

## DECISION OF MUNICIPAL TAX HEARING OFFICER

Decision Date: April 2, 2014

Decision: MTHO # 816

### ***Taxpayer:***

Tax Collector: City of Sedona

Hearing Date: February 28, 2014

## DISCUSSION

### Introduction

On August 6, 2013, a letter of protest was filed by *Taxpayer Trust* of a tax assessment made by the City of Sedona (“City”). A hearing was commenced before the Municipal Tax Hearing Officer (“Hearing Officer”) on February 28, 2014. Appearing for the City were a *City Tax Auditor*, and a *City Accounting Technician*. Appearing for Taxpayer was *himself*, Trustee for Taxpayer. On March 1, 2014, the Hearing Officer indicated the record was closed and a written decision would be issued on or before April 14, 2014.

## DECISION

The City issued an amended assessment to Taxpayer pursuant to City Code Section 14-445 (“Section 445”). The assessment was for \$2,233.63 for the period February 2007 through November 2009. The assessment included \$381.91 for penalties. The assessment was for unreported rental income.

The City indicated Taxpayer was the owner of the property located at *1234 Somewhere* (“Property”) in the City. The Property was occupied by *Taxpayer*, who is a dentist (“Dentist”) as a sole proprietor. The Dentist paid all expenses related to the Property including mortgage, real estate taxes, maintenance, etc.

Taxpayer protested the entire assessment as not being applicable. Taxpayer asserted there was no difference between an individual and his personal trust. Taxpayer also asserted that it did not receive any rent from any separate entity.

Section 445 imposes a tax on the gross income from the business activity upon every person engaging in the business of leasing or renting real property located within the City for a consideration. City Code Section 8-100 (“Section 100”) defines “person” broadly to mean an individual, partnership, joint venture, association, corporation, estate, trust, etc. It further indicates a person shall be considered a distinct and separate person from any

general or limited partnership with which such person is affiliated. Taxpayer established a trust based on professional advice. While Taxpayer was free to use whatever form of business it chose, it must also accept its advantages and disadvantages. In this case, it is clear from the record that Taxpayer and the Dentist were separate persons pursuant to Section 100. Further, Taxpayer owned the Property while another “person” used the Property. The Dentist paid all expenses related to the Property which would constitute consideration. The Dentist was receiving the benefit of using Taxpayer’s real property. As a result, it was proper for the City to assess Taxpayer for rental income pursuant to Section 445. Because of the relationship between Taxpayer and the Dentist, it was proper for the City to determine the “market value” pursuant to City Code Section 8-210 (“Section 210”). Section 210 applies when transactions between affiliated companies or persons is not indicative of the market value. City Code Section 8- 545 (“Section 545”) requires any estimate by the City to be reasonable. It further provides that it is the responsibility of the taxpayer to prove the estimate is not reasonable by providing sufficient documentation. In this case, Taxpayer has not provided sufficient documentation to prove the City’s estimate for the rental income was not reasonable. In fact, Taxpayer was in agreement that the City’s use of a monthly rental amount of \$1,497.70 was a reasonable amount for the market value. Based on the above, we conclude the City properly assessed Taxpayer pursuant to Section 445.

Lastly, the City was authorized to assess penalties pursuant to City Code Section 540(“Section 540”) since Taxpayer failed to file tax returns or timely pay taxes. Those penalties may be waived if there is reasonable cause. “Reasonable cause” is defined in Section 540 to mean the taxpayer exercised ordinary business care and prudence. In this case, Taxpayer relied on professional advice. As a result, we do find Taxpayer has demonstrated reasonable cause to have the penalties waived. Based on all the above, we conclude Taxpayer’s August 6, 2013 protest should be denied (with the exception of the penalties).

### **FINDINGS OF FACT**

1. On August 6, 2013, Taxpayer filed a protest of a tax assessment made by the City.
2. The City issued an amended assessment to Taxpayer pursuant to Section 445.
3. The assessment was for \$2,233.63 for the period February 2007 through November 2009.
4. The assessment included penalties in the amount of \$381.91.

5. The assessment was for unreported rental income.
6. Taxpayer was the owner of the Property located in the City.
7. The Property was occupied by the Dentist as a sole proprietor.
8. The Dentist paid all expenses related to the Property including mortgage, real estate taxes, maintenance, etc.
9. Taxpayer asserted there was no distinction between Taxpayer and the Dentist.
10. Taxpayer asserted it did not receive any rent from any separate entity.
11. During the audit period, Taxpayer did not file any tax returns or pay any City taxes on the rental income of the Property.

### **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. Section 445 imposes a tax on the gross income from the business activity of rental of real property.
3. Pursuant to Section 100, Taxpayer and the Dentist were separate persons.
4. The Dentist was receiving the benefit of using Taxpayer's real property during the audit period.
5. Taxpayer was in the business activity of the rental of real property pursuant to Section 445.
6. Since Taxpayer and the Dentist were affiliated entities, it was proper for the City to determine market value pursuant to Section 210.
7. Taxpayer failed to provide sufficient documentation pursuant to Section 545 to prove the City's estimate was not reasonable.

8. The City was authorized pursuant to Section 540 to assess penalties for failure to timely file and failure to timely pay taxes.
9. Taxpayer has demonstrated reasonable cause to have the penalties waived.
10. Taxpayer's August 6, 2013 protest should be denied (with the exception of the penalties), consistent with the Discussion, Findings, and Conclusions, herein.
11. The parties have timely rights of appeal to the Arizona Tax Court pursuant to Model City Tax Code Section -575.

### **ORDER**

It is therefore ordered that the August 6, 2013 protest by *Taxpayer Trust* of a tax assessment made by the City of Sedona should be denied (with the exception of penalties) consistent with the Discussion, Findings, and Conclusions, herein.

It is further ordered that the City of Sedona shall remove all penalties assessed in this matter.

It is further ordered that this Decision is effective immediately.

*Municipal Tax Hearing Officer*