DECISION OF MUNICIPAL TAX HEARING OFFICER

Decision Date: August 29, 2011
Decision: MTHO # 622
Tax Collector: City of Phoenix
Hearing Date: July 12, 2011

DISCUSSION

Introduction

On December 3, 2010, a letter of protest was filed by ***("Taxpayer")*** of a tax assessment made by the City of Phoenix ("City"). A hearing was commenced before the Municipal Tax Hearing Officer ("Hearing Officer") on July 12, 2011. Appearing for the City were Assistant City Attorney, Senior Tax Auditor, and Tax Auditor. Appearing for Taxpayer was a ***Representative***. On July 13, 2011, the Hearing Officer indicated the record was closed and a written decision would be issued on or before August 29, 2011.

DECISION

On April 18, 2011, the City issued a tax & licensing billing statement to Taxpayer in the amount of $225,496.70 in taxes due. The assessment was based on the rental receipts received by Taxpayer from January 2004 through September 2010.

Taxpayer is the owner of real property located at ***123 W Phoenix Ave*** in the City. ***Company A*** entered into a lease agreement with Taxpayer and had a building constructed on the vacant land. Taxpayer and ***Company A*** are affiliated as both are substantially owned by a California ***limited partnership***. The ***limited partnership*** owns more than 80% of the voting stock of ***Company A*** and more than 80 % of the member interests in Taxpayer.

Taxpayer disputed the City's conclusion that it was "engaged in business". Taxpayer relied on the Arizona appellate decisions in Construction Developers, Inc. v. City of Phoenix, 194 Ariz. 165, 978 P.2d 650 (App. 1999 and/or Arizona Tax Commission v. First Bank Building Corp., 5 Ariz. App. 594, 429 P.2d 481 (1967). Taxpayer argued that the mere receipt of monies and/or the relief from an obligation (e.g., payment of a mortgage or payment of ad valorem real property taxes) cannot, without more, be deemed to be in reality something it is not.
The City disputed Taxpayer's reliance on the Construction Developers case and the First Bank Building case. The City noted that City Code Section 14-100 ("Section 100")

defines "business" as follows: Business means all activities or acts, personal or corporate, engaged in and caused to be engaged in with the object of gain, benefit or advantage, either direct or indirect, but not casual activities or sales. The City asserted that the issue in this case was whether Taxpayer was engaged in an activity or an act that provided it with any direct or indirect gain, benefit or advantage. The City argued that businesses do not engage in activities without a reason. According to the City, businesses do not incur costs that provide it with no direct or indirect advantage.

Taxpayer noted that on May 7, 2010, House Bill 2510 was signed into law amending A.R.S. Section 42-6004 ("Section 6004"). Taxpayer argued that the amended Section 6004 shows a legislative intent that when two companies are in a lessor/lessee relationship and both are owned at least 80% by the same company, the lessor does not have to pay taxes on its lease income. In this case, Taxpayer and ***Company A*** are "affiliated" as each is more than 80% owned by the same entity. Taxpayer noted that A.R.S. Section 43-104 defines corporation as follows: "Corporation" means a corporation, joint stock company, bank, insurance company, business trust or so called Massachusetts Trust, investment company or building and loan association and any other association whether incorporated or unincorporated." As a result, Taxpayer asserted that both Taxpayer and ***Company A*** are statutorily deemed "corporations" and Taxpayer's gross rental receipts from ***Company A*** are exempt from any City transaction privilege tax statute.

The City did not dispute that the amended Section 6004 exempted certain affiliated corporations from the privilege tax. However, the City argued that Taxpayer is not a corporation and so the provision is inapplicable to Taxpayer's lease. Since Section 6004 did not have any special definition for "corporation", the City asserted it must have its normal meaning. The City referred to the statutes that create corporations which are found in Title 10. The definition in Title 10 defines a "corporation" to mean a corporation for profit that is not a foreign corporation and that is incorporated under or subject to chapters 1 through 17 of this title. As a result, the City concluded the exemption in Section 6004 does not apply to limited liability companies.

As noted above, "business" is broadly defined in Section 100. In this case, Taxpayer was formed as a limited partnership which then purchased real property. Taxpayer then entered into a lease agreement with ***Company A*** and collected monthly rental payments. We concur with the City that business arrangements such as setting up the limited partnership are done for a purpose. In this case, Taxpayer is engaged in activities of owning real estate and receiving lease payments which would provide substantial gain, benefit, and advantage as set forth in Section 100. We note that the Court in the Construction Developers case concluded that it could not sustain the City's assessment unless the Court could also determine that CDI leased to Dillard's for a consideration. In this case, we have such a lease in place. In the First Bank Building case, the Court concluded that the Plaintiff was organized for the purpose of doing business and was engaged in such activities by acquiring property, erecting buildings, executing leases and collecting rents. In doing so, First Bank was exercising corporate powers, taking in substantial gross receipts which benefit the corporation. The Court then considered

separately whether First Bank was involved in the business of renting of office buildings and the operation of parking garages. As a result, we concur with the City that the facts in the First Bank Building case are distinguishable from this case. Clearly, Taxpayer and ***Company A*** were separate persons pursuant to Section 100. Consequently, the transaction between Taxpayer and ***Company A*** resulted in the business of leasing or renting of real property in the City pursuant to Section 445. Based on all the above, we conclude Taxpayer's protest should be denied.

FINDINGS OF FACT

1. On December 3, 2010, Taxpayer filed a protest of a tax assessment made by the City.

2. On April 18, 2011, the City issued a tax & licensing billing statement to Taxpayer in the amount of $225,496.70 in taxes due.

3. The assessment was based on the rental receipts received by Taxpayer from January 2004 through September 2010.

4. Taxpayer is the owner of the ***123 W Phoenix Ave*** located in the City.

5. ***Company A*** entered into a lease agreement with Taxpayer and had a building constructed on the vacant land.

6. Taxpayer and ***Company A*** are affiliated as both are substantially owned by a ***limited partnership.***

7. ***Limited partnership*** owns more than 80% of the voting stock of ***Company A*** and more than 80% of the member interests in Taxpayer.

8. Taxpayer received monthly rentals from ***Company A*** during the period from July 2004 through September 2010.

.

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 activity of commercial rental.

3. Taxpayer and ***Company A*** were separate "persons" pursuant to Section 100.

4. Taxpayer was formed for a business purpose which included engaging in activities of owning real estate and receiving lease payments which would provide substantial gain, benefit, and advantage for its partners as set forth in Section 100.

5. During the assessment period, Taxpayer was in the business of leasing and renting real property within the City for a consideration pursuant to Section 445.

6. The facts in the Construction Developers and the facts in the First Bank Building case are distinguishable from the facts in this matter.

7. Section 6004 was amended on May 7, 2010 to provide an exemption for certain affiliated corporations from the privilege tax.

8. The Section 6004 exemption is only for corporations.

9. Taxpayer is a limited partnership and does not qualify as a corporation pursuant to Section 6004.

10. Taxpayer's December 3, 2010 protest should be denied, consistent with the Discussion, Findings, and Conclusions, herein.

ORDER

It is therefore ordered that the December 3, 2010 protest by ***taxpayer*** of a tax assessment made by the City of Phoenix should be denied consistent with the Discussion, Findings, and Conclusions, herein.

Taxpayer has timely rights of appeal to the Arizona Tax Court pursuant to Model City Tax Code Section-575.

It is further ordered that this Decision is effective immediately.

Jerry Rudibaugh
Municipal Tax Hearing Officer