STATE OF VERMONT
WASHINGTON COUNTY

RAYMOND and FRANCINE GIROUX,	)	
Taxpayers-Appellants,	)	**Washington Superior Court**
	)	**Docket No. 400-7-06 Wncv**
v.	)	
	)	
DEPARTMENT OF TAXES,	)	
Appellee.	)	

DECISION
Appeal of Tax Commissioner's Denial of Renter Rebate Claim

During the relevant taxable years, Taxpayers Raymond and Francine Girouxs rented their home from Champlain Bridge Marina, Inc., a Subchapter S corporation. Mr. Giroux is the sole shareholder of the corporation. Both Taxpayers are corporate officers, and both are employees and earn their income from the corporation.

As renters, Taxpayers claimed the benefit of the Homestead Property Tax Income Sensitivity Adjustment, see 32 V.S.A. §§ 6061–6074 (Chapter 154), as it applies to renters, the so-called "renter rebate." The Department disallowed the rebates because "the taxpayers, in essence, rent from themselves." *Appeal of Raymond and Francine Giroux,* ATC-04-29, Determination at 3 (May 12, 2006).

On appeal to the Commissioner, the designated hearing officer affirmed, concluding that it is reasonable in these circumstances to "look behind" the corporation. She reasoned that because an S corporation's income passes through to its shareholder(s) for income tax purposes, the corporation should be disregarded.[1] She concluded, apparently as a result of treating the Girouxs as being taxed on the rental income and therefore being the recipients of it, that the Girouxs stood on both sides of the landlord-tenant relationship, and denied the renter rebate. None of the very few findings in the Determination suggests that in claiming the renter rebate Taxpayers acted with fraudulent or wrongful intent, or otherwise manipulated the rental relationship in some manner leading to a disproportionate income sensitivity adjustment.

Taxpayers appealed to this court pursuant to 32 V.S.A. §§ 5885(b) and 6072.

The court reviews this case "on the basis of the record established before the Commissioner." *Piche v. Dep't of Taxes*, 152 Vt. 229, 233 (1989) (citing *State Dep't of Taxes v. Tri-State Indus. Laundries, Inc.*, 138 Vt. 292, 294 (1980)). The Commissioner's Determination is presumed "correct, valid and reasonable, absent a clear and convincing showing to the contrary." *Tri-State Indus. Laundries*, 138 Vt. at 294.

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[1] While only Mr. Giroux is the corporate shareholder, the Girouxs filed joint returns and paid income tax on corporate income jointly.

As the hearing officer noted, the purpose of the income sensitivity adjustment is to "limit[] property taxes paid by many homeowners and renters to a percentage of their income." Determination at 3. The renter rebate is calculated based on the concept of "rent constituting property taxes," which itself is based on the "rent actually paid during the taxable year." 32 V.S.A. § 6061(7). Obviously aware of the potential for abuse, the Legislature required the Department to disallow in full any adjustment claim that "was filed with fraudulent intent." 32 V.S.A. § 6071(a).

A claim that is excessive, but not fraudulent, is required to be reduced to the proper amount and any excess actually paid is to be recovered. *Id.* § 6071(b). The Legislature recognized that some claims, whether or not they are excessive, are not negotiated at arms-length, and it established a third category in subsection (c) and granted discretion to the Department to "determine the rent constituting property tax" in non-arms-length circumstances. *Id.* § 6071(c). The Department has created a method for doing so in Technical Bulletin TB-28.

The first issue, then, is whether Taxpayers are renters at all. If they are not renters, then they cannot qualify for the renter rebate. If they are renters, and have not acted with fraudulent intent, then under such circumstances, the Department may reduce an excessive claim and/or establish the correct claim amount, but under 32 V.S.A. § 6071, the Department lacks discretion to deny the income sensitivity adjustment altogether.

The Department takes the position that Taxpayers are not renters because Mr. Giroux is the 100% shareholder of the S corporation from which they rent. The only explanation in the Determination for disregarding the corporation as a party to the rental relationship is the proposition that, as sole shareholder, Mr. Giroux had the unbridled ability to control his and his wife's income, approve their own rental agreement, and to receive in income the very rent paid. On appeal to this court, counsel for the Department asserts that "The Girouxs cannot in good conscience be allowed to set up a corporation and simultaneously receive the benefits of owning rental real estate and then require the Department to pay them a rebate based on being renters of the same property they own. The result would be to give them a benefit which the legislature could not possibly have intended, leading to irrational or absurd consequences, and such results are to be avoided." Memorandum of the Department at 5 (filed Dec. 4, 2006).

The rental relationship is no less real or valid because Mr. Giroux is the sole shareholder of the S corporation from which Taxpayers rent than if they rented from a C corporation or a relative in a non-arms length circumstance, as long as the rental arrangement exists in fact.[2] The "benefit" that the Department says the Legislature could not possibly have intended is nowhere identified and explained by the Department and it is not otherwise apparent to the court. In fact, the consequences of corporate ownership of the real estate is that Mr. Giroux pays income tax on the sums he and his wife pay out in after-tax income for rent. There is no apparent basis for concluding that Taxpayers are not "renters" in the sense intended by the Legislature, i.e., renters in fact.

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[2]The record includes tax returns showing that the corporation reported the rental income, and thus income tax was paid on it by the Giroux pursuant to the pass-through applicable to S corporation income taxation. There is no suggestion in the record that the corporation does not exist as a valid business corporation, or that the rental agreement was not real.

The Legislature intended both qualifying homeowners and renters to receive the benefit of the income sensitivity adjustment. It did not exempt sole shareholders of S corporations from the benefit of the renter rebate. If one or both of the Girouxs owned the property individually, they would be entitled to the benefit of the income sensitivity adjustment available to owners. Under the Department's view, the corporation is disregarded, and the Girouxs are not eligible for either the renters or homeowners income sensitivity adjustment. The Department's position is contrary to the legislative policy that residents of property enjoy access to income sensitivity whether they own their residence or pay rent, and creates an exception from income sensitivity eligibility that the Legislature did not enact.

The Department's position also ignores the fact that the property is owned by a valid legal business corporation. There are legitimate business reasons for corporate ownership of property, and the law routinely recognizes the validity of transactions entered into between corporations and their shareholders, including loans, employment contracts, sales, and leases. Just as the Girouxs must accept all the legal consequences of the business and property ownership structure they have created, there does not appear to be any reason why the Department should not also be bound to recognize the legal consequences that flow from a legitimate ownership structure. This includes the entitlement by renters to eligibility for an income sensitivity adjustment.

The record uniformly supports the fact that Taxpayers are renters, and thus are eligible for an income sensitivity adjustment if they otherwise qualify. The next question is whether the Department had a proper basis for denying or adjusting their renter rebate claim under either of the three subsections of 32 V.S.A. § 6071 entitled "Excessive and Fraudulent Claims."

The Department has made clear that it does not contend that Taxpayers have acted with fraudulent intent. Therefore, the Department lacks discretion to deny their rebate claim altogether under 32 V.S.A. § 6071(a). The Department has not made an argument that the claim was excessive under § 6071(b), apart from being non-arms-length, which is governed by § 6071(c).

As noted above, there has never been any dispute in this case about whether the circumstances are non-arms-length; they are. The Legislature has made clear that the Department has discretion in such circumstances to recalculate the rebate to account for such circumstances. While the Department maintains that the rules in Technical Bulletin TB-28 do not pertain to these circumstances, the Department has not explained why it should not modify or adapt those rules to address previously un-considered circumstances rather than decide that because TB-28 is factually inapplicable, the claim is disallowed.

The Department has implied that its reduction of Taxpayers' claims to zero was an exercise of discretion under § 6071(b) and (c). The Department's discretion under 32 V.S.A. § 6071(c) does not extend to disallowing otherwise lawful claims entirely. An exercise of discretion in reliance on § 6071(b) or (c) to such an extent that a claim is wholly disallowed when there is otherwise a valid basis for a claim is an abuse of discretion that cannot be upheld.

For the reasons described, the conclusions in the Determination are not supported by the very few facts found by the hearing officer. Taxpayers have shown that the Determination is not "correct, valid and reasonable," and are entitled to prevail on their claim that the Department did not have a lawful basis for disallowing their claim entirely. Because there are unresolved factual matters, and because the circumstances are non-arms-length, the case is remanded for a determination by the Commissioner.

ORDER

For the foregoing reasons, the Determination of the Commissioner is reversed, and the case is remanded to the Commissioner for further proceedings consistent with this decision.

Dated at Montpelier, Vermont this 29th day of June 2007.

Mary Miles Teachout
Superior Court Judge