

**Jerry Rudibaugh
Municipal Tax Hearing Officer**

DECISION OF MUNICIPAL TAX HEARING OFFICER

Decision Date: May 30, 2003
Decision: MTHO #82
Tax Collector: City of Scottsdale
Hearing Date: March 25, 2003

DISCUSSION

Introduction

On November 4, 2002, *Company A* (“Corporation”) and *Management Company* (“Management Company”) (Collectively, hereafter referred to as “Taxpayers”) filed for a refund of taxes paid to the City of Scottsdale (“City”). After review, the City concluded on November 11, 2002, that the protest ‘was timely and in the proper form. On November 25, 2002, the Municipal Tax Hearing Officer (“Hearing Officer”) ordered the City to file a response to the protest on or before January 9, 2003. The City filed a response on January 3, 2003. On January 8, 2003, the Hearing Officer ordered the Taxpayer to file any reply on or before January 29, 2003. The Taxpayer did not file any reply and the matter was set for hearing commencing on March 25, 2003. The City and Taxpayer both appeared and presented evidence at the March 25, 2003 hearing. On March 28, 2003, the Hearing Officer issued a letter ordering the Taxpayer to file any post-hearing memorandum on or before April 2, 2003, the City to file any response memorandum on or before April 9, 2003, and the Taxpayer to file any reply on or before April 16, 2003. It was further indicated that the record would be closed at that time and a written decision issued on or before May 30, 2003. The Taxpayer filed an initial post-hearing memorandum and a reply memorandum on April 2, 2003, and April 16, 2003, respectively. The City filed a response memorandum on April 8, 2003.

From February 1996 until July 1999, *XYZ, LLC* (“*XYZ*”) was a partnership for tax purposes between the Corporation and *Company B* Corporation (“*Company B*”), a 50-50 partnership. On July 1, 1999, the Corporation purchased 80% of *Company B*’s interest giving the Corporation 90% of the partnership. On December 23, 1999, the Corporation purchased the remaining partnership interest of *Company B* and as of January 1, 2000; the Corporation owned 100% of *XYZ*. The Corporation also owned 100% of the Management Company. *XYZ* always held title to the building known as “The *XYZ*” located at _____ in the City. Both the Corporation and the Management Company paid rent to *XYZ* and paid taxes to the City after January 1, 2000 when the Corporation owned 10% of the stock of *XYZ* and the Management Company.

City Position

City Code Section 445(i) (“Section 445”) provides an exemption from the transaction privilege tax when the lessor’s aggregate holdings in the lessee corporation amount to at least eighty

percent of the voting stock. In this case, the lessee actually owns the lessor and the City argued the exemption would not apply. In response to the Taxpayer's argument that the rent is an economic nullity, the City argued that the tax is on the gross income of the activity of renting real property, which does not take into account the expense of any kind. For that reason, the City asserts the argument that the rent is an economic nullity is not relevant for privilege tax purposes.

The City argued that *XYZ* meets the definition of person as set forth in City Code Section 100 ("Section 100"). *XYZ* is registered with the Arizona Corporation Commission ("Commission") as a limited liability company ("LLC") with a dissolution date of 2045. Furthermore, ARS Section 29-857 ("Section 857") provides as follows:

A limited liability company established under this chapter or a foreign limited liability company transacting business in this state pursuant to this chapter shall pay the taxes that are imposed by the laws of this state or any political subdivision of this state on domestic and foreign limited partnerships on an identical basis, except that, for purposes of title 42, chapter 4 and title 43, 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.

The City argued that since the City is a political subdivision of this State, the Taxpayer is required pursuant to Section 857 to submit taxes to the City as if *XYZ* were organized as a partnership.

Taxpayer Position

According to the Corporation, it was essentially paying rent to itself after January 1, 2000 and the Management Company was essentially paying rent to its owner-parent, the Corporation. As a result, the Taxpayer argued that the Corporation should not be liable for the transaction privilege tax on its owner-occupied space and the Management Company should be exempt from the tax pursuant to Section 445.

The Taxpayers argued that *XYZ* is not a separate entity or "person" pursuant to the City Code. According to the Taxpayers, *XYZ* is a single member limited liability company that is not included in the City's definition of "person". In response to the City's argument that *XYZ* was an association, the Taxpayers argued that *XYZ* was not an association because it does not have centralized management or a continuity of existence, and that *XYZ* does not consist of multiple persons.

The Taxpayers disputed the City's argument that the definition of "person" in Section 100 was intended to be broad in its scope. The Taxpayer argued that the plain language of the definition is not overly broad in scope as it contains a finite list of specific terms that have specific meanings. According to the Taxpayers, a single member LLC is not described by any of the terms listed in the definition of the word "person". For that reason, the Taxpayers concluded *XYZ* is not a "person" pursuant to Section 100.

ANALYSIS

Was *XYZ* a separate entity or “person” from the Corporation pursuant to the City Code? Both parties agree that *XYZ* is a separate legal entity. However, the parties reached different conclusions as to whether or not *XYZ* is a “person” pursuant to the definition contained in the City Code. That definition enumerates a “person” as “an individual, firm, partnership, joint venture, association, corporation, estate, trust, receiver, syndicate, broker, ...”. The City has argued that *XYZ* was either a partnership or an association. The Hearing Officer disagrees with both of these conclusions. The Hearing Officer concludes that the reasonable meaning of either an association or a partnership means more than one. In this case, *XYZ* is a single member LLC with no employees. As to the City’s argument that Section 857 of the State Statutes requires *XYZ* to submit taxes as if it were organized as a partnership, the Hearing Officer finds that requirement is for title 42 and title 43 of the State Statutes and does not refer to the City’s tax code. Based on all the above, the Hearing Officer concludes that it would require constricted or unnatural meaning to include *XYZ* as a taxable “person” under the City Code. Accordingly, the Taxpayer’s protest should be approved.

FINDINGS OF FACT

1. On November 4, 2002, the Taxpayer filed for a refund of taxes paid to the City.
2. After review, the City concluded on November 11, 2002 that the protest was timely and in the proper form.
3. On November 25, 2002, the Hearing Officer ordered the City to file a response to the protest on or before January 9, 2003.
4. The City filed a response on January 3, 2003.
5. On January 8, 2003, the Hearing Officer ordered the Taxpayer file to file any reply on or before January 29, 2003.
6. The Taxpayer did not file any reply and the matter was set for hearing commencing on March 25, 2003.
7. The City and Taxpayer both appeared and presented evidence at the March 25, 2003 hearing.
8. On March 28, 2003, the Hearing Officer issued a letter ordering the Taxpayer to file any post-hearing memorandum on or before April 2, 2003, the City to file any response memorandum on or before April 9, 2003, and the Taxpayer to file any reply on or before April 16, 2003.
9. The Hearing Officer also indicated in the March 28, 2003 letter that the record would be closed after receipt of the memorandums and a written decision would be issued on or before May 30, 2003.

10. The Taxpayer filed an initial post-hearing memorandum and a reply memorandum on April 2, 2003, and April 16, 2003, respectively.
11. The City filed a response memorandum on April 8, 2003.
12. From February 1996 until July 1999, **XYZ** was a 50-50 partnership for tax purposes between the Corporation and **Company B**.
13. On July 1, 1999, the Corporation purchased 80 percent of **Company B**'s interest giving the Corporation 90 percent of the partnership.
14. On December 23, 1999, the Corporation purchased the remaining partnership interest of **Company B** and as of January 1, 2000, the Corporation owned 100 percent of **XYZ**.
15. The Corporation also owned 100 percent of the Managerial Company.
16. **XYZ** always held title to the building known as "The **XYZ**" located at _____ in the City.
17. Both the Corporation and the Management Company paid rent to **XYZ** and paid taxes to the City during the period after January 1, 2000, when the Corporation owned 100 percent of the Stock of **XYZ** and the Management Company.

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. Rental of real property is taxable pursuant to the City Cede.
3. During the period from January 1, 2000 through March 31, 2002, **XYZ** rented real property to the Corporation and the Management Company.
4. **XYZ** has always been a separate legal entity from the Corporation and the Management Company.
5. After December 23, 1999, **XYZ** was a single member limited liability company.
6. Section 445(i) provides an exemption for privilege taxes on rental income when the lessor owns 80 percent of the lessee.
7. In this case, the lessee, the Corporation owned 100 percent of the lessor, **XYZ**.
8. The Taxpayers do not qualify for the Section 445(i) exemption.

9. The reasonable meaning of either association or a partnership means more than one.
10. The requirement pursuant to Section 857 for an LLC to submit taxes as if it were organized as a partnership refers to title 42 and title 43 of the State Statutes and does not refer to the City's tax code.
11. It would require a constricted or unnatural meaning to include *XYZ* as a taxable "person" under the City Code.
12. The Taxpayer's protest should be granted.

ORDER

It is therefore ordered that the November 4, 2002 protest of *Taxpayers* is hereby granted.

It is further ordered that the City of Scottsdale shall refund the taxes paid by *Taxpayers* in the amounts of \$5,426.70 and \$828.59, respectively, for the period of January 1, 2000 through March 31, 2002.

It is further ordered that this decision shall be effective immediately.

Jerry Rudibaugh
Municipal Tax Hearing Officer