

**Jerry Rudibaugh
Municipal Tax Hearing Officer**

DECISION OF MUNICIPAL TAX HEARING OFFICER

Decision Date: March 12, 2003
Decision: MTHO #53
Tax Collector: City of Flagstaff
Hearing Date: November 22, 2002

DISCUSSION

Introduction

On June 17, 2002, (“Taxpayer”) filed a letter of protest regarding tax assessed by the City of Flagstaff (“City”). After review of the protest, the City concluded on July 12, 2002, that the protest was timely and in proper form. On August 6, 2002, the Municipal Tax Hearing Officer (“Hearing Officer”) ordered the City to file a response to the protest on or before September 20, 2002. The City filed its response on September 17, 2002. On September 23, 2002, the Hearing Officer ordered the Taxpayer to file a reply on or before October 7, 2002. The Taxpayer filed its reply on October 7, 2002. The matter was scheduled for hearing commencing on November 22, 2002. The City and Taxpayer both appeared and presented evidence at the November 22, 2002 hearing. The Hearing Officer issued a November 25, 2002 letter ordering the City to file additional information requested by the Taxpayer on or before December 6, 2002. At the same time, the Taxpayer was ordered to file its initial and reply briefs on or before December 20, 2002 and January 10, 2003, respectively. The City was ordered to file its response brief on or before January 3, 2003. The City filed its additional information on December 4, 2002. The Taxpayer filed its initial brief on December 20, 2002. On January 3, 2003, the City requested an extension until January 6, 2003 to file its response brief. On January 3, 2003, the Hearing Officer granted the City’s extension and extended the Taxpayer’s reply brief deadline until January 15, 2003. The Taxpayer filed its reply brief on January 15, 2003. On January 21, 2003, the Hearing Officer issued a letter indicating that the parties could file proposed findings of fact (“FOF”) and conclusions of law (“COL”) on or before January 31, 2003 and indicating a written decision would be issued on or before March 17, 2003. On January 31, 2003, the City filed proposed FOF’s and COL’s.

The Taxpayer was in the contracting business until he discontinued operations. The Taxpayer had two buildings on the same lot within the City but with different addresses of _____ Drive (“**Property One**”) and _____ (“**Property Two**”). Beginning in May 1988, the Taxpayer began leasing the **Property One** building to **Lessee One**. The Taxpayer continued to utilize the **Property Two** building for his own use. In December 1990, the Taxpayer began leasing the **Property Two** building to the Arizona Department of Transportation (“**Lessee Three**”). In May of 1998, the Taxpayer began leasing the **Property One** building **Lessee Two**.

The City conducted an audit of the Taxpayer for the period March 1988 through December 2001. The results of the audit found the Taxpayer owed additional tax of \$1,480 and the Taxpayer had collected excess tax in the amount of \$3,062.30 for a total tax due per the audit of \$4,542.30. In addition, the City assessed interest up through March 31, 2002 in the amount of \$4,927.52 and penalties totaling \$1,491.63.

City Position

Beginning in May 1988, the Taxpayer began leasing the ***Property One*** building to ***Lessee One***. City Code Section 3-5-445 (g) (“Section 445”), allows an exemption for a person who has only one unit of commercial property rented or available for rent. According to the City, two conditions must exist for the single unit provision to apply: (1) The lessor must have income from other sources; and, (2) The scope and degree of rental activity clearly indicates that it is an investment rather than a business activity of the lessor. The City argued that there was no evidence that the Taxpayer had income from any business other than the rental of his property during the audit period. In addition, City Regulation 3-5-445 (6) (7) (“Regulation 445”) provides as follows:

Note that there are four (4) conditions for rental of commercial real property to be deemed “casual activity,” which all must be met. They are, in brief:

- (A) The lessor has only one unit of commercial property rented or available for rent, counting *any commercial property he occupies*, if any; and
- (B) The lessor has no lodging rented or available for rent; and
- (C) The lessor has significant income from another source; and
- (D) The scope of the rental activity is clearly a non-business investment.

While the Taxpayer testified that he discontinued contracting operations in 1987, the records of the Arizona Corporation Commission (“ACC”) indicate that the Taxpayer filed Annual Reports for his contracting business up through 1991. The corporate status was revoked in 1993. As a result, the City concluded the Taxpayer’s occupying one commercial property while renting another removes the rental from the definition of “casual activity”.

While the lease with ***Lessee Three*** is exempt from City tax, the City asserted that it did not enter into the formula whether or not a lease is a casual activity. In response to the Taxpayer’s assertion that he had received erroneous advice, the City asserted that such advice must be in writing in order for the City to be bound by it. In fact, Section 3-5-54 1 (a) (“Section 541”) permits the City to abate penalty and interest charges if the Taxpayer has a written statement of erroneous advice. Since there is no written statement in this case, the City is not authorized to waive any taxes, penalties, and/or interest.

In response to the Taxpayer’s argument on the statute of limitations, the City argued that there was no statute of limitations in this case. According to the City, the Taxpayer had taxable rental property going back to March 1998 but did not obtain a City license and began filing tax returns until May 1998. City Code Section 3-5-550 (c) (“Section 550”) provides that when a taxpayer fails to file a return for any month, the tax may be assessed at any time. As a result, the City concluded that none of the assessment was outside of the statute of limitations. As to the

Taxpayer's request for waiver of the penalties, the City concurs the penalties should be waived.

The lease with *Lessee Three* was exempt from City tax because the City Code contained an exemption for transactions in which a department of the State was the customer. However, between November 1993 and September 1998 the Taxpayer collected \$3,062 in City tax from the lease with *Lessee Three*. The tax was not remitted to the City. As a result, the City treated it as excess tax collected and thus due to the City pursuant to City Code Section 3-5-250 (a) (1) ("Section 250"). From October 1998 through June 2001, the Taxpayer changed the wording in the *Lessee Three* lease so that the lease amount included all applicable taxes. At the same time, the Taxpayer paid the City taxes in the amount of \$1,564.80. The City asserted that they intended to refund these monies to *Lessee Three*.

Subsequent to the hearing, the Taxpayer paid back the \$3,062 to *Lessee Three*. However, the City argued there is still interest outstanding on the amount the Taxpayer collected from *Lessee Three*. The City asserted it has no authority to waive the interest due and must collect and remit the interest to *Lessee Three*.

Subsequent to the hearing, *Lessee Three* sent a letter to the Taxpayer indicating *Lessee Three* does not believe City taxes were paid to the Taxpayer after September 1998. As a result, the City indicated it would refund the \$1,564.80 amount the Taxpayer paid the City in connection with the *Lessee Three* lease after October 1998.

Taxpayer Position

The Taxpayer argued that from March 1998 through November 1990 the Taxpayer was not engaged in the business of leasing or renting real property within the City pursuant to Section 445. According to the Taxpayer, Subsection (g) of Section 445 provides for a presumptive exemption for taxpayers who have only one commercial unit rented or available for rent, According to the Taxpayer, the exemption applied since the Taxpayer was using the other building for storage and thus it was not rented or available to rent. The Taxpayer further alleged that if the exemption does not apply then no interest or penalties should be imposed because the Taxpayer relied on erroneous advice from the City. According to the Taxpayer, he called the City on the telephone in 1988 and 1990 and spoke to a woman who told him that "as long as he didn't have two units he was a casual renter". The Taxpayer asserted that he relied on the verbal advice of the City and pursuant to Section 541 no interest or penalties should be imposed. The Taxpayer acknowledged that he filed annual reports up through 1991 because he wanted to preserve the corporate entity in case he later wanted to reenter the business. However, the Taxpayer asserted the contracting activity was curtailed prior to 1988.

As to the *Lessee Three* lease, the Taxpayer argued that neither the City Code nor Regulations indicate that an exempt lease is counted for purposes of determining whether the activity is casual. According to the Taxpayer, if it was the City's intent to include exempt leases, the City could have included such language in the Code or Regulations. Since it did not, the Taxpayer argued an exempt lease should not be counted. Further the Taxpayer asserts that when the *Lessee Three* lease was entered into, the Taxpayer contacted the City and was verbally told that the exempt lease was not considered as an additional unit.

The Taxpayer argued that the City has no right to claim any interest on the \$3,062.30 excess taxes paid by *Lessee Three* to the Taxpayer. According to the Taxpayer, City Code Section 250 and the related City Regulation 3-5-250 (“Regulation 250”) are unconstitutional as an improper taking under Article 2 of the Arizona Constitution. As to the period from October 1998 through June 2001, the Taxpayer asserts he did not collect any tax from *Lessee Three*. According to the Taxpayer, he erroneously paid \$1,564 to the City. As a result, the Taxpayer argued that money should be returned to him.

The Taxpayer does not dispute that *Lessee Three* overpaid the Taxpayer \$3,062.30 during the period 1993 through 1998. On December 2, 2002, *Lessee Three* requested the overpayment be refunded. As a result, the Taxpayer returned the amount of \$3,062.30 on December 20, 2002. As a result, the Taxpayer requested the assessment be adjusted for the *Lessee Three* excess tax and related interest and penalties.

The *Lessee Three* lease dated November 1, 1998 does not require the payment of transaction privilege tax. Any reference to tax refers to property taxes. Further, *Lessee Three* acknowledged in its December 2, 2002 letter that it did not pay any taxes subsequent to November 1998. Accordingly, the Taxpayer asserted he had erroneously paid the City \$1,564.80. The Taxpayer requested that amount along with related interest be paid back to the Taxpayer.

ANALYSIS

The first issue is whether or not the Taxpayer was engaged in the business of leasing or renting real property within the City during the period from March 1988 through November 1990. The Hearing Officer concludes that the Taxpayer was in the business of leasing or renting during that time period. Subsection (b)(7) provides that in order to be deemed “casual activity”, four conditions must be met. The first condition is that “The lessor has only one unit of commercial property rented or available for rent, counting any commercial property he occupies,…” While the Taxpayer argued that he discontinued contracting operations in 1987, he acknowledged that he continued to file annual reports up through 1991 in case he wanted to reenter the business. As a result, the Hearing Officer is not convinced a final decision had been made during the period March 1988 through November 1990 to cease the contracting business. Based on the evidence, the Taxpayer had placed his equipment/furniture in storage in the *Property Two* building in 1987 but did not conclude until 1991 that he was not going to continue in the contracting business. As a result, the Hearing Officer concludes the Taxpayer was occupying commercial property during the period March 1988 through November 1990 as well as leasing commercial property to *Lessee One*. Accordingly, the casual exemption was not available. The Taxpayer’s protest of the taxes assessed for the period March 1988 through November 1990 is denied.

Since the Taxpayer has refunded the City taxes collected from *Lessee Three* for the period November 1993 through September 1998, the excess tax issue has become moot. However, City Code Section 540 (a) (“Section 540 (a)”) does impose interest on any tax not paid by the delinquency date. Accordingly, the Taxpayer still owes the interest on the excess taxes collected for the period November 1993 through September 1998.

We also find the tax issue on the *Lessee Three* lease after October 1998 has become moot since the City has agreed to refund the \$1,564.80 amount the Taxpayer paid the City. However, we again find the Taxpayer's request for interest is still an issue. The Hearing Officer is not aware of any City Code Section or Regulation that would provide interest to the Taxpayer. However, the Hearing Officer does not find it appropriate for the City to consider the monthly payments by the Taxpayer on the *Lessee Three* lease after October 1998 to be payments on the excess tax collected for the period November 1993 through September 1998. As a result, the Taxpayer's ongoing balance would be reduced and the overall interest for the excess taxes would be reduced.

FINDINGS OF FACT

1. On June 17, 2002, the Taxpayer filed a letter of protest regarding tax assessed by the City.
2. After review of the protest, the City concluded on July 12, 2002 that the protest was timely and in the proper form.
3. On August 6, 2002, the Hearing Officer ordered the City to file a response to the protest on or before September 20, 2002.
4. The City filed its response on September 17, 2002.
5. On September 23, 2002, the Hearing Officer ordered the Taxpayer to file a reply on or before October 7, 2002.
6. The Taxpayer filed its reply on October 7, 2002.
7. The matter was scheduled for hearing commencing on November 22, 2002.
8. The City and Taxpayer both appeared and presented evidence at the November 22, 2002 hearing.
9. The Hearing Officer issued a November 25, 2002 letter ordering the City to file additional information requested by the Taxpayer on or before December 6, 2002.
10. The Taxpayer was ordered to file its initial and reply briefs on or before December 20, 2002 and January 10, 2003, respectively.
11. The City was ordered to file its response brief on or before January 3, 2003.
12. The City filed its additional information on December 4, 2002.
13. The Taxpayer filed its initial brief on December 20, 2002.
14. On January 3, 2003, the City requested an extension until January 6, 2003 to file its response brief.
15. On January 3, 2003, the Hearing Officer granted the City's extension and extended the Taxpayer's reply brief deadline until January 15, 2003.

16. The City filed its brief on January 6, 2003.
17. The Taxpayer filed its reply brief on January 15, 2003.
18. On January 21, 2003, the Hearing Officer issued a letter indicating that the parties could submit proposed FOE's and COL's on or before January 31, 2003 and a written decision would be issued on or before March 17, 2003.
19. On January 31, 2003, the City filed proposed FOF's and COL's.
20. The Taxpayer was in the contracting business until he discontinued operations.
21. The Taxpayer had two buildings on the same lot but with different addresses of Property One and Property Two.
22. Beginning in May 1988, the Taxpayer began leasing the Property One building to Lessee One.
23. The Taxpayer continued to utilize the Property Two Building for his own use.
24. In December of 1990, the Taxpayer began leasing the Property Two building to Lessee Three.
25. In May 1998, the Taxpayer began leasing the Property One building to Lessee Two.
26. The City conducted an audit of the Taxpayer for the period March 1988 through December 2001.
27. The results of the audit found the Taxpayer owed additional tax of \$1,480 and the Taxpayer had collected excess tax in the amount of \$3,062.30 for a total tax due per the audit of \$4,542.30.
28. Additionally, the City assessed interest up through March 31, 2002 in the amount of \$4,927.52 and penalties totaling \$1,491.63.
29. The Taxpayer filed Annual Reports with the ACC for his contracting business up through 1991.
30. The corporate status for the contracting business was revoked in 1993.
31. The lease with Lessee Three was exempt from City tax because the City Code contained an exemption for transactions in which a department of the State was the customer.
32. Between November 1993 and September 1998, the Taxpayer collected \$3,062 in City tax from the lease with Lessee Three.
33. The tax collected from Lessee Three was not remitted to the City.
34. From October 1998 through June 2001, the Taxpayer changed the wording in the Lessee Three lease so that the lease amount included all applicable taxes.
35. During the period from October 1998 through June 2001, the Taxpayer paid the City

taxes in the amount of \$1,564.80 for the Lessee Three lease.

36. Subsequent to the hearing, the Taxpayer paid back the \$3,062.30 to Lessee Three for the taxes collected for the period November 1993 through September 1998.
37. Subsequent to the hearing, Lessee Three sent a letter to the Taxpayer indicating that Lessee Three does not believe City taxes were paid to the Taxpayer after September 1998.
38. The City has agreed to refund the \$1,564.80 amount paid the City in connection with the Lessee Three lease after October 1998.
39. According to the Taxpayer, he was given advice by the City during telephone conversations in 1988 and 1990 that "as long as he didn't have two units he was a casual renter".
40. The City accepted Taxpayer's request for a penalty waiver in the amount of \$1,491.63.

CONCLUSIONS OF LAW

1. Pursuant to ARS Section 42-605 6, the Municipal Tax Hearing Officer is to hear all reviews of petitions for hearing or redetermination under the Model City Tax Code.
2. The City's Code imposes a tax on renting commercial property within the City under Section 3-5-445(a).
3. Section 445 and Regulation 445 allows an exemption for a person who has only one unit of commercial property rented or available for rent.
4. The single unit exemption from taxation as defined in Section 445 and Regulation 445 does not apply to the Taxpayer during the audit period.
5. Section 250 requires excess tax collected to be remitted to the City.
6. Section 541 permits the City to abate penalty and interest charges if the Taxpayer has a written statement of erroneous advice.
7. Since there is no written statement of erroneous advice, the City is not authorized to waive any taxes and/or interest.
8. Section 550 provides that when a taxpayer fails to file a return for any month, the tax may be assessed at any time.
9. Section 540(a) imposes interest on any tax that was not paid by the delinquency date.
10. Section 540(a) prohibits the Hearing Officer from waiving or abating interest except as it relates to a tax abated.
11. The Taxpayer's protest of the taxes assessed for the period March 1988 through November 1990 should be denied.

12. The Taxpayer's protest of the taxes on the Lessee Three lease after October 1998 should be granted.

ORDER

It is therefore ordered that the June 17, 2002 protest of *Taxpayer* is granted in part and denied in part consistent with the Discussion herein.

It is further ordered that the City of Flagstaff in calculating the amount of interest owed by *Taxpayer* on the excess tax collected for the period November 1993 through September 1998 shall consider the monthly payments by *Taxpayer* on the *Lessee Three* lease after October 1998 to be payments on the excess tax collected.

It is further ordered that the City of Flagstaff shall credit *Taxpayer* in the amount of \$1,564.80 for the monies paid to the City as taxes on the *Lessee Three* lease after October 1998.

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

Jerry Rudibaugh
Municipal Tax Hearing Officer