

DECISION OF MUNICIPAL TAX HEARING OFFICER

Decision Date: October 31, 2007
Decision: MTHO #357
Taxpayer: *Taxpayer A*
Tax Collector: City of Mesa
Hearing Date: September 19, 2007

DISCUSSION

Introduction

On April 4, 2007, *Taxpayer A* (“Taxpayer”) filed a protest of a tax assessment made by the City of Mesa (“City”). After review, the City concluded on April 18, 2007 that the protest was timely and in the proper form. On April 28, 2007, the Municipal Tax Hearing Officer (“Hearing Officer”) ordered the City to file a response to the protest on or before June 12, 2007. On June 14, 2007, the City filed an email requesting an extension to file a response. On June 19, 2007, the Hearing Officer granted the City an extension until June 29, 2007. On June 21, 2007, the City sent an email requesting another extension in order to have time to review additional information requested from Taxpayer. On June 13, 2007, the Hearing Officer granted the City another extension until August 5, 2007. On August 2, 2007, the City filed a response. On August 6, 2007, the Hearing Officer ordered Taxpayer to file a reply on or before August 27, 2007. On August 13, 2007, a Notice of Tax Hearing (“Notice”) scheduled the matter for hearing commencing on September 19, 2007. Taxpayer failed to appear at the September 19, 2007 hearing, while the City appeared and presented evidence. On September 24, 2007, the Hearing Officer granted Taxpayer until October 24, 2007 to provide good cause for failure to appear at the September 19, 2007 hearing. Taxpayer failed to respond to the Hearing Officer’s September 24, 2007 letter.

City Position

The City conducted a compliance audit on Taxpayer for the period December 2000 through December 2006. The City assessment consisted of tax of \$21,709.06, interest up through December 2006 of \$191.94, penalties of \$5,252.42, and a license fee of \$50.00. Taxpayer was assessed tax on the rental of real property located on E. Alder Avenue (“*Property 123*”) in the City pursuant to Mesa Tax Code 5-10-445 (“Section 445”).

The City noted that *Mr. ABC* (“*Mr. ABC*”) was the trustee for Taxpayer. *Mr. ABC* had purchased five lots consisting of the *Property 123*. According to the City, *Mr. ABC* quit claimed the *Property 123* to Taxpayer on October 10, 2001. The City indicated Taxpayer leased the *Property 123* to *Taxpayer B*. (“*Taxpayer B*”), a related party, whose sole officer was *Mr. ABC*. The City first advised Taxpayer of the commercial lease tax

liability on October 19, 2006 during the audit of the *Taxpayer B*. The City requested on several occasions for Taxpayer to submit a self-assessment worksheet. The City asserted that Taxpayer failed to respond to the City's requests. As a result, the City indicated an estimate was made for Taxpayer's gross income. As part of the *Taxpayer B* audit, the City obtained federal tax returns for 2002, 2003, and 2004. The tax returns contained rent expense for the *Property 123* for each of those years. The City noted that the 2004 rent expense claimed was much lower than the other years. For that reason, the City did not accept the lower 2004 rent expense because the other two years established a higher market value. The City utilized the amounts claimed for 2002 and 2003 to estimate Taxpayer's annual gross income throughout the audit period. The City indicated a willingness to review documentation to prove the City's estimate was not reasonable, however, Taxpayer failed to provide any documentation. Based on the above, the City requested the tax assessment be upheld.

The City also assessed penalties because Taxpayer failed to file returns and failed to timely pay taxes. The City requested the penalties be upheld.

Taxpayer Position

Taxpayer protected the assessment of \$27,203.42. Taxpayer asserted that the assessment was based on a limited amount of records. According to Taxpayer, "once the records are available, the amount of assessment will be less."

ANALYSIS

During the audit period, we find that Taxpayer owned the *Property 123* and the *Taxpayer B* occupied the *Property 123* in the conduct of the *Taxpayer B* business activity. Section 5-10-100 ("Section 100") defines "trusts" and "corporations" as "persons" under the City Code. As a result of the *Taxpayer B* and Taxpayer being separate "persons", we conclude that Taxpayer was in the business of leasing or renting real property to the *Taxpayer B* pursuant to Section 445. City Code Section 5-10-210 ("Section 210") provides when a transaction is between affiliated companies or persons, the City is to determine the "market value" upon which the City tax is to be levied. Clearly, Taxpayer and the *Taxpayer B* were affiliated companies/persons since *Mr. ABC* was the trustee for Taxpayer and *Mr. ABC* was the sole owner of the *Taxpayer B*. Section 5-10-545 ("Section 545") requires that any estimate by the City must be made on a reasonable basis. We conclude that the City's use of the federal tax returns of the *Taxpayer B* to determine a "market value" for the rental of the *Property 123* to be a reasonable method. We also conclude that the City's refusal to accept a much lower rent expense for 2004 versus amounts for 2002 and 2003 for the exact same property to be reasonable. While Taxpayer had an opportunity to demonstrate the City's estimate was not reasonable, Taxpayer failed to provide any documentation. Based on the above, we find the City's tax assessment to be reasonable and is upheld.

Because Taxpayer failed to file tax reports and failed to timely pay taxes, the City was

authorized pursuant to Section 5-10-540 (“Section 540”) to assess penalties. While those penalties may be waived for “reasonable cause”, Taxpayer failed to demonstrate “reasonable cause”. As a result, the penalties are upheld.

FINDINGS OF FACT

1. On April 4, 2007, Taxpayer filed a protest of a tax assessment made by the City.
2. After review, the City concluded on April 18, 2007 that the protest was timely and the proper form.
3. On April 28, 2007, the Hearing Officer ordered the City to file a response to the protest on or before June 12, 2007.
4. On June 14, 2007, the City filed an email requesting an extension to file a response.
5. On June 19, 2007, the Hearing Officer granted the City an extension until June 29, 2007.
6. On June 21, 2007, the City sent an email requesting an additional extension in order to have time to review additional information requested from Taxpayer.
7. On June 23, 2007, the Hearing Officer granted the City another extension until August 5, 2007.
8. On August 2, 2007, the City filed a response.
9. On August 6, 2007, the Hearing Officer ordered Taxpayer to file any reply on or before August 27, 2007.
10. On August 13, 2007, a Notice scheduled the matter for hearing commencing on September 19, 2007.
11. Taxpayer failed to appear at the September 19, 2007 hearing while the City appeared and presented evidence at the hearing.
12. On September 24, 2007, the Hearing Officer granted Taxpayer until October 24, 2007 to provide good cause for failing to appear at the September 19, 2007 hearing.
13. Taxpayer failed to respond to the Hearing Officer’s September 24, 2007 letter.
14. The City conducted a compliance audit on Taxpayer for the period December

- 2000 through December 2006.
15. The City assessment consisted of tax of \$21,709.06, interest up through December 2006 of \$191.94, penalties of \$5,252.42, and a license fee of \$50.00
 16. Taxpayer was assessed tax on the rental of *Property 123* in the City.
 17. *Mr. ABC* was the trustee for Taxpayer.
 18. *Mr. ABC* had purchased five lots consisting of the *Property 123*.
 19. *Mr. ABC* quit claimed the *Property 123* to Taxpayer on October 10, 2001.
 20. Taxpayer leased the *Property 123* to *Taxpayer B*, a related party, whose sole officer was *Mr. ABC*.
 21. The City advised Taxpayer of the commercial lease tax liability on October 19, 2006 during the audit of the *Taxpayer B*.
 22. The City requested on several occasions for Taxpayer to submit a self-assessment worksheet.
 23. Taxpayer failed to respond to the City's requests.
 24. The City estimated Taxpayer's gross income from information obtained from the *Taxpayer B*'s federal tax returns for 2002, 2003 and 2004.
 25. The City did not accept the 2004 rent expense on the 2004 federal tax return because it was much lower than for other years for the same property.
 26. The City utilized the amounts claimed for 2002 and 2003 rent expense to estimate Taxpayer's annual gross income throughout the audit period.
 27. The City was willing to review documentation to prove the City's estimate was not reasonable.
 28. Taxpayer failed to provide any documentation.
 29. The City assessed penalties because Taxpayer failed to file returns and failed to timely pay taxes.

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. Taxpayer and *Taxpayer B* were both “persons” pursuant to Section 100.
3. Taxpayer was in the business of leasing or renting real property to *Taxpayer B* pursuant to Section 445.
4. Taxpayer and *Taxpayer B* were affiliated companies or persons.
5. The City was authorized to determine the “market value” of the rental of the pursuant to Section 210.
6. The City’s method of estimating the rental value of the *Property 123* was reasonable.
7. Because Taxpayer failed to file tax reports or timely pay taxes, the City was authorized pursuant to Section 540 to assess penalties.
8. Taxpayer failed to demonstrate “reasonable cause” for failing to file reports and failing to timely pay taxes.
9. Taxpayer’s protest should be denied.

ORDER

It is therefore ordered that the April 4, 2007 protest of *Taxpayer A* of a tax assessment made by the City of Mesa is hereby denied.

It is further ordered that this Decision is effective immediately.

Jerry Rudibaugh
Municipal Tax Hearing Officer