Decision Date: November 27, 2006
Decision: MTHO #290
Taxpayer: ***Taxpayer ABC***
Tax Collector: City of San Luis
Hearing Date: April 19, 2006

DISCUSSION

Introduction

On December 16, 2005, ***Taxpayer ABC*** ("Taxpayer") filed a protest of a tax assessment made by the City of San Luis ("City"). On December 29, 2005 the City filed an opposition to the protest. After review, the City concluded on January 5, 2006, that the protest was timely and in the proper form. On January 13, 2006, the Municipal Tax Hearing Officer ("Hearing Officer") ordered the City to file a response to the protest on or before February 27, 2006. On February 21, 2006, the City filed a response to the protest. On February 27, 2006, the Hearing Officer ordered the Taxpayer to file a reply on or before March 20, 2006. On March 14, 2006, a Notice of Tax Hearing ("Notice") scheduled the matter for hearing commencing on April 17, 2006. On March 16, 2006, the Taxpayer requested an extension to file its reply. On March 18, 2006, the Hearing Officer granted the Taxpayer an extension until April 3, 2006. On April 3, 2006, the Taxpayer filed a reply. Both parties appeared and presented evidence at the April 17, 2006 hearing. On April 19, 2006, the Hearing Officer set forth the following schedule: the Taxpayer would file an opening brief on or before June 16, 2006; the City would file a response brief on or before July 17, 2006; and, the Taxpayer would file a reply brief on or before August 1. 2006. On May 17, 2006, the City filed an amended assessment. On June 14, 2006, the Taxpayer requested an extension for its opening brief. On June 16, 2006, the Hearing Officer set forth the following amended schedule: Taxpayer would file an opening brief on or before June 30, 2006; the City would file a response brief on or before July 31, 2006; and, the Taxpayer would file a reply brief on or before August 15, 2006. On June 22, 2006, the Taxpayer filed its opening brief. On July 21, 2006, the City requested an extension for the response brief. On July 24, 2006, the Hearing Officer extended the City's deadline for a response brief until September 11, 2006 and the Taxpayer's reply brief deadline until September 26, 2006. The City filed a response brief on September 11, 2006. On September 21, 2006, the Taxpayer requested an extension for the reply brief. On September 25, 2006, the Hearing Officer extended the deadline for the reply brief until October 10, 2006. On October 10, 2006, the Taxpayer filed a reply brief. On October 13, 2006, the Hearing Officer closed the record and indicated a written decision would be issued on or before November 27, 2006.

City Position

The City conducted an audit of the Taxpayer for the period January 1, 2000 through September 30, 2005. As a result of the audit, the City assessed the Taxpayer for taxes due in the amount of $57,473.49, penalties for failure to file and failure to pay totaling $13,935.57, and interest up through October 2005 in the amount of $9,864.86. The City concluded that the Taxpayer was an LLC operating an apartment complex located at ***Address ABC*** in the City. The City was unable to locate a license for the business and the Taxpayer provided no records. As a result, the City

made an assessment based on an estimate of $500 of rent per month for each of the 64 units. On May 12, 2006, the City amended the assessment to reflect a more accurate estimate of the rental income based on 92 apartments. The amended assessment assessed the Taxpayer for taxes due in the amount of $84,173.43, penalties totaling $21,043.36, and interest up through April 30, 2006 in the amount of $17,325.40.

The City asserted that the Taxpayer was a for-profit owner of an apartment complex that is commonly known as IRC Section 42 low income housing. The City noted that through the use of federal income tax credits, private capital is used to construct housing at lower than market rates and still allow the investors to make a sufficient return. According to the City, the Taxpayer collected monthly rental income from its tenants but never filed any return or remitted any tax to the City. The City indicated there was no dispute that the Taxpayer was subject to tax pursuant to City Code Section 7A-445 ("Section 445").

In response to the Taxpayer, the City argued that the application of equitable estoppel against the City under the facts of this case is fundamentally against the public interest. The City noted that until recently they had depended upon the Arizona Department of Revenue ("DOR") for the collection of its taxes. The City indicated that last year it initiated its own program to augment State enforcement. The City asserted that practically every audit involves going back several years. The City argued that if inaction alone was sufficient to support estoppel, there would not be a single situation in which the doctrine of estoppel would not apply. According to the City, no one would ever have to pay any tax if there were no threat to pursue unpaid tax retroactively.

The City argued the Taxpayer does not qualify for estoppel under Valencia Energy Co. v. Arizona Department of Revenue, 191 Arizona 565, 959 P.2d 1256(1998). The three elements of equitable estoppel as set forth in Valencia are as follows: The party to be estopped commits acts inconsistent with a position it later adopts; Reliance by the other party; and Injury to the latter resulting from the former's repudiation of its prior conduct. The city asserted there were no affirmative acts by the City. The City opined that Valencia requires a formal written affirmative act in order for estoppel to apply. Since there was no formal written act, the City argued there was no affirmative act.

The City argued that since there was no affirmative act, there could be no reliance by the Taxpayer. According to the City, the Taxpayer argued there was inaction by the City and the Taxpayer knew nothing about the tax until the audit. The City asserted the Taxpayer could not "have reasonable reliance on nothing. In Valencia, the City noted the taxpayer affirmatively approached the Department with specific tax questions. Subsequently, the Department provided three letters to the taxpayer as formal opinions as to the applicability of the tax at issue.

According to the City, the courts have held there is no detriment incurred when the party's only injury is that it must pay taxes legitimately owed under the correct interpretation of the law. The City opined that the Taxpayer did not dispute that the tax applies. As a result, the City asserted that the Taxpayer did not suffer detriment as result of relying on an act by the City.

The City argued that it has been long established that ignorance of the law does not excuse anyone from the consequences of the law. The City opined that a rental housing business that is

based on tax credits for its existence should have had the foresight to get tax advice in other areas. The City indicated that ordinances identical to Section 445 have been enacted in every city in Arizona for almost twenty years. Furthermore, the City noted that the Courts have held that taxpayers are responsible for determining their liabilities for city privilege license taxes, reporting the tax on the appropriate return, and submitting the return and payments to the appropriate city. As noted in Tucson Mechanical Contracting v. Arizona Department of Revenue, 175 Arizona 176, 854 P.2d 1162, 1164 (Ct. App. 1992), the City's role is to audit and review taxpayers when it suspects they have not complied with their legal self-assessment responsibility. The City argued that was what happened in this case.

In response to the Taxpayer, the City asserted that there was no delay justifying laches. According to the City, laches results because of a time delay on the part of one party that causes an injury to another party. The City argued there was no delay of any kind by the City because it was under no obligation to do or say anything. The City opined that the only legal limitation based on elapsed time was the statute of limitations ("SOL"). The City noted that since the Taxpayer never filed any tax returns, City Code Section 7A-550(c) ("Section 550(c)") provides for an unlimited SOL.

The City asserted it has the authority to amend and raise the original tax assessment pursuant to the City Code Section 7A-556(c) ("Section 556(c)"). Section 556(c) provides that the City may increase the proposed deficiency when a taxpayer fails to disclose a material fact. According to the City, the Taxpayer failed to provide records requested by the City during the audit. The City noted this was confirmed in an August 2, 2006 letter from the Taxpayer's Yuma attorney in which he stated as follows:

Based upon the foregoing, ***Sponsor XYZ*** is not subject to transaction privilege taxes. Accordingly, the City's request to audit the books and records of ***Sponsor XYZ*** is unwarranted given what is a well known fact. Accordingly, I would respectfully request that you refrain from any further requests to ***Sponsor XYZ*** to participate in an audit for which the City has no jurisdiction.

The City opined there was no question that the Taxpayer received a request for records during the audit and failed to respond. After completion of the audit, the City indicated it received better information about the apartment building and issued the amended assessment to reflect that there were 92 units available. Based on all the above, the City requested the City's original and amended tax audit assessment be upheld.

Taxpayer Position

Taxpayer opined that ***Apt Complex ABC*** was a low-income housing property in the City that was developed by ***ABC Construction*** and sponsored by ***Sponsor XYZ***, a nonprofit organization formed to alleviate the community housing problems of the City and improve living and health standards in the community. Taxpayer indicated Phase I of the project, consisting of 92 units opened in mid-2000.

Taxpayer noted that City Code Section 445 ("Section 445") imposes a tax on the gross income

from the business activity upon every person engaging or continuing in the business of leasing or renting real property located within the City for a consideration. Further, City Code Section 270(c) ("Section 270(c)") provides that a non-profit organization exempt under Internal Revenue Code Section 501(c) ("Section 501(c)"), generally is not subject to the City's privilege license tax. Taxpayer asserted that ***Sponsor XYZ*** was a Section 501(c) tax exempt charity and thus exempt from City sales tax pursuant to Section 270(c). According to the Taxpayer, no sales tax was paid on the ***Apt Complex ABC*** project based on the Taxpayer's belief that the project was like ***Sponsor XYZ***'s other projects. Taxpayer indicated if ***Apt Complex ABC*** was owned and operated directly by ***Sponsor XYZ***, there would be no question the rental receipts from the project would be exempt pursuant to Section 270. Taxpayer argued that because the City played a critical role as the "Local Government" involved in the project and the City took no action regarding the potential application of City sales tax for six or more years, then the City should not now be allowed to assess taxes. Taxpayer opined that because the ***Apt Complex ABC*** were low income units subject to rent restrictions, the Taxpayer can not now raise rents for the past taxes the City attempts to impose.

Taxpayer argued the City's delay of more than six years to assert a right to collect tax from the rent-restricted rental income of the Taxpayer is unreasonable. Taxpayer acknowledged that under ordinary circumstances there would be no question the City would be within its right to issue an assessment for a six-year period (or longer) when a taxpayer fails to file a return. Taxpayer asserted that laches was the equitable counterpart of a SOL. Taxpayer indicated laches involves two elements: An unreasonable delay in asserting some right and a showing of prejudice resulting from the delay. According to the Taxpayer, laches will apply not withstanding that the delaying party is within its legal rights under the applicable statute. In State V. Garcia, 187 Ariz. 527, 931 P .2d 427 (App. 1996), the State waited until six months before a minor child's emancipation, but nine years after first being informed of the identity of the minor's father, before seeking arrearages for reimbursement of public aid provided for the father's child. The Court held that under the circumstances the delay was unreasonable. Taxpayer noted the Court applied the laches defense even though the conduct supporting the defense was governmental inaction or silence. Taxpayer asserted the City was well aware of the existence and nature of the ***Apt Complex ABC*** project from before the time construction began. According to the Taxpayer, the City played an instrumental role in the procedures required for financing and construction of the project. Taxpayer argued that under the circumstances, the City's attempt to assert a right to tax the rent-restricted rental revenue of this project after six years of silence regarding the tax creates an injustice that should be barred under the doctrine of laches. Taxpayer opined that in Valencia Energy Co. v. Arizona Department of Revenue, 191 Ariz. 565, 959 P .2d 1256 (1998), the Court held that when a taxpayer can " no longer pass the cost of the tax to its buyers," the taxpayer has been prejudiced for purposes of estoppel. Taxpayer asserted that applying laches to the unique facts of this case does not unduly interfere with the City's ability to assess tax against other taxpayers, nor does it detract from the public policy of promoting compliance with the City's tax laws.

Taxpayer argued that the City's amended assessment violates State Statute and Section 556. According to the Taxpayer, the City was well aware the ***Apt Complex ABC*** Phase I consisted of 92 apartments since at least as early as August 24, 1999. Taxpayer provided a copy of an August 24, 1999 letter from a City Administrator indicating ***Sponsor XYZ*** was to pay development fees

for 92 apartments. Taxpayer asserted the City may not, in good faith, claim that it incorrectly identified the number of units due to ***Sponsor XYZ***'s "failure to provide material information during the initial audit," when the City was well aware of this information.

Taxpayer noted that ***Sponsor XYZ*** served as the nonprofit sponsor of the ***Apt Complex ABC*** housing project, and ***MGMT Group ABC***, an affiliate of ***Sponsor XYZ***, was manager of the Taxpayer, together with the developer, ***ABC Construction*** Investments. Taxpayer indicated its sole member was the tax credit fund involved in the tax credit financing for the project. In a separate case, the City withdrew an assessment against ***Sponsor XYZ*** because ***Sponsor XYZ*** was not subject to City tax pursuant to Section 270(c). Taxpayer asserted that all the documentation requests by the City related expressly to the City's audit of ***Sponsor XYZ***. Taxpayer argued that if the City insists on treating the Taxpayer as part and parcel of ***Sponsor XYZ***, for purposes of arguing that "the Taxpayer was completely aware of the City's records request," and "the Taxpayer intentionally refused to comply with the City's records request," then the assessment against the Taxpayer should be abated on the basis that ***Sponsor XYZ*** is not subject to City tax.

Lastly, Taxpayer asserted the City's original and amended assessments were based on erroneous income information. Taxpayer opined that based on the actual books and records, the net taxable income for the period January 1, 2000 through October 31, 2005 was $2,000,033 or $1,135,794 less than the amount included in the City's assessment.

ANALYSIS

There was no dispute that Taxpayer collected rental income during the audit period that was taxable by the City pursuant to Section 445. It was also clear that because Taxpayer failed to file any reports or pay any taxes that an unlimited SOL was authorized pursuant to Section 550(c). Because Taxpayer failed to file any returns, the City was authorized pursuant to City Code Section 545 ("Section 545") to make an estimated assessment. Further, Taxpayer failed to demonstrate the estimate was not reasonable.

The next issue was whether or not the Taxpayer was entitled to an equitable defense because of some type of action/inaction by the City. We think not. Clearly, there were various administrators of the City that had encouraged/supported the construction of the low-income housing project. While any major construction within the City would require City involvement, the City's involvement with the Taxpayer was more extensive because of the tax credits involved. We find that the taxability of the gross income from the rentals from the apartments was separate and apart from the construction of the low-income apartments. The law is clear that ignorance of the tax law is not a defense. ***Sponsor XYZ*** had other businesses that were tax exempt because ***Sponsor XYZ*** was a non-profit organization pursuant to Section 270(c). ***Sponsor XYZ*** made the assumption, without checking with the City, that Taxpayer was also exempt. There was no evidence the City ever informed Taxpayer that the income from the apartments was tax exempt. Nor was there any evidence that the City was aware Taxpayer was not filing returns or paying taxes and the City simply sat back and waited before doing an audit. We conclude the Taxpayer failed to perform due diligence to determine if its income was taxable and is now trying to place the blame on the City for the Taxpayer's failure.

The next issue is whether the City was authorized pursuant Section 556 to amend and raise the original tax assessment. Section 556(c) provides that a Tax Collector may increase the proposed deficiency when "the Tax Collector submitted a written request for information prior to issuance of the assessment, and the taxpayer, despite possessing or having access to such information, failed to provide it within 60 days as required by Section 7A-555(c)." We find that the burden of proof is on the City to demonstrate that the Taxpayer failed to provide information requested in a written request. While the City made written requests for information, we must agree with the Taxpayer that the written requests were made to ***Sponsor XYZ*** and not to the Taxpayer. While ***Sponsor XYZ*** was very closely related to the Taxpayer, ***Sponsor XYZ*** was not the Taxpayer. We also note that the City should have been able to determine the number of units by simply counting them or by reviewing various City documents that indicated that there were 92 units being built in Phase I. Accordingly, we must conclude that the City's amended assessment violates Section 556.

Lastly, the Taxpayer attempted in its reply brief to introduce, for the first time, the actual rental income figures for the periods at issue. While it is normally preferable to utilize actual numbers instead of estimates, we must deny the introduction of these numbers at this time. The Taxpayer has had the opportunity to provide such documentation for at least over a year (the original estimated assessment was dated November 2, 2005) and failed to do so. The accuracy of the numbers cannot be verified since the City has never had an opportunity to review and audit the documentation. We also note that if we were to permit the Taxpayer to provide actual income numbers at this late date, we would require the actual number of units to also be utilized. Based on the above, the City's original assessment is upheld.

FINDINGS OF FACT

1) On December 16, 2005, the Taxpayer filed a protest of a tax assessment made by the City.

2) On December 29, 2005, the City filed an opposition to the protest.

3) After review, the City concluded on January 5, 2006, that the protest was timely and in the proper form.

4) On January 13, 2006, the Hearing Officer ordered the City to file a response to the protest on or before February 27, 2006.

5) On February 21, 2006, the City filed a response to the protest.

6) On February 27, 2006, the Hearing Officer ordered the Taxpayer to file a reply on or before March 20, 2006.

7) On March 14, 2006, a Notice scheduled the matter for hearing commencing on April 17, 2006.

8) On March 16, 2006, the Taxpayer requested an extension to file its reply.

9) On March 18, 2006, the Hearing Officer granted the Taxpayer an extension until April 3, 2006.

10) On April 3, 2006, the Taxpayer filed a reply.

11) Both parties appeared and presented evidence at the April 17, 2006 hearing.

12) On April 19, 2006, the Hearing Officer set forth the following schedule: Taxpayer would file an opening brief on or before June 16, 2006; the City would file a response brief on or before July 17, 2006; and, Taxpayer would file a reply brief on or before August 15, 2006.

13) On May 12, 2006, the City filed an amended assessment.

14) On June 14, 2006, the Taxpayer requested an extension for its opening brief.

15) On June 16, 2006, the Hearing Officer set forth the following amended schedule: Taxpayer would file an opening brief on or before June 30, 2006; the City would file a response brief on or before July 31, 2006; and, Taxpayer would file a reply brief on or before August 15, 2006.

16) On June 22, 2006, the Taxpayer filed a protest of the amended assessment.

17) On June 30, 2006, the Taxpayer filed its opening brief.

18) On July 21, 2006, the City requested an extension for its response brief.

19) On July 24, 2006, the Hearing Officer extended the City's deadline for a response brief until September 11, 2006, and Taxpayer's reply brief deadline until September 26, 2006.

20) The City filed a response brief on September 11, 2006.

21) On September 21, 2006, the Taxpayer requested an extension for its reply brief.

22) On September 22, 2006, the Hearing Officer extended the deadline for the reply brief until October 10, 2006.

23) On October 10, 2006, the Taxpayer filed a reply brief.

24) On October 13, 2006, the Hearing Officer closed the record and indicated a written decision would be issued on or before November 27, 2006.

25) The City conducted an audit of the Taxpayer for the period January 1, 2000 through

September 30, 2005.

26) The City assessed the Taxpayer for taxes due in the amount of $57,473.49, penalties for failure to file and failure to pay totaling $13,935.52, and interest up through October 2005 in the amount of $9,864.86.

27) Taxpayer was an LLC operating an apartment building located at ***Address ABC*** in the City.

28) The City was unable to locate a license for the business and the Taxpayer provided no records.

29) The City made an assessment based on an estimate of $500.00 of rent per month for each of 64 units.

30) On May 12, 2006, the City amended the assessment to reflect a more accurate estimate of the rental income based on 92 apartments.

31) The amended assessment assessed the Taxpayer for taxes due in the amount of $84,173.43, penalties totaling $21,043.36, and interest up through April 30, 2006 in the amount of $17,325.40.

32) Taxpayer was a for-profit owner of an apartment complex that is commonly known as IRC Section 42 low income housing.

33) Through the use of federal income tax credits, private capital is used to construct housing at lower than market rates and still allow the investors to make a sufficient return.

34) Taxpayer collected monthly rental income from its tenants but never filed any returns or remitted any taxes to the City.

35) Taxpayer was a low-income housing property in the City that was developed by ***ABC Construction*** and sponsored by ***Sponsor XYZ***, a nonprofit organization formed to alleviate the community housing problems of the City and assist and improve living and health standards in the community.

36) Phase I of the project consisting of 92 units, opened in mid-2000.

37) Taxpayer did not pay any sales tax on the ***Apt Complex ABC*** rental income because Taxpayer believed the project was like ***Sponsor XYZ***'s other projects.

38) During the audit period, Taxpayer failed to file any reports or pay any taxes.

39) Taxpayer never checked with the City to determine if the Taxpayer's rental income was taxable.

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) During the audit period, the Taxpayer had unreported taxable income pursuant to Section 445.

3) The City was authorized pursuant to Section 550(c) to utilize an unlimited SOL.

4) The City was authorized pursuant to Section 545 to make an estimated assessment.

5) Taxpayer failed to demonstrate the City's estimate was not reasonable.

6) Ignorance of the tax law is not a valid defense.

7) Taxpayer assumed they were exempt from tax because their sponsor (***Sponsor XYZ***) was exempt from tax.

8) Taxpayer failed to perform due diligence to determine if its income was taxable.

9) There was no evidence of any delay by the City that would justify a defense of laches by the Taxpayer.

10) There was no evidence of any formal written act by the City that would justify an equitable estoppel defense by the Taxpayer.

11) There was no evidence that the City was aware Taxpayer was not filing returns or paying taxes and the City sat back and waited before doing an audit.

12) The City failed to prove that the Taxpayer did not provide information requested in a written request to the Taxpayer.

13) The City's amended assessment violates Section 556 and should be denied.

14) Taxpayer's attempt to introduce, for the first time, actual rental numbers is hereby denied.

15) Taxpayer's protest should be partly granted and partly denied, consistent with the Discussion, Findings, and Conclusions, herein.

ORDER

It is therefore ordered that the December 16, 2005 protest and June 22, 2006 amended protest by ***Taxpayer ABC*** of a tax assessment made by the City of San Luis is hereby granted, in

part, and denied, in part, consistent with the Discussion, Findings, and Conclusions, herein.

It is further ordered that the City of San Luis shall revise their assessment consistent with the Discussion, Findings, and Conclusions, herein.

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

Jerry Rudibaugh
Municipal Tax Hearing Officer