were semi-private and assignments to the rooms were made by *Marwood*, which reserved to itself the authority to change room assignments at any time. The court considered the totality of these circumstances to conclude that *Marwood* was the actual user or occupier of the premises. The residents at ***Company A*** have significantly more control over their living quarters.

Taxpayer cited *Tempe Life Care* for its holding that the nursing home in that case was held to be engaged in the business of leasing.⁴ Neither *Tempe Life Care* nor *Marwood* is dispositive. Each case dealt with a different circumstance. In the end, whether a health care facility providing any level of care to its residents or patients is leasing the premises or primarily providing a service will depend on the facts and circumstances of each case. Based on the record in this case, ***Company A*** is leasing the apartment units to its residents, the tenants in actual possession. While the answer might be different if ***Company A*** were a nursing home providing a different level of service, that is not the circumstance here.

⁴ *Tempe Life Care* was cited in this decision for its definition of the term lease or rent, and not for its holding that a nursing home is engaged in the business of leasing.

The proposed assessment included a penalty for failure to file and to pay tax. The penalty for failure to file and to pay tax may be waived if the taxpayer can demonstrate reasonable cause for its failure to file a return or pay the tax. Given the holding of the *Tempe Life Care* case, that MTC § 5-10-445(q) excludes from the operation of the tax certain assisted living facilities (implying they would be taxable otherwise) and the unique nature of the issue presented, Taxpayer has shown reasonable cause for its failure to file a return and pay the privilege taxes to the City.

Based on all the above, we conclude Taxpayer's protest should be granted in part and denied in part. The City's privilege tax assessment against Taxpayer was not proper for the lease of the area occupied by the apartment units, representing 71.70% of Taxpayer's receipts. The City's assessment was proper for the lease of areas not occupied by the apartment units representing 28.30% of Taxpayer's receipts. The failure to file and failure to pay tax penalties are waived.

Findings of Fact

1. Taxpayer owns real property containing improvements in the City.
2. Taxpayer leased the property to an operator of an assisted living facility ("Facility") known as *Company A* Retirement Community ("*Company A*").
3. Greenfields is licensed by the Arizona Department of Health Services to operate an assisted living facility that provides personal care services.
4. Each resident of *Company A* enters into an agreement called *Company A* Assisted Living Month To Month Rental Agreement ("Agreement").
5. Under the terms of the Agreement, *Company A* provides:
 - a. Living accommodations in a designated apartment with elevator service where necessary, security, central cable TV hookup and utilities other than telephone.
 - b. Furnishings consisting of electric range, refrigerator/freezer, carpeting or tile and vertical blinds,
 - c. Three meals per day,
 - d. Weekly housekeeping service,
 - e. A program of recreational, educational and cultural opportunities designed to enhance the physical and social well being of the residents,
 - f. Scheduled transportation within a five mile radius,
 - g. An emergency call system in each unit and coordination of emergency responses when called upon to do so,
 - h. General health observations of the resident to the extent of making a reasonable effort to be aware of any change in the health needs of the resident.
6. Small domestic household pets may be kept for an additional pet fee.
7. Parking for a resident's automobile is available on a first come, first serve basis.

8. The Agreement provides that the apartment shall be used and occupied by the resident as a private residence and shall not be used for the purpose of carrying on any business, profession or trade of any kind, or for any purpose other than a private residence.
9. **Company A** may enter a resident's apartment at reasonable times for the purpose of inspection, pest control or maintenance.
10. **Company A** may enter a resident's apartment at any time in the case of an emergency.
11. The resident must be physically and mentally capable of evacuating the Facility unassisted in the case of an emergency.
12. A resident is required to use the locks and locking devices provided with the apartment.
13. **Company A's** policy is to check all rooms at least once each shift unless the resident signs a room check waiver.
14. All of the residents are elderly and have some need for assistance.
15. **Company A** is not designed as a lock-down facility and residents may leave the premises.
16. If a resident's needs cannot be met by the assisted living program of services offered by **Company A** then the resident may be required to vacate the apartment unit.
17. The Facility is comprised of apartment units, common areas, kitchens, restaurant, a front desk, laundry facilities, a lounge, maintenance room, elevator space, janitor's area and storage areas. Exhibit 11.
18. The Facility has 112 apartment units ranging from studio apartments to two bedroom apartments. Exhibit 11.
19. The square footage for the apartment units ranges from 400 square feet to 650 square feet. Exhibit 11.
20. The total square footage for all of the apartment units is 56,350 square feet. Exhibit 11.
21. The total square footage of the Facility is 78,587. Exhibit 11.
22. Based on the record in this case, the square footage of the apartment units represents 71.70% of the total square footage of the Facility.
23. The Tax Collector conducted an audit assessment of Taxpayer for the period October 2003 through September 2009 and assessed Taxpayer City privilege tax under the commercial lease or licensing of real property classification.
24. The assessment resulted in a privilege tax liability in the amount of \$58,275.56, \$14,568.85 in penalties and \$13,598.91 in interest (thru June 2010) for a total assessment of \$86,553.32.
25. The Tax Collector considered Taxpayer's lease to **Company A** to be a lease to the tenant in actual possession of the property.
26. Taxpayer timely protested the assessment contending that its lease is not taxable because **Company A**, Taxpayer's tenant, subleases the property to its residents, who are in the actual possession of the property.
27. The parties did not request post-hearing memoranda and the record closed at the conclusion of the hearing on May 25, 2011.

Conclusions of Law

1. MTC § 5-10-445 imposes a privilege tax on the business activity of renting, leasing or licensing for use real property located in the City to the tenant in actual possession or to the final licensee for a consideration.
2. "Assisted living center" means an assisted living facility that provides resident rooms or residential units to eleven or more residents. A.R.S. § 36-401.A.7.
3. "Assisted living facility" means a residential care institution, including an adult foster care home, that provides or contracts to provide supervisory care services, personal care services or directed care services on a continuous basis. A.R.S. § 36-401.A.8.
4. "Personal care services" means assistance with activities of daily living that can be performed by persons without professional skills or professional training and includes the coordination or provision of intermittent nursing services and the administration of medications and treatments by a nurse who is licensed pursuant to Title 32, Chapter 15 or as otherwise provided by law. A.R.S. § 36-401.A.35.
5. "Directed care services" means programs and services, including supervisory and personal care services, that are provided to persons who are incapable of recognizing danger, summoning assistance, expressing need or making basic care decisions. A.R.S. § 36-401.A.14.
6. "Nursing care institution" means a health care institution that provides inpatient beds or resident beds and nursing services to persons who need continuous nursing services but who do not require hospital care or direct daily care from a physician. A.R.S. § 36-401.A.31.
7. "Nursing services" means those services that pertain to the curative, restorative and preventive aspects of nursing care and that are performed at the direction of a physician by or under the supervision of a registered nurse licensed in this state. A.R.S. § 36-401.A.32.
8. "Residential care institution" means a health care institution other than a hospital or a nursing care institution that provides resident beds or residential units, supervisory care services, personal care services, directed care services or health-related services for persons who do not need continuous nursing services. A.R.S. § 36-401.A.37.
9. "Residential unit" means a private apartment, unless otherwise requested by a resident, that includes a living and sleeping space, kitchen area, private bathroom and storage area. A.R.S. § 36-401.A.38.
10. Residents in an assisted living facility have the right to request to relocate or refuse to relocate within the facility based upon the resident's needs, desires, and availability of such options. A.A.C. R9-10-710.D.11.
11. A lease is a contract for the possession and profits of tenements and land, either for life, for a certain period of time or during the pleasure of the parties. *Tempe Life Care Village, Inc., v. City Of Tempe*, 148 Ariz. 264, 714 P.2d 434 (App. 1985); *Joy Enterprises, Inc. v. Reppel*, 112 Ariz. 42, 537 P.2d 591 (1975).

12. Statutes imposing taxes are to be strongly construed against the government and in favor of the taxpayer. Any doubts as to the meaning of the statute are to be resolved against the tax authority. *Wenner v. Dayton-Hudson Corp.* 123 Ariz. 203, 208, 598 P.2d 1022, 1027 (App. 1979).
13. **Company A** leases or rents the apartment units to the residents under the Agreement.
14. Taxpayer is not leasing the area occupied by the apartment units to the tenant in actual possession.
15. "Licensing (for Use)" is defined as any agreement between the user ("licensee") and the owner or the owner's agent ("licensor") for the use of the licensor's property whereby the licensor receives consideration, where such agreement does not qualify as a "sale" or "lease" or "rental" agreement. MTC § 5-10-100.
16. Under Arizona Department of Health Services rules "Common areas" are defined as portions of a facility or facility grounds accessible to residents. A.A.C. R9-10-701.23.
17. Common areas are those parts of the premises that are used by all the tenants, of which the landlord retains control and is responsible to maintain in a reasonably safe condition; for example, an elevator, hallway, or stairway. *Webster's New World Law Dictionary*, Copyright 2010. See also *Jackson v. Cartwright School District*, 125 Ariz. 98, 103 607 P.2d 975, 980 (App. 1980).
18. **Company A** does not lease, rent or license the common areas, kitchens, restaurant, front desk, laundry facilities, lounge, maintenance room, elevator space, janitor's area, storage areas or other similar areas to the residents.
19. The City's privilege tax assessment against Taxpayer was not proper with respect to the assessment of privilege tax on the lease of the residential apartment units leased to the residents.
20. The City's privilege tax assessment against Taxpayer was proper with respect to Taxpayer's lease of areas other than the apartment units.
21. Taxpayer is subject to the City's privilege tax under MTC § 5-10-445 on 28.30% of its gross receipts from its lease to Greenfields.
22. The penalty for failure to file and to pay tax may be waived if the taxpayer demonstrates reasonable cause for its failure to file a return or pay the tax. MTC § 5-10-540.
23. Taxpayer demonstrated reasonable cause for its failure to file a return and to pay the tax that was assessed and the penalties for failure to file and failure to pay are abated.

Ruling

The August 12, 2010 protest by Taxpayer of an assessment made by the City of Mesa for the period October 2003 through September 2009 is granted in part and denied in part consistent with Conclusions of Law numbers 19 through 21 and 23.

The Tax Collector shall remove from the assessment 71.70% of Taxpayer's gross receipts from its lease to **Company A** and shall also remove the penalties for failure to file and pay the tax.

Both parties have timely rights of appeal to the Arizona Tax Court pursuant to Model City Tax Code Section –575.

Sincerely,

Hearing Officer

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c: ***City of Mesa***
Municipal Tax Hearing Office