

## DECISION OF MUNICIPAL TAX HEARING OFFICER

Decision Date: November 18, 2011

Decision: MTHO # 653

### ***Taxpayer:***

Tax Collector: Town of Wickenburg

Hearing Date: October 25, 2011

## DISCUSSION

### Introduction

On May 21, 2011, a letter of protest was filed by *Taxpayers* of a tax assessment made by the Town of Wickenburg (“Town”). A hearing was commenced before the Municipal Tax Hearing Officer (“Hearing Officer”) on October 25, 2011. Appearing for the Town was a *tax audit firm*. Taxpayers appeared on behalf of themselves. On October 26, 2011, the Hearing Officer indicated the record was closed and a written decision would be issued on or before December 9, 2011.

## DECISION

On April 29, 2011, the Town issued a tax audit assessment of Taxpayers. The assessment was for the audit period of June 2004 through March 2011. The assessment was for additional taxes in the amount of \$4,857.48, penalties for failure to file and failure to timely pay in the amount of \$1,170.57, and interest up through April 2011 in the amount of \$936.11.

Taxpayers owned the property at *12345 Some Place* (“Wickenburg Property”) in the Town. The Wickenburg Property was occupied during the audit period by a related limited liability company, *Good Steaks*. *Good Steaks* paid the expenses related to the real property such as property taxes and expenses for the upkeep of the property. There was no lease agreement between Taxpayers and *Good Steaks*. The Town assessed Taxpayers for unreported real property rental revenue pursuant to Town Code Section 9A-445 (“Section 445”). The Town indicated that Taxpayers and *Good Steaks* were both persons pursuant to Town Code Section 9A-100 (“Section 100”). Additionally, the Town noted that a lease transaction concerning real property cannot be a “casual activity” pursuant to Section 100. The Town advised Taxpayers that tax was due on transactions between related parties based on market value pursuant to Town Code Section 9A-210 (“Section 210”). As part of the audit process, the Town requested Taxpayers provide comparable rentals to determine market value. As Taxpayers provided no comparable, the Town

estimated the rental income at \$1.00 per square foot or \$3,435.00 per month.

Taxpayers argued that no tax was due as no rent was paid. Taxpayers asserted that if rent was due, they had the right to charge whatever they feel is right.

At the hearing, Taxpayers presented evidence that a much larger restaurant (*Big Time*) in the Town was paying approximately \$4,000.00 per month for a building that could serve almost three times as many people. Taxpayers also presented evidence that because of the economy; *Good Steaks* is only open seven months per year. The Town acknowledged that based on the evidence presented, a rental amount of \$1,500.00 per month would be more reasonable.

Clearly, Taxpayers and *Good Steaks* were separate persons pursuant to Section 100. Consequently, the transaction between Taxpayers and *Good Steaks* resulted in the business of leasing or renting of real property in the Town pursuant to Section 445. It also clear that because the parties to the transaction were related, it was proper for the Town to utilize an estimate pursuant to Section 210. The next issue was whether or not Taxpayers were able to provide sufficient documentation to demonstrate pursuant to Town Code Section 9A-545 (“Section 545”) that the Town’s estimate was not reasonable. In this case, we conclude that Taxpayers did provide sufficient documentation to support a revision to the Town’s estimate. Based on that documentation, the Town agreed to reduce the monthly rental amounts to \$1,500.00 per month. We conclude the reduced amount of \$1,500.00 per month is reasonable under the circumstances. We do not conclude it should further be reduced because the restaurant is only open seven months of the year. We also note that it is unclear for how much of the audit period was the restaurant only open for seven months of the year.

Lastly, we have the matter of penalties. The Town assessed Taxpayers for penalties pursuant to Town Code Section 9A-540 (“Section 540”) for failure to file, and failure to timely pay. The penalties for failure to timely file and failure to timely pay may be waived for “reasonable cause”. Reasonable cause is defined in Section 540 that a taxpayer exercised ordinary business care and prudence, i.e., had a reasonable basis for believing that the tax did not apply to the business activity. While we did not totally approve Taxpayer’s protest of the underlying taxes, we do conclude that Taxpayers exercised ordinary business care and prudence. As a result, we conclude Taxpayers have demonstrated reasonable cause to have all penalties waived. Based on all the above, we conclude that Taxpayers protest should be partly, denied and partly granted, consistent with the Discussion, Findings, and Conclusions, herein.

### **FINDINGS OF FACT**

1. On May 21, 2011, Taxpayers filed a protest of a tax assessment made by the Town.

2. On April 29, 2011, the Town issued a tax audit assessment of Taxpayers.
3. The assessment was for additional taxes in the amount of \$4,857.48, interest up through April 2011 in the amount of \$936.11, and penalties totaling \$1,170.57.
4. The audit period was for the period of June 2004 through March 2011.
5. Taxpayers owned the Wickenburg Property in the Town.
6. During the audit period, the Wickenburg Property was occupied by ***Good Steaks***.
7. ***Good Steaks*** paid for the expenses related to the Wickenburg Property such as property taxes and expenses for the upkeep of the property.
8. As part of the audit process, the Town requested Taxpayers provide comparable rental values in order to determine market value.
9. Since Taxpayers failed to provide any comparable, the Town estimated the rental income to be \$1.00 per square foot or \$3,435.00 per month.
10. At the hearing, Taxpayers presented evidence that a much larger restaurant in the local area was paying \$4,000.00 per month for a building that could serve approximately three times as many people.
11. Taxpayers presented evidence that ***Good Steaks*** is currently only open seven months of the year.

### 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. Pursuant to Section 100, Taxpayers and ***Good Steaks*** were separate persons.
3. Since Taxpayers and ***Good Steaks*** were related, the Town was authorized pursuant to Section 210 to estimate the rental income.
4. The transaction between Taxpayers and ***Good Steaks*** resulted in the business of leasing or renting of real property pursuant to Section 445.

5. Taxpayer's provided sufficient documentation to demonstrate pursuant to Section 545 that the Town's estimates were not reasonable.
6. The Town was authorized pursuant to Section 540 to assess penalties.
7. Taxpayer demonstrated reasonable cause to have the penalties waived for failing to timely file or timely pay taxes.
8. Taxpayer's May 21, 2011 protest should be partly granted and partly denied, consistent with the Discussion, Findings, and Conclusions, herein.
9. The parties have timely rights of appeal to the Arizona Tax Court pursuant to Model City Tax Code Section-575.

### **ORDER**

It is therefore ordered that the May 21, 2011 protest by *Taxpayers* of a tax assessment made by the Town of Wickenburg should be partly granted and partly denied consistent with the Discussion, Findings, and Conclusions, herein.

It is further ordered that the Town of Wickenburg shall revise the assessment to reflect a monthly rental income of \$1,500.00 per month.

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

It is further ordered that this Decision is effective immediately.

Municipal Tax Hearing Officer