

DECISION OF MUNICIPAL TAX HEARING OFFICER

January 17, 2013

Taxpayer, LLC
Taxpayer's Address

Taxpayer, LLC
MTHO # 745

Dear Taxpayer , LLC:

We have reviewed the evidence submitted for redetermination by *Taxpayer LLC* and the City of Scottsdale (Tax Collector or City). The review period covered was February 2006 through January 2012. Taxpayer's protest, Tax Collector's response, and our findings and ruling follow.

Taxpayer's Protest

Taxpayer is a limited liability company. Taxpayer leases real property to a corporation. The two organizations are owned by the same people. Two entities were set up to protect assets from frivolous lawsuits. The rent paid to Taxpayer covers expenses. There is no profit margin. The rent should not be taxed. Taxpayer also disagrees with going back seven years to assess tax. The review should include the last two years at the most. Finally the interest charged was unreasonable and should be absorbed by the City. Taxpayer requests that the back taxes be forgiven and Taxpayer will continue to pay tax as it has since being notified of the requirement.

Tax Collector's Response

Taxpayer is in the business of renting real property in the City. Taxpayer LLC does not qualify for the exemption for a lease of real property to a corporation at least 80% owned by the lessor. Taxpayer does not own the required minimum 80% of the tenant corporation's voting stock. Taxpayer did not file returns during the audit period. There are no time limitations on assessing tax on unreported gross income when a taxpayer has not filed returns. The City however limited its review to six years.

Discussion

The Tax Collector conducted an audit assessment of Taxpayer for the period February 2006 through January 2012 and issued an assessment. Taxpayer had not filed City privilege tax returns during the audit period. The Tax Collector considered Taxpayer taxable under the commercial lease classification. The assessment included license fee penalties. No other penalties were assessed. Taxpayer timely protested the assessment.

Taxpayer holds title to the real property at issue. During the audit period, the property was leased to *AD Inc.*. The rent payments were used to cover association fees, mortgage payments and real estate taxes. No profit margin is included.

Taxpayer is a limited liability company. The members of Taxpayer are *Owner #1, Owner #2, Jr.* and *Owner #3. Owner #1* and *Owner #2, Jr.* are also listed as Managers.

AD Inc. is a corporation. The State of Arizona Corporation Commission Corporation Annual Report & Certificate of Disclosure lists *Owner #1* as a shareholder holding more than 20% of any class of shares issued by the corporation. Taxpayer is not listed on the report as a shareholder.

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 for a consideration. 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.

Taxpayer is subject to the tax under STC § 445.

Taxpayer contends that it is not taxable under the commercial lease classification because the two organizations are owned by the same people. Taxpayer and *AD, Inc.* are separate persons. Taxpayer does not own at least 80% of *AD, Inc.* Taxpayer is not listed on the Arizona Corporation Commission annual report as a shareholder owning more than 20% of any class of shares. Taxpayer is therefore subject to the City privilege tax on commercial leases for the audit period.

Statute of Limitations.

Taxpayer did not file returns during the audit period. STC § 550(c) allows the Tax Collector to assess taxes for any month for which a return was not filed at any time without any reliance by the taxpayer on time limitations provided elsewhere in the Code. The audit period selected by the Tax Collector was therefore allowable under the Code.

Interest.

Taxpayer did not file returns or pay taxes during the audit period on its commercial lease. STC § 540(a) imposes interest on any taxpayer who does not pay before the delinquency date taxes which were due or found to be due. Interest continues to accrue until the tax is paid. The Tax Collector waived all penalties for Taxpayer not filing a return or not paying privilege taxes for the period at issue.

Interest is not a penalty, but is compensation to the City for the lost time-value of money received after the due date. *Valencia Energy Co. v. Arizona Dep't of Revenue*, 191 Ariz. 565, 959 P.2d 1256, (1998). As the court noted, non-punitive interest is nothing more than compensation for the use of money. The taxpayers had the benefit of using the funds before paying the tax claim and, in the legal sense, suffer no loss by reason of paying interest on the money it retained in its possession. As long as the taxes are unpaid, interest accrues.

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 limited liability company.
2. The members of Taxpayer are **Owner #1, Owner #2, Jr.** and **Owner #3.**
3. **Owner #1** and **Owner #2, Jr.** are also listed as Managers Taxpayer.
4. Taxpayer is title owner to real property within the City.
5. Taxpayer leases the property to **AD, Inc.**
6. Rent payments received by Taxpayer were used to cover association fees, mortgage payments and real estate taxes. No profit margin is included.
7. **AD, Inc.** is a corporation.
8. The State of Arizona Corporation Commission Corporation Annual Report & Certificate of Disclosure lists **Owner #1** as a shareholder holding more than 20% of any class of shares issued by the corporation.
9. Taxpayer is not listed on the report as a shareholder.
10. Taxpayer does not own at least 80% of **AD, Inc.**'s voting stock.
11. Separate entities were established to protect assets from frivolous lawsuits.
12. Taxpayer did not pay City privilege tax from the lease of the property to **AD, Inc.**
13. The Tax Collector conducted an audit assessment of Taxpayer for the period February 2006 through January 2012 and issued an assessment.
14. The Tax Collector considered Taxpayer taxable under the commercial lease classification.
15. Taxpayer timely protested the assessment.
16. Taxpayer believed its lease was exempt from the City privilege tax because the two entities are owned by the same people, the audit period was excessive and no interest should be charged.

Conclusions of Law

1. 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. The amount of the tax is measured by the gross income Taxpayer receives from the business activity. STC § 445(a).
3. STC § 445 assesses a tax on the gross income from the business and does not take into consideration whether or not there was any profit.
4. Taxpayer received rent from **AD, Inc.**
5. STC § 445(i) provides an exemption from the tax for gross income derived from the leasing of real property to a corporation if the lessor's aggregate holdings in the lessee corporation amount to at least eighty percent (80%) of the voting stock of the lessee corporation.

6. Taxpayer did not pay the privilege tax for the period February 2006 through January 2012 before those taxes became delinquent.
7. 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.
8. 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.
9. Taxpayers are free to use whatever form of business they choose, but in choosing a form they must accept its advantages and disadvantages. *Higgins v. Smith*, 308 U.S. 473 (1940).
10. Tax deductions, exemptions, and credits are to be strictly construed. *Arizona Department of Revenue v. Raby*, 204 Ariz. 509, 511, 65 P.3d 458 (App. 2002).
11. 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).
12. Taxpayer's lease of the property to **AD, Inc.** is not exempt from the City privilege tax under STC § 445 (i).
13. The City may assess taxes for periods for which a return was not filed at any time without regard to audit statute of limitations. STC § 550(c).
14. The City's assessment was within the allowable limitation period.
15. STC § 540(a) imposes interest on any taxpayer who fails to pay any of the taxes which were due or found to be due before the delinquency date until the tax is paid.
16. STC § 540(a) recognizes the time value of money, and thus requires a taxpayer that is holding or using money that rightfully belongs to the City to pay interest for the use of that money. See, *Valencia Energy Co. v. Arizona Dep't of Revenue*, 191 Ariz. 565, 959 P.2d 1256, (1998).
17. Taxpayer is liable to pay interest on the taxes that are unpaid from the date the taxes were due until paid.
18. The Hearing Officer does not have the authority to waive the interest.
19. The City's privilege tax assessment against Taxpayer was proper. Taxpayer's protest should be denied.

Ruling

The protest by Taxpayer of an assessment made by the City of Scottsdale for the period February 2006 through January 2012 is denied.

The Tax Collector's Notice of Assessment is upheld.

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

Sincerely,

Hearing Officer

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c: *Audit Associate*
Municipal Tax Hearing Office