DECISION OF MUNICIPAL TAX HEARING OFFICER

October 2, 2013

Taxpayers
Address for Taxpayers

Taxpayers
MTHO #781

Dear Taxpayers:

We have reviewed the evidence and information presented by ***Owners*** and ***Owner/Taxpayers*** (collectively Taxpayers) and the City of Chandler (Tax Collector or City) at the hearing on June 21, 2013. The review periods covered were December 1999 through December 2002 for ***Owners*** and January 2003 through April 2005 for ***Taxpayers***. Taxpayers' protest, Tax Collector's response, and our findings and ruling follow.

Taxpayer's Protest

Taxpayers were assessed City privilege tax for the rental of residential real property in the City. Taxpayers do not live in the City and were not aware of the City tax on the lease of one residential property. There was no effort by the City to educate taxpayers. The first notice Taxpayers received from the City was thirteen years after Taxpayers bought the property and eight years after they sold it. The statute of limitations precludes the assessments.

Tax Collector's Response

Taxpayers owned the property during the audit period, leased the property to tenants and received rent payments. Taxpayers were therefore subject to the privilege tax during the audit period. Taxpayers did not file privilege tax returns with the City during the audit period and therefore the audit statute of limitations did not apply. The Tax Collector based the assessments on an estimate of rental income. Taxpayers have not shown that the estimate was not correct. The assessments should be upheld.

Discussion

Taxpayers are individuals and are the members of ***Taxpayer's Company***, a limited liability company. The individual Taxpayers leased real property in the City from December 1999 through December 2002. The property was leased by the LLC for the period January 2003 through April 2005.

Taxpayers owned the property. Other persons occupied the property and paid rent to Taxpayers. Chandler Tax Code (CTC) § 62-445 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. The tax applies to the activity of leasing a single residential unit. Taxpayers were thus taxable for their activity of leasing real property located in the City for a consideration.

Taxpayers, however, are not residents of the City and were not aware during the audit period that the City imposed the privilege tax on the lease of single residential units. Taxpayers contend they are not subject to the City privilege tax because:

- Taxpayers were not aware of the City tax and the first notice of the tax they received from the City was thirteen years after they purchased the property;
- There was no effort by the City to educate taxpayers;
- The assessments are precluded by the statute of limitations;
- The Tax Collector used an estimate and not actual rental income.

The City did not Notify Taxpayers of the Tax.

The question is whether the City is precluded from enforcing the tax during the review period even if the City did not personally inform Taxpayers that the City imposed the privilege tax on Taxpayers' lease of a single unit of residential property. Generally, it is taxpayers' responsibility to be familiar with the code of the jurisdiction where they operate. Every person is presumed to know the law and its requirements, and a mistake as to such requirements is no excuse for failure to meet them. *Newman v. Fidelity Savings and Loan Association,* 14 Ariz. 354, 128 P. 53 (1912).

The taxation of renting or leasing real property is governed by CTC § 62-445. Neither that section nor the Model City Tax Code has a legal requirement for the City to give personal notice to taxpayers that their activity is taxable before the tax may be imposed. No authority has been cited that would allow us to invalidate the assessments because Taxpayers did not receive personal notice of the tax from the City.

Statute of Limitations.

Under the Chandler Tax Code, the City generally has four years after a return has been filed to issue an assessment. However, there is no limitation period if no return is filed. This is consistent with both state and Internal Revenue Code provisions. *See,* A.R.S. § 42-1104(B)(1)(b) (the department may assess the tax at any time in the case of failure to file a return) and I.R.C. § 6501(c)(3) (in the case of failure to file a return, the tax may be assessed at any time.)

The assessments at issue are not barred by the audit statute of limitations. Taxpayers did not file returns during the review period. CTC § 62-550(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 in the Code.

The Amount of Income Used in the Assessments.

The Tax Collector estimated that Taxpayers received rent of $1,244 in each month of the audit period. At the hearing Taxpayers submitted copies of their federal Schedule E forms showing the yearly rental received for Taxpayers' properties, including the property at issue. The City did not submit a post hearing response addressing the Schedule E's. Based on the record, the yearly rental amounts shown on Taxpayers' Schedule E's for the audit period more accurately reflect Taxpayers' gross rental income received from the property.

Taxpayers did not submit information regarding actual monthly receipts during the audit period. In recalculating the assessments, the yearly rental income shown in Taxpayers' Schedule E for

each year should be pro-rated evenly to each month of the particular year included in the audit period.

Interest and Penalty.

CTC § 62-540(a) imposes interest on any taxpayer who does not pay taxes which were due or found to be due before the delinquency date. Interest continues to accrue until the tax is paid. 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). The court noted that non-punitive interest is nothing more than compensation for the use of money. The taxpayer had the benefit of using the funds before paying the tax claim and, in the legal sense, suffers no loss by reason of paying interest on the money it retained in its possession.

Interest was properly included in the assessments. It is not necessary to address whether or not the City was aware that taxes were owed by Taxpayers earlier than shortly before the assessments was issued.[1] As long as the taxes are unpaid, interest accrues.

The Tax Collector agreed to waive the penalties for Taxpayers not filing a return or paying privilege taxes for the period at issue.

Based on the foregoing, Taxpayers' protest is upheld in part and denied in part. Taxpayers are subject to the privilege tax and associated interest on their lease of the property in the City during the audit period. The Tax Collector shall base the assessments on the gross rental income reflected in Taxpayers' federal Schedule E forms for tax years 1999 through 2005. The Tax Collector shall not include any penalties in the recalculated assessments.

Findings of Fact

1. Taxpayers are individuals and are the members of ***Taxpayer's Company***, a limited liability company.
2. Taxpayers did not live in the City of Chandler.
3. Taxpayers purchased real property in the City in 1999 and sold the property in 2005.
4. The individual Taxpayers leased the real property in the City from December 1999 through December 2002.
5. The property was leased by the LLC for the period January 2003 through April 2005.
6. Taxpayers did not file privilege tax returns with the City or pay City privilege taxes for the period December 1999 through April 2005.
7. The Tax Collector issued an assessment to the individual Taxpayers under the rental of real property classification for the period December 1999 through December 2002, and a separate assessment to the LLC for the period January 2003 through April 2005.
8. The Tax Collector estimated that Taxpayers received monthly rent of $1,244.
9. At the hearing Taxpayers testified that:
    a. Taxpayers were not aware of the City privilege tax on single residential rentals.

[1] No evidence was presented that the City was aware of Taxpayers' potential tax liability before 2012.

b. The City did not contact Taxpayers regarding a possible tax liability until 2012.

c. The City failed to provide Taxpayers a copy of the City code in effect during the audit period.

d. If Taxpayer had known, they would have added the tax to the lease. Taxpayers are not trying to evade the tax.

10. Tax Collector testified and stated in its Response to the Protest that:

a. Chandler has taxed single residential rentals since 1960.

b. Chandler started the project to locate and license unlicensed residential rentals in 2005.

c. The City did not have records or information showing whether the City contacted Taxpayers before 2012.

d. The City did try to inform taxpayers of the tax by notices included in utility billings.

11. Taxpayers submitted copies of their federal Schedule E forms at the hearing showing their gross rents received from the rental of the property for tax years 1999 through 2005.

12. The Schedule E's reported yearly income as follows:

1999	$1,050
2000	$12,600
2001	$9,379
2002	$12,112
2003	$6,100
2004	$7,750
2005	$0

13. The Tax Collector agreed at the hearing to abate the penalties that were imposed in the assessments.

Conclusions of Law

1. CTC § 62-445 imposed the City privilege tax on the business activity of renting, leasing or licensing for use real property located in the City for a consideration during the audit period.

2. The tax under CTC § 62-445 applies to the rental of a single residential property.

3. Taxpayers leased property in the City during the audit period and were subject to the City privilege tax under CTC § 62-445.

4. Taxpayers are presumed to know the law and its requirements, and a mistake as to such requirements is no excuse for failure to meet them. *Newman v. Fidelity Savings and Loan Association,* 14 Ariz. 354, 128 P. 53 (1912).

5. The Chandler Tax Code does not require the City to give personal notice to individual taxpayers that their activity is taxable before the tax can be imposed.

6. The assessments were based on an estimate by the Tax Collector.

7. It is the responsibility of the taxpayer to prove that the Tax Collector's estimate is not reasonable and correct by providing sufficient documentation of the type and form required by the Code or satisfactory to the Tax Collector. CTC § 62-545(b).

8. At the hearing Taxpayers submitted copies of their federal Schedule E's on which they reported their rental income from the property at issue.

9. Taxpayers' Schedule E's provided sufficient documentation to show that the Tax Collector's estimate in this case was not reasonable and correct.

10. The record does not show the amount of rent Taxpayers received for each month.

11. The assessments shall be amended to include the yearly amounts shown on the Schedule E's for each year, pro-rated evenly to each month of the particular year included in the audit period.

12. The City privilege tax is a tax on the person engaging in business and not a tax on the customer. *Arizona Department of Revenue v. Action Marine, Inc.* 218 Ariz. 141, 181 P.3d 188 (2008).

13. A business may, but is not required to, pass the cost of the tax onto its customers.

14. A taxpayer is liable for the tax whether or not the taxpayer passes the cost of the tax onto its customers. *Arizona Department of Revenue v. Action Marine, Inc., supra.*

15. The City may assess taxes for periods for which a return was not filed at any time without regard to audit statute of limitations. CTC § 62-550(c).

16. CTC § 62-540(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.

17. CTC § 62-540(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).

18. Taxpayers are liable to pay interest on the taxes that are unpaid from the date the taxes were due until paid.

19. The City's privilege tax assessments against Taxpayers are upheld in part and reversed in part. Taxpayers are subject to the privilege tax and associated interest on their lease of the property in the City during the audit period. The Tax Collector shall base the assessments on the gross rental income reflected in Taxpayers' federal Schedule E forms for tax years 1999 through 2005, pro-rated evenly to each month of the particular year included in the audit period. The Tax Collector shall not include any penalties in the recalculated assessments.

Ruling

The protests by Taxpayers of the assessments made by the City of Chandler for the periods December 1999 through December 2002 for ***Owners*** and January 2003 through April 2005 are upheld in part and denied in part.

Taxpayers' lease of the property in the City during the audit period was subject to the City privilege tax under CTC § 62-445.

The Tax Collector shall recalculate the assessments based on the gross rental income reflected in Taxpayers' federal Schedule E forms for tax years 1999 through 2005, pro-rated evenly to each month of the particular year included in the audit period. The Tax Collector shall not include any penalties in the recalculated assessments.

The parties have 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: ***Tax Audit Supervisor***
Tax and License Division
Municipal Tax Hearing Office