

DECISION OF MUNICIPAL TAX HEARING OFFICER

February 26, 2013

Taxpayers Trust
Taxpayer's address

Taxpayers Trust
MTHO #751

Dear *Taxpayers Trust*:

We have reviewed the evidence and information presented by *Taxpayers Trust* and the City of Mesa (Tax Collector or City) at the hearing on January 28, 2013. The review period covered was January 2011 through July 2012. 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 two properties in the City. Taxpayer does not lease the properties and receives no rent or income. There is no lease agreement. No tax should be due on either of the properties. Even if there were a lease, the amount of the tax assessed is excessive.

Tax Collector's Response

Taxpayer owned both properties during the audit period. Taxpayer leased those properties and received a benefit because the tenants paid the property taxes, insurance and repairs for the properties. Taxpayer was therefore subject to the privilege tax during the audit period. Taxpayer did not file any returns during the audit period. The assessment was based on the estimated market value of the rent. The assessment should be upheld.

Discussion

Taxpayer is a trust (Trust). The Trust owns two properties in the City that are at issue. Property 1 is located at **1234 E. University** and is occupied by **CI, Inc. dba CBB**. Property 2 is located at **5678 W. University** and is occupied by *Taxpayer's* daughter and is used as her family's residence. Both occupants pay certain expenses associated with the property, including property taxes.

The Trustors of the Trust are *Taxpayer's Trust*. *Taxpayer's Trust* also own 100% of **CI, Inc.** The City assessed Taxpayer City privilege tax under Mesa Tax Code (MTC) § 5-10-445 for the rental of the two properties.

MTC § 5-10-445 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. Taxpayer contends it is not subject to the privilege tax on either of the properties because:

- There is no lease agreement and no transaction took place,
- No income was received,
- One property is occupied by *Taxpayer's Trust* corporation and the other by the Trustors' daughter,
- Even if there were a lease, the assessment is overstated, and
- Taxpayer is being singled out because others are doing the same thing and are not paying taxes.

Taxpayer is Subject to the Tax Under MTC § 5-10-445.

Taxpayer contends it is not taxable under MTC § 5-10-445 because it did not enter into a lease agreement with either *CI, Inc.* or the Trustors' daughter and neither occupant made any lease payments to Taxpayer. 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. Other persons occupied the property and paid property tax on behalf of Taxpayer. Making the property tax 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.

The occupants of the properties are the Trustors' wholly owned corporation and their daughter and her family. Transactions in circumstances where the relationship between the parties is such that the gross income from the transaction is not indicative of the market value of the subject matter of the transaction are subject to tax based on market value. MTC § 5-10-210. Market value is to correspond as nearly as possible to the gross income from similar transactions of like quality or character by other taxpayers where no common interest exists between the parties, but otherwise under similar circumstances and conditions.

The auditor calculated the market value of the rent for Property 1 by considering three sources. First, the auditor considered a schedule compiled by an independent company of average rental amounts by city and by industry. That indicated a rental value of \$1.22 per square foot. The auditor also considered comparable rentals in the area. That indicated a rental value of \$.92 per square foot. Finally, the auditor considered the quarterly return filed by Taxpayer showing rent for the quarter of \$8,000. The auditor considered that to indicate a monthly rental of \$2,666.67 or \$.44 per square foot. The auditor based the assessment for Property 1 on a monthly rental of \$2,666.67.

The auditor calculated the market value of the rent for Property 2 at \$1.00 per square foot. The Tax Collector stated that the \$1.00 figure was based on the filing history of other residential properties in the City. The Tax Collector further stated that it found that to be the most accurate estimate of market value.

Taxpayer did not provide specific evidence regarding the market value of either rental. Based on the record here, we conclude that the Tax Collector's estimate of the market value for both rentals were made on a reasonable basis.

Taxpayer is not Exempt from the Tax.

MTC § 5-10-445 allows exemptions for a single lease of residential property if no commercial property is leased (subsection (F)) and for leases from a corporation to an affiliated corporation (subsection (S)). First, Taxpayer is leasing commercial property (Property 1 used by the baby boutique) along with the residential property. Consequently the exemption under subsection (F) is not applicable. Second, neither the Trust nor Taxpayer's daughter are corporations. Therefore the exemption under subsection (S) is not applicable.

Taxpayer was not Improperly Singled out for an Audit?

Taxpayer contends it is being singled out because others are doing the same thing and are not paying taxes. The Tax Collector testified that the City receives information regarding properties that may be subject to the rental tax. An auditor researches the information and attempts to contact the property owner to determine whether the property is subject to the tax on rentals of real property. That was the circumstance in this case.

The Tax Collector cannot audit every taxpayer, and there is no requirement that it audit every taxpayer. It is no defense to an audit that another Taxpayer may not have been audited absent a showing that the action was based upon an unjustifiable standard, such as race, religion or some other arbitrary classification. *Tucson Mechanical Contracting, Inc. v. Arizona Department of Revenue*, 175 Ariz. 176, 854 P.2d 1162 (1992). Taxpayer presented no evidence to show that it was chosen for some improper reason. The Tax Collector did not improperly choose Taxpayer for an assessment.

Findings of Fact

1. Taxpayer is a trust.
2. The Trustors' of Taxpayer are *Taxpayer's Trust*.
3. Taxpayer holds title to two properties in the City identified as:
 - a. Property 1 – *1234 E. University*
 - b. Property 2 – *5678 W. University*
4. Property 1 is occupied by *CI, Inc.*, which operates *CBB* on the property.
5. *CI, Inc.* is wholly owned by *Taxpayer's Trust*.
6. Taxpayer held title to Property 1 during the audit period.
7. *CI, Inc.* paid property taxes, insurance, maintenance and repair on the property during the audit period.
8. Taxpayer reported rental income of \$8,000 for Property 1 on one quarterly return for a period before the audit period.
9. Taxpayer did not report any rental income on other returns it had filed and did not file any returns during the audit period.
10. Property 2 is occupied by *Taxpayer's Trust daughter* and is used as her family's residence.
11. Taxpayer held title to Property 2 during the audit period.

12. Trustors' daughter paid utilities, content insurance and property taxes on the property during the audit period.
13. Taxpayer has not filed any returns for Property 2.
14. The Tax Collector issued an assessment to Taxpayer under the rental of real property classification for the rental of Properties 1 and 2.
15. Taxpayer timely protested the assessment.
16. Taxpayer testified that:
 - a. There is no lease agreement and no transaction took place,
 - b. Taxpayer received no income,
 - c. One property is occupied by *Taxpayer's Trust* corporation and the other by the Trustors' daughter,
 - d. Even if there were a lease, the assessment is overstated.
 - e. Taxpayers are being singled out because others are doing the same thing and are not paying taxes.
17. Tax Collector testified and stated in its Response to the Protest that:
 - a. The auditor receives information regarding properties that may be subject to the rental tax.
 - b. The auditor researches the property to determine whether or not the property is subject to the privilege tax.
 - c. For properties not clearly exempt, the auditor sends the property owner an inquiry letter.
 - d. For properties where there was no response the auditor issues an assessment.
 - e. The auditor based the assessment on the market value of the lease.
 - f. For Property 1,
 - i. The auditor considered a study by an independent company that compiled the average rental amount for property by city and industry and developed a per square foot rental value. The study indicated a rental value of \$1.22 per square foot.
 - ii. The auditor also reviewed the rentals of comparable properties in the area. The comparables indicated a rental value of \$0.92 per square foot.
 - iii. The auditor also considered the one quarterly return that had been filed by Taxpayer showing rental receipts of \$8,000 for the quarter. Based on that information the auditor assumed a monthly rental of \$2,666.67 for the audit period. That indicated a rental value of \$0.44 per square foot.
 - iv. The auditor based the assessment on a monthly rental value of \$2,666.67 or \$0.44 per square foot.
 - g. For Property 2,
 - i. The auditor used \$1 per square foot.

- ii. The valuation of \$1 per square foot was based on the filing history of other residential properties in the City.
- iii. The Tax Collector has found that to be the most accurate estimate of market value.

Conclusions of Law

1. MTC § 5-10-445 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. 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. The occupancy of Property 1 by Trustors' corporation with Taxpayer's consent created a landlord and tenant relationship between Taxpayer and **CI, Inc.**
4. The occupancy of Property 2 by Trustors' daughter with Taxpayer's consent created a landlord and tenant relationship between Taxpayer and Trustors' daughter.
5. 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.
6. Taxpayer received consideration when the occupants paid property taxes on the properties.
7. MTC § 5-10-445(F) provides that a person who has less than two (2) 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 and is therefore exempt from the tax imposed by this Section on such income. However, a person who has one (1) or more units of commercial property is subject to the tax imposed by this Section on rental, lease, and license income from all such lodging spaces and commercial units of real estate, even though said person may have fewer than two (2) lodging spaces.
8. MTC § 5-10-445(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.
9. 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).
10. 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).
11. Taxpayer rented commercial property in addition to a residential property during the audit period.
12. Taxpayer is a trust and is not a reciprocal insurer or a corporation.

13. Taxpayer Trust is a separate and distinct person from its Trustees and the occupants of the properties. MTC § 5-10-100.
14. Taxpayer's leases of the property to the occupants are not exempt from the City privilege tax under either MTC § 5-10-445 (F) or (S).
15. Transactions in circumstances where the relationship between the parties is such that the gross income from the transaction is not indicative of the market value of the subject matter of the transaction are subject to tax based on market value. MTC § 5-10-210.
16. Market value is to correspond as nearly as possible to the gross income from similar transactions of like quality or character by other taxpayers where no common interest exists between the parties, but otherwise under similar circumstances and conditions. MTC § 5-10-210.
17. The Tax Collector's estimate of market value was reasonable for both Property 1 and Property 2.
18. Taxpayer did not prove that the Tax Collector's estimate of market value was not reasonable and correct.
19. The Tax Collector is not required to audit every taxpayer. *Tucson Mechanical Contracting, Inc. v. Arizona Department of Revenue*, 175 Ariz. 176, 854 P.2d 1162 (1992).
20. The Tax Collector may use his discretion to select some taxpayers for audit. *Tucson Mechanical Contracting, Inc. v. Arizona Department of Revenue, supra*.
21. The fact that the Tax Collector subjects one taxpayer to an audit and assessment but not another does not establish a denial of equal protection absent a showing that the action was based upon an unjustifiable standard, such as race, religion or some other arbitrary classification. *Tucson Mechanical Contracting, Inc. v. Arizona Department of Revenue, supra*.
22. There was no showing that the Tax Collector's reason for selecting Taxpayer for an assessment was based on an unjustifiable standard.
23. The City's privilege tax assessment against Taxpayer was proper. Taxpayer's protest should be denied.

Ruling

The protest by Taxpayer of the assessments made by the City of Mesa for the period January 2011 through July 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: ***Tax Administrator***
Municipal Tax Hearing Office