

DECISION OF MUNICIPAL TAX HEARING OFFICER

August 24, 2011

Representative's Name
Representative's Address

Taxpayer
MTHO # 613

Dear Representative:

We have reviewed the evidence presented by *Taxpayer* and the Town of Fountain Hills (Tax Collector or City) at the hearing on July 18, 2011. The review period covered was January 1, 2004 through June 30, 2010. Taxpayer's protest, Tax Collector's response, and our findings and ruling follow.

Taxpayer's Protest

Taxpayer was assessed Town of Fountain Hills privilege tax under the commercial lease classification for the lease of real property owned by Taxpayer to a *Charter School*. Charter schools are established by state law and are therefore agencies of the state. Fountain Hills Tax Code (FHTC) § 8A-280 exempts otherwise taxable transactions if the customer is the State of Arizona, its departments and agencies. Therefore Taxpayer's lease of real property to a charter school is exempt from the Town's privilege tax.

Tax Collector's Response

The Charter School is a separate entity that contracts with the state to provide alternative education resources to students. The charter school is neither a school district nor an agency of the state. Therefore FHTC § 8A-280 does not exempt Taxpayer's lease of the real property to *the Charter School*. The Town's assessment should be upheld.

Discussion

The Tax Collector conducted an audit assessment of Taxpayer for the period January 1, 2004 through June 30, 2010 and issued an assessment. The Tax Collector considered Taxpayer taxable under the commercial lease classification. Taxpayer timely protested the assessment stating it was leasing the property to a charter school and that the charter school is an agency of the state. Therefore the lease is exempt under FHTC § 8A-280.

FHTC § 8A-280 provides in relevant part:

Notwithstanding provisions contained elsewhere in this Chapter, "gross income" derived from transactions that would be deemed taxable, if conducted with or for other customers or consumers, shall be deemed exempt from the taxes imposed by this Chapter when the customer or consumer is:

* * *

(2) the State of Arizona, its departments and agencies, including the State universities maintained by the State Board of Regents; but not including State-chartered or State-insured banks, savings and loan institutions, and credit unions.

(3) any county of this State, its departments and agencies, including, but not limited to, public school districts.

Taxpayer argues that charter schools:

- were established by the state legislature under A.R.S. § 15-181.A.,
- are defined as public schools in A.R.S. § 15-103.3,
- are funded by the State of Arizona,
- their employees are eligible to participate in the Arizona state retirement system and Arizona’s health and accident insurance coverage,
- are included in the definition of “public educational agency” under A.R.S. § 15-761.26.
- are exempt from city use tax (A.R.S. § 42-6004.F.) and property tax (A.R.S. § 42-11104.C.1.),
- property leased to charter schools for educational instruction is classified as class nine property.

Taxpayer’s position finds support in Arizona Attorney General Opinion I95-10 and Maricopa County Superior Court Minute Entry decision in *Rolling Hills Charter School v. Arizona State Board for Charter Schools*, LC2005-000430-001 DT holding that charter Schools are “public bodies” subject to the state’s public records laws and the state’ open meeting laws and in Arizona Attorney General Opinion I04-006 holding that charter schools function as local educational agencies.

The Town argues that *the Charter School* is a private entity that contracted with the state to operate a charter school. The charter school is neither the state nor an agency of the state. The Town’s position finds support in *Salt River Pima-Maricopa Indian Community School v. State*, 200 Ariz. 108, 23 P.3d 103 (App. 2001) (charter schools were not considered the “state” for purposes of a federal statute that limited the amount of federal funds such schools could receive), *Caviness v. Horizon Community Learning Center, Inc.* 590 F.3d 808 (9th Cir. 2010) (a charter school was not a state actor for purposes of federal civil rights provisions) and Arizona Attorney General Opinion I03-006 (holding that voluntary associations comprised, in whole or in part, of political subdivisions or officers of political subdivisions but that are neither created by state law nor designated as political subdivisions in the state’s statutes or constitution are not political subdivisions under the state retirement statutes).

The Town Tax Code does not specify what entities would qualify as a department or agency of the state or whether charter schools may be considered political subdivisions of the state. We have not found a standard definition that is helpful for determining what constitutes a department

or agency of the state in the context of a privilege tax exemption. General definitions are of minimal help. For example, Black's Law Dictionary, 6th Edition has the following definitions:

- Department – A branch or division of governmental administration.
- Administrative agency – A governmental body charged with administering and implementing particular legislation. Such governmental bodies may be called commissions, corporations, boards, departments or divisions.
- Political subdivision – a division of the state made by proper authorities thereof, acting within their constitutional powers, for purpose of carrying out a portion of those function of state which by long usage and inherent necessities of government have always been regarded as public.

Both Taxpayer and the Town have presented legal arguments supporting their respective position. However, statutes granting deductions and exemptions from tax are to be strictly construed against the deduction or exemption. The taxpayer has the burden to show he is entitled to an exemption or deduction from tax. Construing FHTC § 8A-280 strictly against the exemption, we conclude that Taxpayer's lease of its property to the *Charter School* is not exempt from the Town's privilege tax.

Taxpayer's arguments do not mandate a different result. First, Taxpayer contends that charter schools are established by the state. The Arizona legislature does not create charter schools; the legislature authorizes their establishment. Charter schools are established through a contract with a school district governing board, the state board of education or the state board for charter schools. *The Charter School* was not created by a legislative enactment.¹

Second, a state's statutory characterization of a private entity as a public actor for some purposes is not necessarily dispositive with respect to all of that entity's conduct. *See, Caviness v. Horizon Community Learning Center, Inc.* 590 F.3d 808 (9 Cir. 2010). The fact that charter schools are defined as public schools in A.R.S. § 15-103.3 and are subject to the states public records laws and open meeting laws does not mandate the same result relating to city privilege tax exemptions.

Footnote 4 in Attorney General Opinion I95-10 recognized that whether an entity is a public body under other state statutes depends on the definition used in those statutes and upon a factual and legal analysis consistent with the particular statute. The conclusion reached by the Attorney General Opinion was therefore limited to the Public Records and Open Meeting Laws.

In addition, Attorney General Opinion I95-10 explicitly adhered to the principle of broadly construing the Open Meeting Law with a view to maximizing public access to the government process. By contrast, exemptions from tax must be strictly construed against the exemption. If there is any doubt, the exemption does not apply.

Third, state sponsorship and oversight does not transform charter schools into the "State". There is no state provision defining charter schools as state agencies or political subdivisions of the

¹ Compare A.R.S. § 15-182.A. (The state board for charter schools is established consisting of the following members...) with A.R.S. § 15-181.A. (Charter schools may be established pursuant to this article...).

state. Charter schools operate as separate entities from the state, but are subject to the same agency supervision and oversight as any other contracting entity. *See, Salt River Pima-Maricopa Indian Community School v. State*, 200 Ariz. 108, 23 P.3d 103 (App. 2001). Even if charter schools provide a public education function, providing public education is not traditionally and exclusively the province of the state. *Caviness*, 590 F.3d at 815.

Fourth, charter schools do not become agencies of the state by virtue of providing teachers at charter schools certain state benefits, such as the ability to participate in the state's retirement system. This argument was raised in *Caviness v. Horizon Community Learning Center, Inc.* The court stated that permitting charter schools to participate in the state's retirement plan provides additional compensation to entities that operate charter schools by relieving them from pension or retirement obligations they might otherwise face. Such subsidy does not convert the acts of a private entity into those of the state. *Caviness*, 590 F.3d at 817.

Finally, statutes allowing non-profit charter schools certain tax exemptions or favorable tax treatment specifically name charter schools as being entitled to the tax exemption or favorable property tax classification. That does not suggest that charter schools are the state or its agency. Similarly, the Attorney General's holding in Opinion I04-006 holding that charter schools function as local educational agencies was based on the fact that charter schools were specifically included within the definition of "public educational agency" in A.R.S. § 15-761.26.

Based on all the above, because tax exemption statutes must be strictly construed against the exemption, we conclude Taxpayer's protest should be denied. The Town's privilege tax assessment against Taxpayer was proper.

Findings of Fact

1. Taxpayer owned real property (Property) within the City.
2. Taxpayer leased the Property to **a Charter School**.
3. **The Charter School** is a non-profit entity exempt from federal income tax under Internal Revenue Code Section 501(c)(3).
4. Taxpayer did not pay City privilege tax on its gross receipts from the lease of the Property to **the Charter School**.
5. The Tax Collector conducted an audit assessment of Taxpayer for the period January 1, 2004 through June 30, 2010 and issued an assessment.
6. The Tax Collector considered Taxpayer taxable under the commercial lease classification.
7. Taxpayer timely protested the assessment.
8. Taxpayer believed it was exempt from City privilege tax because its lease of the Property to a charter school was a lease to a state agency.

Conclusions of Law

1. Fountain Hills Tax Code (FHTC) § 445 imposes the city privilege tax on the business activity of renting, leasing or licensing for use real property located in the City.

2. Transactions with the State of Arizona, its departments and agencies and with any county of Arizona, its departments and agencies are exempt from the City privilege tax. FHTC § 8A-280.
3. Tax deductions and exemptions are to be strictly construed against the deduction or exemption. *Arizona Department of Revenue v. Raby*, 204 Ariz. 509, 511, 65 P.3d 458 (App. 2002).
4. 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).
5. The Fountain Hills Tax Code does not specifically define the phrase “the State of Arizona, its departments and agencies” agencies or “any county of this State, its departments and agencies”.
6. Charter schools are authorized by A.R.S. § 15-181.
7. Charter schools are not established by state law.
8. Charter schools are established by applicants contracting with a school district governing board, the state board of education or the state board for charter schools. A.R.S. § 15-183.
9. Charter schools operate as separate entities from the state. *Salt River Pima-Maricopa Indian Community School v. State*, 200 Ariz. 108, 23 P.3d 103 (App. 2001).
10. An entity may be a state actor for some purposes but not for others. *Caviness v. Horizon Community Learning Center, Inc.* 590 F.3d 808, 813 (9th Cir. 2010).
11. A charter school is not the State of Arizona, its department or agency, or a political subdivision of the State of Arizona. *Salt River Pima-Maricopa Indian Community School v. State*, 200 Ariz. 108, 23 P.3d 103 (App. 2001). *See, also Caviness v. Horizon Community Learning Center, Inc., supra.*
12. ***The Charter School*** is a private non-profit entity.
13. ***The Charter School*** is not the State of Arizona, its department or agency or a political subdivision of the State of Arizona or of any county of the State of Arizona within the meaning of FHTC § 8A-280.
14. Taxpayer’s lease of the Property to ***the Charter School*** is not exempt from the Town’s privilege tax under FHTC § 8A-280.
15. The Town’s privilege tax assessment against Taxpayer was proper.

Ruling

The protest by Taxpayer of an assessment made by the Town of Fountain Hills for the period January 1, 2004 through June 30, 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,

Hearing Officer

HO/7100.doc/10/03

c: *Town of Fountain Hills*
Municipal Tax Hearing Office