

DECISION OF MUNICIPAL TAX HEARING OFFICER

January 23, 2016

Taxpayer
Taxpayer's address

Taxpayer
MTHO # 883

Dear *Taxpayer*:

We have reviewed the evidence and information presented by *Taxpayer* and the City of Phoenix (Tax Collector or City) at the hearing on October 5, 2015 and in post-hearing submissions. The review period covered was June 2012 through January 2014. Taxpayer's protest, Tax Collector's response, and our findings and ruling follow.

Taxpayer's Protest

Taxpayer was assessed City privilege tax for the rental of five residential properties. Taxpayer does not lease three or more properties. The properties are under separate limited liability companies (LLC's) and therefore not under the same entity. Taxpayer does not qualify as a broker. In addition, at least one of the listed properties is not a rental but is being purchased by Taxpayer's son. No tax should be due on any of the properties.

Tax Collector's Response

Taxpayer held title two of the properties during a portion of the audit period. The properties were otherwise held by different limited liability companies. Taxpayer personally entered into lease agreements for four of the properties and received the rent. Taxpayer was responsible for the maintenance on those properties. One of the properties was occupied by Taxpayer's son. Taxpayer was liable on the mortgage for the property. Taxpayer also leases a threeunit residential property (triplex) on which the taxes have been paid. Taxpayer leases three or more properties and is therefore subject to the privilege tax on all properties. The LLC's should either be ignored or Taxpayer be considered a broker. Taxpayer was subject to the privilege tax during the audit period.

Discussion

Taxpayer was assessed City privilege tax for the rental of five residential properties. Taxpayer protested contending she is not subject to the privilege tax on any of the five properties because:

- She is not renting three or more units,
- Two of the properties belong to her son and daughter,
- Her son and daughter each manage two of the other properties, and
- The properties were owned by LLC's, not her personally.

The Tax Collector had previously conducted an audit of Taxpayer for the period November 2011 through May 2012 and issued an assessment under the real property lease classification. Taxpayers protested and we upheld that assessment. (*See*, MTHO # 717). For the reasons that follow, we conclude that Taxpayer is subject to the City privilege tax during the audit period consistent with our decision in MTHO # 717.

Property 1 – 1st Place

Property 1 is occupied by Taxpayer's son. Title to the property was held by **LLC #1** until August 2, 2013. By deed dated August 2, 2013 Taxpayer deeded the property to herself for purposes of refinancing the mortgage on the property. Taxpayer testified that lenders would not refinance to an LLC. Taxpayer had not deeded the property back to **LLC #1** until October 5, 2015, after the end of the audit period.

Taxpayer was liable on the mortgage for the property during the audit period because her son could not qualify on his own for a mortgage. While Taxpayer's son makes the mortgage payments, he is not shown on the title. Taxpayer is also the policy holder on the insurance for the property.

The mortgage payments made by Taxpayer's son constitute consideration (a benefit) to Taxpayer. The occupancy of the property by Taxpayer's son with Taxpayer's consent created a landlord and tenant relationship between Taxpayer and her son. Taxpayer cannot hold herself out as the owner of the property for purposes of obtaining a mortgage, refinancing that mortgage and obtaining insurance on the property and deny that status for privilege tax purposes.

Taxpayer contends the property is being purchased by her son. As held in MTHO # 717, the deed of trust did not operate to transfer Property 1 to Taxpayer's son. We therefore hold that Taxpayer leased Property 1 to her son during the audit period and is liable for the privilege tax on that lease during a portion the audit period.

Effective July 1, 2013 A.R.S. § 42-6004(12) precluded cities from taxing rentals of real property between related entities. Therefore, starting July 1, 2013 Taxpayer's lease of the property to her son is not subject to the City privilege tax. The City in its post-hearing response recognized that because the property was leased to Taxpayer's son, pursuant to A.R.S. § 42-6004(12) the lease would be exempt as a lease to a related person for periods on or after July 1, 2013. The City agreed to amend the assessment for Property 1 to reflect the exemption.

Property 2 – 2nd Place

Taxpayer contends that Property 2 is owned by her daughter. Taxpayer's daughter did not occupy Property 2 during the audit period.¹ The property was leased to others. While **LLC #2**, Taxpayer's LLC, held title to Property 2, the lease agreements during the audit period showed Taxpayer as the landlord. Taxpayer testified that she was listed as the landlord on the lease because if she had to go to court regarding the lease, only a lawyer or the property owner could appear. Taxpayer testified she did go to court on one occasion. Taxpayer received the rental

¹ Taxpayer's daughter began living at Property 2 in October 2014, after the end of the audit period.

payments on Property 2. In June 2015, Taxpayer, not **LLC #2**, executed a deed transferring title to Property 2 to Taxpayer's daughter. This is indication that Taxpayer considered herself the owner of Property 2. As we stated in MTHO # 717, Taxpayer cannot hold herself out as the landlord and the owner of the property in court and deny that status for privilege tax purposes. The City's assessment regarding Property 2 is upheld for the audit period.

The City in its post-hearing response stated that because the property was leased to Taxpayer's daughter, pursuant to A.R.S. § 42-6004(12) the lease would be exempt as a lease to a related person. However, Taxpayer provided testimony at the hearing that her daughter did not occupy the property until October of 2014, after the end of the audit period. Prior to that date, the property was leased to others. Because the audit period ended before Taxpayer's daughter occupied the property, none of the lease of Property 2 was exempt pursuant to A.R.S. § 42-6004(12).

Property 3 – 3rd Place

Property 3 is a rental property and is registered as a rental property. **While LLC #2**, Taxpayer's LLC, held title to Property 3, the lease agreements during the audit period showed Taxpayer as the landlord. Taxpayer again testified that she was listed as the landlord on the lease because if she had to go to court regarding the lease, only a lawyer or the property owner could appear. Taxpayer is responsible for repair and maintenance of the property and receives the rents. For the reasons stated for Property 2, and as held in MTHO # 717, Taxpayer is liable for the privilege tax on the leases of Property 3.

Property 4 – 4th Place

Property 4 is a rental property and is registered as a rental property. **While LLC #3**, Taxpayer's LLC, held title to Property 4, the lease agreements during the audit period showed Taxpayer as the landlord. Taxpayer is responsible for repair and maintenance of the property and receives the rents. For the reasons stated for Property 2, and as held in MTHO # 717, Taxpayer is liable for the privilege tax on the leases of Property 4.

Property 5 – 5th Place

Property 5 is a rental property which Taxpayer manages. Title to the property was held **by LLC #4** until July 18, 2013. By deed dated July 18, 2013 Taxpayer deeded the property to herself for purposes of refinancing the mortgage on the property. Taxpayer testified that lenders would not refinance to an LLC. Taxpayer had not deeded the property back to **LLC #4** until October 5, 2015, after the end of the audit period.

Taxpayer contends that the rental of Property 5 is not the rental of three or more units and is therefore not subject to the tax. As we already stated, PCC § 14-445(f) only applies to persons who have less than three lodging spaces rented or available for rent. Each unit of Taxpayer's triplex is a separate lodging space for purposes of subsection (f). Subsection (f) does not apply to Taxpayer. As held in MTHO # 717, Taxpayer is subject to tax on the rental of Property 5.

Taxpayer has not presented substantial credible and relevant evidence sufficient to establish that the assessment by the Tax Collector was erroneous. Based on the above, Taxpayer's protest is

denied in part and the Tax Collector's Notice of Assessment is upheld in part. The Tax Collector shall exclude from the assessment the lease of Property 1 for periods beginning from and after July 1, 2013. The Tax Collector's assessment is upheld in all other respects.

Findings of Fact

1. The City issued an assessment to Taxpayer for the period June 2012 through January 2014.
2. The assessment involved five properties identified as:
 - a. ***Property 1 – 1st Place***
 - b. ***Property 2 – 2nd Place***
 - c. ***Property 3 – 3rd Place***
 - d. ***Property 4 – 4th Place***
 - e. ***Property 5 – 5th Place***
3. Property 1 is occupied by Taxpayer's son.
4. Taxpayer purchased Property 1 in May 2007.
5. Taxpayer deeded the property to ***LLC #1*** by deed dated November 22, 2011.
6. Taxpayer was liable on the mortgage on the property during the audit period.
7. ***LLC #1*** deeded the property to Taxpayer by deed dated August 2, 2013 so Taxpayer could refinance the mortgage on the property because lenders would not refinance to an LLC.
8. Taxpayer held title to Property 1 during a portion of the audit period.
9. Taxpayer's son made the mortgage payments on the property.
10. Taxpayer entered into an agreement labeled Deed of Trust with her son.
11. The agreement identified Taxpayer's son as Trustor and stated that the Trustor was the owner of the estate in Property 1.
12. Nothing was introduced into the record showing that Taxpayer's son was the owner of the estate in Property 1 during the audit period.
13. The agreement did not contain language conveying Property 1 or an interest in Property 1 from Taxpayer to her son.
14. The agreement contained a promise to pay \$900 per month.
15. The agreement was not notarized or recorded with the county recorder during the audit period.
16. Property 2 was leased to a tenant during the audit period.
17. The lease agreements for Property 2 identify Taxpayer as landlord.
18. Taxpayer was listed as landlord to allow her to represent herself as the property owner in case Taxpayer needed to go to court regarding the lease. Taxpayer testified she had to go to court on an occasion.
19. Taxpayer purchased Property 2 in August 2010.

20. Taxpayer deeded the property to **LLC #2** by deed dated March 9, 2012.
21. Taxpayer entered into an agreement labeled Deed of Trust with her daughter.
22. The agreement identified Taxpayer's daughter as Trustor and stated that the Trustor was the owner of the estate in Property 2.
23. Nothing was introduced into the record showing that Taxpayer's daughter was the owner of the estate in Property 2 during the audit period.
24. The agreement did not contain language conveying Property 2 or an interest in Property 2 from Taxpayer to her daughter.
25. The agreement contained a promise to pay \$900 per month.
26. The agreement was not notarized or recorded with the county recorder during the audit period.
27. Taxpayer (not **LLC #2**) conveyed the property to her daughter by deed dated June 9, 2015.
28. Taxpayer's daughter moved into Property 2 in October 2014.
29. Properties 3, 4 and 5 are leased to tenants.
30. Taxpayer purchased Property 3 in May 2009.
31. **LLC #2**, Taxpayer's LLC, held title to Property 3 during the audit period.
32. Taxpayer purchased Property 4 in March 2009.
33. **LLC #3**, Taxpayer's LLC, held title to Property 4 during the audit period.
34. Taxpayer purchased Property 5 in August 2008.
35. **LLC #4**, Taxpayer's LLC, held title to Property 5 during a portion of the audit period.
36. **LLC #4** conveyed title to the property back to Taxpayer on July 18, 2013 when Taxpayer refinanced the loan on the property because lenders would not refinance to an LLC.
37. Taxpayer testified that her son manages Properties 1 and 4.
38. Taxpayer testified that her daughter manages Properties 2 and 3.
39. Taxpayer did not have a written management agreement with either her son or her daughter or pay either her son or her daughter for managing the properties during the audit period.
40. Taxpayer testified that she manages Property 5.
41. Taxpayer testified that she is listed as the landlord and received the rent for Properties 3, 4 and 5.
42. Taxpayer paid for maintenance on the Properties.
43. Taxpayer is the sole member of the LLC's that held title to the properties.
44. Taxpayer also owns a triplex that she leases. Taxpayer has reported and paid tax on the rentals of the triplex.

45. Taxpayer timely protested the assessments arguing that she was not subject to the City privilege tax.²

Conclusions of Law

1. Phoenix City Code (PCC) § 14-445 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.
2. PCC § 14-445(f) provides that a person who has less than three apartments, houses, trailer spaces, or other lodging spaces rented, leased or licensed or available for rent, lease, or license within the State and no units of commercial property for rent, lease, or license within the State, is not deemed to be in the rental business.
3. Taxpayer had three or more lodging spaces rented or available for rent during the audit periods and is therefore subject to the City privilege tax.
4. Leases of real property to an affiliated person are exempt from city privilege tax on or after July 1, 2013. A.R.S. § 42-6004(12).
5. 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).
6. Taxpayer has the burden to show she 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 presumption is that an assessment of additional tax is correct and the burden is on the taxpayer to overcome the presumption. *See, Arizona State Tax Commission v. Kieckhefer*, 67 Ariz. 102, 191 P.2d 729 (1948).
8. Once the presumption of correctness attaches, the taxpayer must present substantial credible and relevant evidence sufficient to establish that the assessment was erroneous. *U.S. v. McMullin*, 948 F.2d 1188 (10th Cir.,1991); *Anastasato v. C.I.R.*, 794 F.2d 884 (3rd Cir.,1986).
9. A general denial of liability is not sufficient to overcome the presumption that the assessment is correct. *Avco Delta Corp. Canada Ltd. v. U.S.*, 540 F.2d 258 (7th Cir., 1976).
10. The occupancy of premises by one person with the consent or permission of the owner may create between the parties an implied contract which yields the necessary foundation for a landlord and tenant relationship. *Kransky v. Hensleigh*, 146 Mont. 486, 490, 409 P.2d 537, 539 (1965).
11. The occupancy of Property 1 by Taxpayer's son with her consent created a landlord and tenant relationship between Taxpayer and her son.
12. Consideration is some right, interest, profit or benefit accruing to one party or some detriment, loss or responsibility, given, suffered or undertaken by the other. *Black's Law Dictionary*, Sixth Edition.

² The Tax Collector argued that Taxpayer's protest was not timely. Based on testimony at the hearing in this matter, we held that Taxpayer's protest was timely.

13. Taxpayer received consideration when her son made mortgage payments on behalf of Taxpayer.
14. Taxpayer's lease of Property 1 to her son is not taxable for periods beginning on or after July 1, 2013. A.R.S. § 42-6004(12).
15. A conveyance of real property must be by a written instrument. A.R.S. § 33-401.A.
16. A deed or conveyance of real property must be signed by the seller and be duly acknowledged before an officer authorized to take acknowledgements. A.R.S. § 33-401.B.
17. The deeds of trust between Taxpayer and her son and daughter did not operate to transfer an interest in real property.
18. For the reasons stated in our prior decision dated January 7, 2013 in MTHO # 717, Taxpayer continues to be taxable under the real property lease classification for Properties 2, 3, 4 and 5 and for periods before July 1, 2013 for Property 1.
19. The City's privilege tax assessment against Taxpayer was proper except for tax on the lease of Property 1 to Taxpayer's son for periods beginning on or after July 1, 2013.
20. Taxpayer's protest is granted in part and denied in part consistent with Conclusion of Law No. 20.

Ruling

The protests by Taxpayer of the assessments made by the City of Phoenix for the period June 2012 through January 2014 is granted in part and denied in part.

The Tax Collector shall remove from its Notices of Assessment taxes on Property 1 for periods beginning on or after July 1, 2013. The Tax Collector's Notice of Assessment for the period June 2012 through January 2014 is upheld in all other respects.

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: ***Asst. City Attorney***
Municipal Tax Hearing Office