

## DECISION OF MUNICIPAL TAX HEARING OFFICER

September 14, 2010

### *Taxpayer Address*

*Taxpayer*  
MTHO # 582

Dear *Taxpayer*:

We have reviewed the evidence presented by *Taxpayer* and the City of Scottsdale (Tax Collector or City) at the hearing on August 4, 2010. The review period covered was September 2006 through March 2010. *Taxpayer's* protest, Tax Collector's response, and our findings and ruling follow.

### Taxpayer's Protest

*Taxpayer* was assessed City of Scottsdale privilege tax under the commercial lease classification for the lease of real property owned by the *Taxpayer* trust (Trust) to a corporation (Corporation). *Taxpayers* are the grantors of the Trust and own the entire voting stock of the lessee Corporation. The City does not tax rents paid by a corporation to an entity that owns at least 80% of the corporation's voting stock. The Trust is disregarded for federal income tax purposes. The Trust should also be disregarded here, *Taxpayer's* should be considered the lessor of the real property to their Corporation and the lease should be exempt from the City's privilege tax.

### Tax Collector's Response

*Taxpayer* Trust does not qualify for the exemption for a lease of real property to a corporation at least 80% owned by the lessor. The voting stock of the lessee Corporation is owned by the grantors of the Trust. The Trust has no ownership interest in the Corporation. Under the City tax code the Trust is a separate taxable entity. The treatment of the Trust for federal income tax purposes is not applicable to the City's privilege tax. The Trust cannot be disregarded by the Tax Collector. Because the voting stock of the Corporation is not owned by the lessor, the exemption does not apply.

### Discussion

The Tax Collector conducted an audit assessment of *Taxpayer* for the period September 2006 through March 2010 and issued an assessment. The Tax Collector considered *Taxpayer* taxable under the commercial lease classification. *Taxpayer* timely protested the assessment.

*Taxpayer's* owned the real property at issue. *Taxpayer's* established the *Taxpayer* Trust and transferred the real property to the Trust. *Taxpayer's* also owned all of the voting stock of the lessee Corporation. *Taxpayer's* did not transfer their stock in the Corporation to the Trust. During the audit period the Trust leased real property to the Corporation.

Scottsdale Tax Code (STC) § 445 imposes the city privilege tax on the business activity of renting, leasing or licensing for use real property located in the city. STC § 445 (i) provides an exemption from the tax for a lease to a corporation if the lessor owns at least 80% of the lessee corporation's voting stock.

The Trust is disregarded for federal income tax purposes and is not treated as an entity separate from the grantors. Taxpayer contends the Trust should be disregarded here so that the grantors of the Trust (*Taxpayer's*) are actually leasing the real property to their Corporation. The question presented is whether a trust that is disregarded for federal income tax purposes should therefore be disregarded for city privilege tax purposes.

The Internal Revenue Code (IRC) has specific provisions establishing the circumstances under which a trust will be disregarded. IRC §§ 671 – 677. Generally, income of a trust is taxed to a grantor if:

- the grantor has retained a reversionary interest in the trust, within specified time limits;
- the grantor has certain powers over the beneficial interests under the trust;
- certain administrative powers over the trust exist under which the grantor can or does benefit;
- the grantor has a power to revoke the trust or return the corpus to the grantor, or
- the grantor has the power to distribute income to or for the benefit of the grantor or the grantor's spouse.

The Scottsdale Tax Code does not have provisions similar to the IRC under which a trust would be disregarded. Scottsdale's tax code imposes the privilege tax on the person leasing the real property. A "person" is defined by the code as including an individual, firm, partnership, corporation, estate or trust. The code further provides that for the purposes of the tax, a person is to be considered a distinct and separate person from any general or limited partnership or joint venture or other association with which such person is affiliated. Therefore, the Trust, the Corporation and *Taxpayer's* are all separate entities for purposes of the city privilege tax.

The exemption under STC § 445 (i) applies if the lessor holds at least eighty percent of the voting stock of the lessee corporation. Here, the lessor is the Trust. The Trust does not own any of the voting stock of the lessee Corporation. Taxpayer (the Trust) does not fall within the scope of the exemption. The terms of the exemption do not extend to the situation where both the lessor and the lessee are owned by the same person.

Based on all the above, we conclude Taxpayer's protest should be denied. The City's privilege tax assessment against Taxpayer was proper.

#### Findings of Fact

1. Taxpayer is a Trust established by *Taxpayer's*.
2. The Trust is disregarded for federal income tax purposes.

3. Taxpayer Trust owned real property (Property) within the City.
4. **Taxpayer's** owned all of the voting stock of a Corporation.
5. Taxpayer has no ownership interest in the Corporation.
6. Taxpayer leased the Property to the Corporation.
7. Taxpayer did not pay city privilege tax on its gross receipts from the lease of the Property to the Corporation.
8. The Tax Collector conducted an audit assessment of Taxpayer for the period September 2006 through March 2010 and issued an assessment.
9. The Tax Collector considered Taxpayer taxable under the commercial lease classification.
10. The assessment waived penalties.
11. Taxpayer timely protested the assessment.
12. Taxpayer believed its lease was exempt from the city privilege tax because both the lessor Trust and the lessee Corporation were owned by **Taxpayer's**.

#### Conclusions of Law

1. Scottsdale Tax Code (STC) § 445 imposes the city privilege tax on the business activity of renting, leasing or licensing for use real property located in the city.
2. STC § 445 (i) provides an exemption from the tax for gross income derived from the leasing of real property to a corporation; provided that the lessor's aggregate holdings in the lessee corporation amount to at least eighty percent (80%) of the voting stock of the lessee corporation.
3. Person means an individual, firm, partnership, joint venture, association, corporation, estate, trust, receiver, syndicate, broker, the Federal Government, this State, or any political subdivision or agency of this State. STC § 100.
4. A person is considered a distinct and separate person from any general or limited partnership or joint venture or other association with which such person is affiliated. STC § 100.
5. Tax deductions, subtractions, exemptions, and credits are to be strictly construed. *Arizona Department of Revenue v. Raby*, 204 Ariz. 509, 511, 65 P.3d 458 (App. 2002).
6. Taxpayer has the burden to show he is entitled to an exemption or deduction from taxation. *Ebasco Servs., Inc. v. Ariz. State Tax Comm'n*, 105 Ariz. 94, 99, 459 P.2d 719, 724 (1969).
7. The Internal Revenue Code has specific provisions establishing the circumstances under which a trust will be disregarded for federal income tax purposes. IRC §§ 671 – 677.
8. The City of Scottsdale Tax Code does not have specific provisions establishing circumstances under which a trust would be disregarded for city privilege tax purposes.

9. Taxpayer Trust is a separate and distinct person from *Taxpayer's*, the grantors of the Trust and the Corporation owned by *Taxpayer's*.
10. The lessor of the Property did not own at least 80% of the entire voting stock of the lessee Corporation.
11. Taxpayer's lease of the Property to the Corporation is not exempt from the city privilege tax under STC § 445 (i).
12. The City's privilege tax assessment against Taxpayer was proper.

Ruling

The protest by Taxpayer of an assessment made by the City of Scottsdale for the period September 2006 through March 2010 is denied.

The Tax Collector's Notice of Assessment is upheld.

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

Sincerely,

Frank L. Migray  
Hearing Officer

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c: *Tax Audit Manager*  
Municipal Tax Hearing Office