

DECISION OF MUNICIPAL TAX HEARING OFFICER

January 7, 2013

Taxpayer
Taxpayer's Address

Taxpayer
MTHO #717

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 September 17, 2012 and in post-hearing memoranda. The review periods covered were June 2007 through October 2011 (first audit period) and November 2011 through May 2012 (second audit period). 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 companies 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. No tax should be due on any of the properties.

Tax Collector's Response

Taxpayer owned all five properties during the first audit period. Taxpayer leased those properties and collected rent. Taxpayer also leases a three unit 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. During the second audit period the properties were held by different limited liability companies (LLC's). The LLC's should either be ignored or Taxpayer was taxable as a broker. Taxpayer was subject to the privilege tax during both audit periods.

Discussion

Taxpayer was assessed City privilege tax for the rental of five residential properties. The same five properties are the subject of both assessments. Taxpayer transferred four of the properties to LLC's in November 2011 and one of the properties in March 2012. The City issued separate assessments for the periods before and after the properties were transferred to LLC's.

Taxpayer also owns a triplex that she leases. Taxpayer has reported and paid tax on the rentals of the triplex. The triplex is not directly in issue here. Taxpayer contends 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.

Taxpayer is subject to the City privilege tax during the first audit period.

Under Phoenix City Code (PCC) § 14-445(f), a person who has less than three apartments, houses, trailer spaces, or other lodging spaces rented or available for rent is not deemed to be in the rental business. Taxpayer contends that a property must have three or more units to qualify for the rental tax. The five properties at issue are single family residences which do not have three or more units.

PCC § 14-445(f) applies to persons who have less than three apartments, houses, trailer spaces, or other lodging spaces rented or available for rent. Each unit of Taxpayer's triplex is a separate apartment or lodging space for purposes of subsection (f). Taxpayer is therefore subject to tax on the rental of any additional residential rentals. The question then is whether Taxpayer is taxable for renting any of the five properties during the first audit period.

Property 1

Property 1 is occupied by Taxpayer's son. He makes monthly payments to Taxpayer. Taxpayer contends the property is being purchased by her son. Taxpayer holds title and is liable on the mortgage for the property because her son could not qualify on his own on the mortgage. Taxpayer's son is not shown on the title. The occupancy of the property by Taxpayer's son with her consent created a landlord and tenant relationship between Taxpayer and her son.

Taxpayer submitted a copy of a deed of trust between her son and herself which Taxpayer contends is evidence that the home is being purchased by her son. The City argued in its post-hearing response that the deed of trust is defective for a number of reasons including that it was not notarized or recorded as required by state statute and the trustee listed in the deed of trust is not one of the entities specified in state statute. However, we do not have to address the validity of the deed of trust because the deed of trust did not operate to transfer Property 1 to Taxpayer's son. Taxpayer owned Property 1 during the first audit period.

Taxpayer also contended that her son manages or takes care of Property 1. Even if Taxpayer's son could be considered a broker or manager of the property, City Regulation § 14-100.1(d) provides that the liability of a broker does not relieve the principal of liability until the tax is paid. There is no evidence here that Taxpayer's son paid the privilege tax to the City. Taxpayer is therefore liable for the tax whether or not her son manages the property or may be considered a broker.

Property 2

Taxpayer contends that Property 2 is owned by her daughter. While Taxpayer's daughter does not occupy Property 2, it is being leased and her daughter manages the property. Taxpayer holds title to Property 2 and the lease agreement shows Taxpayer as the landlord. Taxpayer testified

that she is listed as the landlord on the lease because if they have to go to court regarding the lease, only a lawyer or the property owner could appear.

The reasons why Taxpayer holds title to Property 2 or why she appears as landlord on the lease agreement are not relevant. Taxpayer is free to use whatever form of business she chooses. However, Taxpayer must accept its advantages and disadvantages. Taxpayer cannot hold herself out as the landlord and the owner of the property in court and deny that status for privilege tax purposes.

Taxpayer submitted a copy of a deed of trust between her daughter and herself which Taxpayer contends is evidence that the home is belongs to her daughter. The deed of trust for Property 2 is similar to the deed of trust for Property 1. For the reasons stated regarding Property 1, neither the existence of the deed of trust nor the contention that Taxpayer's daughter is the manager or a broker relieves Taxpayer of liability for the privilege tax.

Property 3

Property 3 is a rental property and is registered as a rental property. Taxpayer holds title to Property 3 and she is listed as the landlord on the lease. Taxpayer contends the property is managed by her daughter. For the reasons stated for Property 2, the contention that Taxpayer's daughter is the manager or a broker does not relieve Taxpayer of liability.

Property 4

Property 4 is a rental property and is registered as a rental property. Taxpayer holds title to Property 4 and she is listed as the landlord on the lease. Taxpayer contends the property is managed by her son. For the reasons stated for Property 2, the contention that Taxpayer's son is the manager or a broker does not relieve Taxpayer of liability.

Property 5

Property 5 is a rental property which Taxpayer manages. 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. Taxpayer is therefore subject to tax on the rental of Property 5.

Taxpayer is subject to the City privilege tax after the creation of the LLC's.

Taxpayer created LLC's for the purpose of holding title to the properties. While the LLC's were first created in 2009, the properties were not deeded to the LLC's until November 2011 for four of the properties and March 2012 for one of the properties.

Taxpayer first contends that the LLC's should be considered the owners of the properties even before the properties were deeded to the LLC's. However, the creation of the LLC's by themselves did not operate to transfer the properties to the LLC's. Under A.R.S. § 33-401 there

was no conveyance of the properties until the properties were actually deeded to the LLC's by deeds meeting the requirements in A.R.S. § 33-401.

Taxpayer next contends that she is not subject to the privilege tax for periods after she transferred title to the properties to the LLC's. However, the lease agreements were not amended to reflect the transfer of title to the LLC's. Taxpayer collected the rental payments and deposited them in her personal account. Taxpayer paid for maintenance on the properties with her personal credit card and paid the credit cards from her personal account.

PCC § 14-100 defines "broker" as any person engaged or continuing in business who acts for another for a consideration in the conduct of a business activity taxable under this Chapter, and who receives for his principal all or part of the gross income from the taxable activity. Under City Regulation § 14-100.1(b) a broker may be taxable even if the activity would have been a causal activity for the principal.

Here, Taxpayer acted as a broker for the LLC's. City Regulation § 14-100.1(d) provides that the broker is not relieved of the responsibility to file and pay taxes until the principal files and pays the correct amount of tax. Taxpayer therefore continues to be liable for the payment of the tax on the five properties after the title to the properties were transferred to the LLC's.¹

Based on the above, the Tax Collector's assessments for the periods June 2007 through October 2011 and November 2011 through May 2012 are upheld.

Findings of Fact

1. Taxpayer held title to five residential properties in the City during the first audit period.
2. The five properties are identified as:
 - a. Property 1 – ***1111 East Eden***
 - b. Property 2 – ***2222 East Eden***
 - c. Property 3 – ***3333 East Eden***
 - d. Property 4 – ***4444 East Eden***, and
 - e. Property 5 – ***5555 East Eden***
3. Property 1 is occupied by Taxpayer's son.
4. Taxpayer purchased Property 1 in May 2007.
5. Taxpayer held title to Property 1 during the first audit period.
6. Taxpayer is liable for the mortgage on the property.
7. Taxpayer receives payments from her son of \$900 per month.
8. Taxpayer entered into an agreement labeled Deed of Trust with her son.
9. The agreement identified Taxpayer's son as Trustor and stated that the Trustor was the owner of the estate in Property 1.

¹ Because we hold Taxpayer subject to tax as a broker, the fact that one of the properties was not transferred to an LLC until March 2012 is not significant.

10. Nothing was introduced into the record showing that Taxpayer's son was the owner of the estate in Property 1.
11. The agreement did not contain language conveying Property 1 or an interest in Property 1 from Taxpayer to her son.
12. The agreement contained a promise to pay \$900 per month.
13. The agreement was not notarized or recorded with the county recorder.
14. Property 2 is leased to a tenant.
15. The lease agreement for Property 2 identifies Taxpayer as landlord and requires lease payments of \$900 to be made to the landlord at her address.
16. Taxpayer purchased Property 2 in August 2010.
17. Taxpayer held title to Property 2 during the first audit period.
18. Taxpayer entered into an agreement labeled Deed of Trust with her daughter.
19. The agreement identified Taxpayer's daughter as Trustor and stated that the Trustor was the owner of the estate in Property 2.
20. Nothing was introduced into the record showing that Taxpayer's daughter was the owner of the estate in Property 2.
21. The agreement did not contain language conveying Property 2 or an interest in Property 2 from Taxpayer to her daughter.
22. The agreement contained a promise to pay \$900 per month.
23. The agreement was not notarized or recorded with the county recorder.
24. Properties 3, 4 and 5 are leased to tenants.
25. Taxpayer purchased Property 3 in May 2009.
26. Taxpayer held title to Property 3 during the first audit period.
27. Taxpayer purchased Property 4 in March 2009.
28. Taxpayer held title to Property 4 during the first audit period.
29. Taxpayer purchased Property 5 in August 2008.
30. Taxpayer held title to Property 5 during the first audit period.
31. Taxpayer testified that her son manages Properties 1 and 4.
32. Taxpayer testified that her daughter manages Properties 2 and 3.
33. Taxpayer testified that she manages Property 5.
34. Taxpayer testified that she is listed as the landlord and collects the rent for Properties 3, 4 and 5.
35. Taxpayer paid for maintenance on the Properties with her personal credit card and paid the credit cards from her personal account.
36. Taxpayer transferred four of the properties to LLC's in November 2011 and one of the properties (Property 2) in March 2012.

37. Taxpayer is the sole member of the LLC's.
38. The City issued separate assessments for the periods before and after the properties were transferred to LLC's.
39. The second assessment with respect to Property 2 included the months of November 2011 through February 2012 which were before Property 2 was transferred to an LLC.
40. Taxpayer also owns a triplex that she leases. Taxpayer has reported and paid tax on the rentals of the triplex.
41. Taxpayer timely protested the assessments arguing that she was not subject to the City privilege tax.

Conclusions of Law

1. 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.
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. 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. 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.
6. 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).
7. The occupancy of Property 1 by Taxpayer's son with her consent created a landlord and tenant relationship between Taxpayer and her son.
8. Taxpayer's son's payments of \$900 per month to Taxpayer constituted rent.
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. A broker is any person engaged or continuing in business who acts for another for a consideration in the conduct of a business activity taxable under this Chapter, and who receives for his principal all or part of the gross income from the taxable activity. PCC § 14-100.

11. Brokers shall be, wherever necessary, treated as taxpayers for all purposes, and shall file a return and remit the tax imposed on the activity on behalf of the principal. City Regulation § 14-100.1(a).
12. A broker acting for a lessor deriving gross income in a category upon which this Chapter imposes a tax is liable for such tax, even if the activity would be considered a casual activity for his principal. City Regulation § 14-100.1(b).
13. The liability of a broker does not relieve the principal of liability except upon presentation to the Tax Collector of proof of payment of the tax, and only to the extent of the correct payment. City Regulation § 14-100.1(d).
14. A broker is not relieved of the responsibility to file and pay taxes until the principal files and pays the correct amount of tax. City Regulation § 14-100.1(d).
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. The City's privilege tax assessments against Taxpayer were proper. Taxpayer's protests should be denied.

Ruling

The protests by Taxpayer of the assessments made by the City of Phoenix for the periods June 2007 through October 2011 and November 2011 through May 2012 are denied.

The Tax Collector's Notices of Assessment are 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: ***City of Phoenix***
Municipal Tax Hearing Office