Decision Date: July 23, 2007
Decision: MTHO #320
Taxpayer: ***Taxpayer***
Tax Collector: City of Surprise
Hearing Date: April 16, 2007

DISCUSSION

Introduction

On August 7, 2006, ***Taxpayer*** ("Taxpayer") filed a protest of a tax assessment made by the City of Surprise ("City"). After review, the City concluded on August 15, 2006 that the protest was timely and in the proper form. On August 29, 2006, the Municipal Tax Hearing Officer ("Hearing Officer") ordered the City to file a response to the protest on or before October 9, 2006. On October 4, 2006, City filed a response to the protest. On October 13, 2006, the Hearing Officer ordered Taxpayer to file a reply on or before November 3, 2006. On November 7, 2006, a Notice of Tax Hearing ("Notice") scheduled the hearing to commence on November 27, 2006. On November 9, 2006, Taxpayer requested the hearing be rescheduled. On December 1, 2006, a Notice rescheduled the hearing to commence on January 10, 2007. On January2, 2007, Taxpayer sent an email requesting the hearing be continued. On January 4, 2007, the Hearing Officer granted Taxpayer's request for a continuance. On January 18, 2007, a Notice rescheduled the hearing to commence on February 12, 2007. On January 22, 2007, a Notice rescheduled the hearing to commence on April 16, 2007. Both parties appeared and presented evidence at the April 16, 2007 hearing. On April 19, 2007, the Hearing Officer indicated parties had agreed to the following schedule: Taxpayer would file an initial brief on or before May 16, 2007; the City would file a response brief on or before June 15, 2007; and, Taxpayer would file a reply brief on or before July 2, 2007. On May 16, 2007, Taxpayer sent an email indicating the parties had agreed to extend Taxpayer's initial brief deadline until May 23, 2007. On May 18, 2007, the Hearing Officer indicated the revised briefing schedule was as follows: Taxpayer would file an initial brief on or before May 23, 2007; the City would file a response brief on or before June 22, 2007; and, Taxpayer would file a reply brief on or before July 9, 2007. Taxpayer filed an opening brief on May 23, 2007. The City filed a response brief on June 22, 2007.On July 12, 2007, the Hearing Officer indicated no reply brief had been filed and as a result the record was being closed and a written decision would be issued on or before August 27. 2007.

City Position

The City conducted an audit of Taxpayer for the period March 2002 through March 2006. The City assessed Taxpayer for additional taxes in the amount of $63,653.46 and interest up though June 2006 in the amount of $6,382.68. According to the City, Taxpayer was in the business of renting and leasing for use of real property and the gross income was taxable pursuant to City Code Section 3.14-445 ("Section 445"). The City asserted that Section 445 declares that tax shall be applied to "the gross income from the business activity upon every person engaging or continuing in the business of leasing or renting real property located within the City…." The City noted that City Code Section 3.14-200 ("Section 200") defines "gross income" in relevant part as "all receipts, cash, credits, barter, exchange, reduction of or forgiveness of indebtedness, and

property of every kind or nature derived from a lease, license for use, rental, or other taxable activity." As a result, the City concluded there can be little doubt that Taxpayer's income from a "second occupant" fee was taxable. During the audit period, Taxpayer added an additional charge to its lessee's invoices when the lessee allowed an additional person to live in the dwelling.

Similarly, the City argued the gross income from the "amenity package" was also taxable. The "amenity package" was an additional charge to Taxpayer's tenants for items such as housekeeping, laundry, and food. While Taxpayer alleged that some of its activities would fall under separate business classifications, the City noted that Taxpayer has never taken any action to establish additional business classifications. Because the Code provisions at issue are broadly written, the City concluded all of Taxpayer's income was properly taxed. While Taxpayer relied on the Court's decision in *Ebasco Services Inc. v. Arizona State Tax Comm'n*, 105 Ariz 94, 459 P.2d 719 (1969), the City argued *Ebasco* applied an entirely different law. The City concluded that *Ebasco* was not applicable to the case. Based on all the above, the City requested Taxpayer's protest be denied.

Taxpayer Position

Taxpayer asserted it correctly reported and paid tax on lodging income over thirty days. According to Taxpayer, it is in the business of leasing or renting real property located within the City. Taxpayer acknowledged it received additional income during the audit period for "ancillary charges" which included charges for items such as housekeeping, meals, and a beautician. Taxpayer disputed the City's inclusion of the gross receipts from the "ancillary charges" as part of the Taxpayer's rental business. Taxpayer indicated it separately accounted in its books and records for the receipts for base rent and how much it receives for each of the ancillary services. Taxpayer argued that the City's position that all of Taxpayer's gross income is from the business of leasing or renting real property is an overly broad reading of the ordinance. Taxpayer asserted the Supreme Court of Arizona ("Court") in *Ebasco* ruled that a construction company that provided separate design and engineering services and accounted separately for each of its business activities was taxable or not taxable based on the discrete business activity in question. Taxpayer argued this case was the same as *Ebasco* in that Taxpayer was involved in more than one line of business and accounted for each separately. Based on the above, Taxpayer requested the Hearing Officer grant its petition and abate the assessment.

ANALYSIS

The primary issue to decide in this matter is whether or not all of Taxpayer's gross receipts were taxable pursuant to Section 445. Section 445 imposes a tax on "the gross income from the business activity upon every person engaging or continuing in the business of leasing or renting real property located within the City…." Section 200 broadly defines "gross income" as including "all receipts, cash, credits, barter, exchange, reduction of or forgiveness of indebtedness, and property of every kind or nature derived from a lease, license for use, rental or other taxable activity". While "gross income" is broadly defined, we conclude that in order for "gross income" to be taxable pursuant to Section 445 that income must be from the business activity of leasing or renting real property. Clearly a taxpayer can be in more than one business

activity that may be taxable under other provisions of the Code. Such a conclusion is consistent with *Ebasco* in which the Court ruled a construction company was in more than one business activity. The City has separated out two income sources that were not reported by Taxpayer and which the City included as taxable income. Those two sources were described as an "amenity package" and a "second occupant rent." The "second occupant rent" was an additional charge for allowing an additional person to live in an occupied room. We agree with the City that this would fall under the business activity of leasing or renting real property and thus be taxable pursuant to Section 445.

In analyzing the "amenity package," our focus is on whether the package is such an integral part of the rental of the real property that they are one and the same activity. We think not. Based on the evidence provided, the "amenity package" is not a mandatory part of the rental of a room. According to the testimony, a customer may choose to not have the "amenity package." Taxpayer also maintained a record of the separate charges made for the lodging and "amenity package". Another indication that the "amenity package" is not an integral part of the rental of a room was the fact that a third party has begun to provide the "amenity package" after the audit period. Based on the above, we conclude the gross income from the "amenity package" was not part of the gross income of real property. This is conclusion is consistent with the Model City Tax Regulation 445.3. We note that the issue of whether the gross income from the "amenity package" was taxable pursuant to other provisions of the Code was not brought before the Hearing Officer.

FINDINGS OF FACT

1) On August 7, 2006, Taxpayer filed a protest of a tax assessment made by the City.

2) After review, the City concluded on August 15, 2006 that the protest was timely and in the proper form.

3) On August 29, 2006, the Hearing Officer ordered the City to file a response to the protest on or before October 9, 2006.

4) On October 4, 2006, the City a response to the protest.

5) On October 13, 2006, the Hearing Officer ordered Taxpayer to file a reply on or before November 3, 2006.

6) On November 7, 2006, a Notice scheduled the hearing to commence on November 27, 2006.

7) On November 9, 2006, Taxpayer requested the hearing be rescheduled.

8) On December 1, 2006, a Notice rescheduled the hearing to commence on January 10, 2007.

9) On January 2, 2007, Taxpayer sent an email requesting the hearing be continued.

10) On January 4, 2007, the Hearing Officer granted Taxpayer's request for a continuance.

11) On January 18, 2007, a Notice rescheduled the hearing to commence on February 12, 2007.

12) On January 22, 2007, a Notice rescheduled the hearing to commence on April 16, 2007.

13) Both parties appeared and presented evidence at the April 16, 2007 hearing.

14) On April 19, 2007, the Hearing Officer indicated the parties had agreed to the following schedule: Taxpayer would file an initial brief on or before May 16, 2007; the City would file a response brief on or before June 15, 2007; and. Taxpayer would file a reply brief on or before July 2, 2007.

15) On May 15, 2007, Taxpayer sent an email indicating the parties had agreed to extend Taxpayer's initial brief deadline until May 23, 2007.

16) On May 18, 2007, the Hearing Officer indicated the revised briefing schedule was as follows: Taxpayer would file an initial brief on or before May 23, 2007; the City would file a response brief on or before June 22, 2007; and, Taxpayer would file a reply brief on or before July 9, 2007.

17) Taxpayer filed an opening brief on May 23, 2007.

18) The City filed a response brief on June 22, 2007.

19) On July 12, 2007, the Hearing Officer indicated no reply brief had been received and as a result the record was being closed and a written decision would be issued on or before August 27, 2007.

20) The City conducted an audit of Taxpayer for the period March 2002 through March 2006.

21) The City assessed Taxpayer for additional taxes in the amount of $63,653.46 and interest up through June 2006 in the amount of $6,382.68.

22) During the audit period, Taxpayer was in the business of renting and leasing for use of real property.

23) Taxpayer received income from "amenity packages" sold to its customers which included items such as housekeeping, laundry, and food.

24) Taxpayer received income from "second occupant" fees that were charged when an additional person lived in an occupied room.

25) Subsequent to the audit period, a third party began providing the "amenity package."

26) The “amenity package” was not mandatory for Taxpayer’s customers.

27) Taxpayer maintained a record of the separate charges made for the lodging and the “amenity package”.

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) During the audit period, Taxpayer was in the business of leasing or renting real property located within the City pursuant to Section 445.

3) In order for “gross income” to be taxable pursuant to Section 445, that income must be from the business activity of leasing or renting real property.

4) The gross income from the “second occupant rent” was income from the business activity of leasing or renting real property.

5) The gross income from the “amenity package” was not from the business activity of leasing or renting real property.

6) The Taxpayer's protest should be partly granted and partly denied consistent with the Discussion, Findings, and Conclusions, herein.

ORDER

It is therefore ordered that the August 7, 2006 protest by ***Taxpayer*** of a tax assessment made by the City of Surprise is hereby partly granted and partly denied, consistent with the Discussion, Findings, and Conclusions, herein.

It is further ordered that the City of Surprise shall revise the assessment by removing the gross income from the “amenity package” from the taxable income.

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

Jerry Rudibaugh
Municipal Tax Hearing Officer