

DECISION OF MUNICIPAL TAX HEARING OFFICER

December 10, 2012

Taxpayer

Taxpayer's Address

Taxpayer
MTHO #731

Dear Taxpayer:

We have reviewed the evidence presented by Taxpayer and the City of Scottsdale (Tax Collector or City) at the hearing on November 7, 2012. The review period covered was June 2007 through May 2012. Taxpayer's protest, Tax Collector's response, and our findings and ruling follow.

Taxpayer's Protest

Taxpayer is a limited liability company whose sole member is **Mr. GD**. Taxpayer was assessed City of Scottsdale privilege tax under the commercial lease classification for the lease of real property owned by Taxpayer to a Professional Limited Liability Company, **GDL Limited, PLLC**, whose sole member is also **Mr. GD**. There is no lease agreement. Taxpayer does not collect any rent and is not included in the member's federal Schedule C. Taxpayer is essentially a non-entity that has no money or bank account. Also, the City does not tax rents paid by a corporation to an entity that owns at least 80% of the corporation's voting stock. Since both LLC's are wholly owned by the same person, they are affiliated and no tax should be due in any event.

Tax Collector's Response

Taxpayer LLC does not qualify for the exemption for a lease of real property to a corporation at least 80% owned by the lessor. That section only applies to corporations and not limited liability companies. Under the City tax code the LLC is a separate taxable entity. Taxpayer is considered to be in the business of leasing real property. Under the City code transactions concerning real property are not considered casual. While rent payments may not be made, the payments made by **GDL Limited, PLLC** on behalf of Taxpayer for the loan on the property is considered gross income subject to privilege tax.

Discussion

The Tax Collector conducted an audit assessment of Taxpayer for the period June 2007 through May 2012 and issued an assessment. The Tax Collector considered Taxpayer taxable under the commercial lease classification. Taxpayer timely protested the assessment.

Taxpayer holds title to the real property at issue. The property has a loan from the Small Business Administration (SBA). Taxpayer is liable on the loan. During the audit period, the

property was used by a law firm, *GDL Limited, PLLC*. The sole member of both Taxpayer and *GDL Limited, PLLC* is *Mr. GD*. The loan payments to the SBA were made by *GDL Limited, PLLC*. There was no lease agreement between Taxpayer and *GDL Limited, PLLC* and *GDL Limited, PLLC* did not make lease payments to Taxpayer. The question is whether Taxpayer is subject to tax under Scottsdale Tax Code (STC) § 445 and whether any of the exclusions from tax apply.

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. In additions, STC § 445(s) exempts the gross proceeds of sales or gross income derived from a commercial lease in which a reciprocal insurer or a corporation leases real property to an affiliated corporation.

Taxpayer is subject to the tax under STC § 445.

Taxpayer contends that it is not taxable under the commercial lease classification because it did not enter into a lease agreement with *GDL Limited, PLLC* and *GDL Limited, PLLC* did not make any lease payments. However, no particular form of words are necessary to create the relationship of landlord and tenant or the obligation to pay rent. The occupancy of premises by one person with the consent or permission of the owner can create between the parties the relation of landlord and tenant. An implied contract may thus be created which yields the necessary foundation for a landlord and tenant relationship. *Kransky v. Hensleigh*, 146 Mont. 486, 490, 409 P.2d 537, 539 (1965). Here, Taxpayer owned the property. Another entity, *GDL Limited, PLLC* used the property and made the loan payments on behalf of Taxpayer. Making the loan payments was a benefit to Taxpayer and constituted consideration. Taxpayer was thus engaged in the activity of leasing real property located in the City for a consideration.

STC § 100 defines "business" to mean all activities or acts, personal or corporate, engaged in and caused to be engaged in with the object of gain, benefit or advantage, either direct or indirect, but not casual activities or sales. STC § 100 defines "casual activities" as not including the rental or lease of real property. Under the language of the STC, Taxpayer was engaged in the business activity of leasing or renting real property within the City for a consideration.

Taxpayer is not exempt from the tax.

The exemptions provided by STC § 445, subsections (i) and (s) apply to leases to a controlled corporation or by a corporation to an affiliated corporation. First, while both Taxpayer and *GDL Limited, PLLC* are owned by the same person, there is no direct ownership between them. Second, neither Taxpayer nor *GDL Limited, PLLC* are corporations. Therefore the exemptions under subsections (i) and (s) do not apply.

This is consistent with written guidance issued by the Arizona department of revenue. The City code provides that when the state statutes and Model City Tax Code are the same and where the Arizona department of revenue has issued written guidance, the department's interpretation is binding on cities and towns. The department issued Transaction Privilege Ruling (TPR) 93-39 regarding leases between affiliated corporations. The ruling provides that there are no exemptions under the commercial lease classification which apply to

affiliated parties other than corporations. Entities such as individuals, trusts, estates, partnerships, joint ventures, and associations are not considered to be corporations.

Taxpayer is a separate person under the privilege tax.

Taxpayer also argued that it was a disregarded entity for federal income tax purposes. Taxpayer's treatment for federal or state income tax purposes does not dictate its treatment for privilege tax purposes. Under A.R.S. § 29-857, a limited liability company is required to pay taxes that are imposed on limited partnerships other than for income tax purposes. It is for state income tax purposes that a limited liability company will be taxed in the same manner as determined under the internal revenue code. For privilege tax purposes the City can tax an LLC that is otherwise disregarded for federal income tax purposes.

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 established by **Mr. GD**.
2. Taxpayer is disregarded for federal income tax purposes.
3. Taxpayer was set up on accountant's advice.
4. Taxpayer is title owner to real property within the City.
5. **Mr. GD** is the only member and the manager of Taxpayer.
6. **Mr. GD** is also the only member and manager of **GDL Limited, PLLC**, a law firm operated as a limited liability company.
7. Taxpayer has no direct interest in **GDL Limited, PLLC**.
8. Neither Taxpayer nor **GDL Limited, PLLC** is a corporation.
9. **GDL Limited, PLLC** uses the property in the operation of the law firm.
10. There is no executed lease agreement between Taxpayer and **GDL Limited, PLLC** and **GDL Limited, PLLC** makes no lease payments to Taxpayer.
11. The property was purchased with a loan from the SBA.
12. Taxpayer is liable on the loan from the SBA.
13. Payments on the loan are made by **GDL Limited, PLLC**.
14. The loan payments are approximately \$6,000 per month.
15. It is the City's position that Taxpayer is leasing the property to **GDL Limited, PLLC**.
16. Taxpayer did not pay City privilege tax from the lease of the property to **GDL Limited, PLLC**.
17. The Tax Collector conducted an audit assessment of Taxpayer for the period June 2007 through May 2012 and issued an assessment.
18. The Tax Collector considered Taxpayer taxable under the commercial lease classification.

19. The assessment was based on the Tax Collector's estimate of the value of the lease from Taxpayer to ***GDL Limited, PLLC***.
20. The Tax Collector's estimate ranged from \$3,614.52 to \$4,726.68 per month.
21. Taxpayer timely protested the assessment.
22. Taxpayer believed its lease was exempt from the City privilege tax because both LLC's are owned by the same person and because Taxpayer is essentially a non-entity that has no money or bank account.

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 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)
3. 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.
4. Taxpayer received consideration when ***GDL Limited, PLLC*** made payments on the loan.
5. STC § 445(i) provides an exemption from the tax for gross income derived from the leasing of real property to a corporation; provided that 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. STC 445(s) provides an exemption from the tax for gross proceeds of sales or gross income derived from a commercial lease in which a reciprocal insurer or a corporation leases real property to an affiliated corporation.
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. A limited liability company transacting business in Arizona is required to pay the taxes that are imposed by the laws of Arizona or any political subdivision of Arizona on domestic and foreign limited partnerships on an identical basis, except that, for purposes of Title 43, A.R.S. a domestic or foreign limited liability company and its members shall be taxed as if the limited liability company is either a partnership or a corporation or is disregarded as an entity as determined pursuant to the internal revenue code as defined in section 43-105. A.R.S. § 29-857.
10. Taxpayer's tax treatment for federal and state income tax purposes is not relevant to Taxpayer's tax treatment for privilege tax purposes.

11. 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).
12. 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).
13. 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).
14. When the state statutes and model city tax code are the same and where the department of revenue has issued written guidance, the department's interpretation is binding on cities and towns. A.R.S. § 42-6005.D.; STC § 500(e)(2).
15. The state exemption for leases by a corporation to an affiliated corporation does not apply to affiliated parties other than corporations. TPR 93-39.
16. Neither STC § 19-445, subsection (i) nor subsection (s) preclude the City from taxing Taxpayer on its lease of the property to ***GDL Limited, PLLC***.
17. Taxpayer LLC is a separate and distinct person from its sole member and from ***GDL Limited, PLLC***.
18. Taxpayer's lease of the property to ***GDL Limited, PLLC*** is not exempt from the City privilege tax under either STC § 445 (i) or (s).
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 June 2007 through May 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: ***Scottsdale Tax Audit Manager***
Municipal Tax Hearing Office