

Decision Date: July 10, 2006
Decision: MTHO #211
Tax Collector: Cities of Phoenix and Peoria
Hearing Date: October 17, 2005

DISCUSSION

Introduction

On August 20, 2004, *Company ABC* ("Taxpayer") filed a protest of a tax assessment made by the City of Peoria. After review, the City of Peoria concluded on August 26, 2004 that the protest was timely and in the proper form. On October 4, 2004, the Municipal Tax Hearing Officer ("Hearing Officer") ordered the City of Peoria to file a response to the protest on or before November 18, 2004. On November 16, 2004, the City of Peoria filed a response to the protest. On December 4, 2004, the Hearing Officer ordered the Taxpayer to file any reply on or before December 27, 2004. On December 21, 2004, the Taxpayer filed a reply to the City of Peoria. On January 13, 2005, a Notice of Tax Hearing ("Notice") scheduled the matter for hearing commencing on February 16, 2005. On January 28, 2005, the Taxpayer requested the hearing be continued. On January 28, 2005, the Taxpayer filed a protest of a tax assessment by the City of Phoenix. After review, the City of Phoenix concluded on February 2, 2005 that the protest was timely and in the proper form. On February 5, 2005, the Hearing Officer continued the hearing scheduled for February 16, 2005. On February 10, 2005, the Hearing Officer ordered the City of Phoenix to file any response to the protest on or before March 28, 2005. On February 10, 2005, the Hearing Officer consolidated the tax protests. On March 23, 2005 the City of Phoenix filed a response to the protest. On March 28, 2005, the Hearing Officer ordered the Taxpayer to file any reply on or before April 18, 2005. On April 29, 2005, the Taxpayer requested a continuance to file a reply. On May 2, 2005, the Hearing Officer granted the Taxpayer an extension until May 20, 2005 to file a reply. On May 20, 2005, the Taxpayer filed a reply. On June 14, 2005, a Notice scheduled the consolidated hearing commencing on July 8, 2005. On June 20, 2005, a Notice rescheduled the consolidated hearing to commence on July 7, 2005. On June 20, 2005, the Taxpayer requested the hearing to be continued. On July 2, 2005, the Hearing Officer continued the hearing. A Notice rescheduled the hearing to commence on October 17, 2005. Both parties appeared and presented evidence at the October 17, 2005 hearing. On October 24, 2005, the Hearing Officer indicated the closing briefs from the Cities of Phoenix and Peoria would be filed on or before December 19, 2005 and the Taxpayer's reply brief would be filed on or before January 19, 2006. On December 16, 2005, the City of Phoenix sent an email requesting a continuance for the closing brief. On December 17, 2005, the Hearing Officer granted an extension for the Cities of Phoenix and Peoria until February 2, 2006, and the Taxpayer until March 6, 2006. On December 19, 2005, the City of Peoria filed a closing brief. On January 31, 2006, the City of Phoenix sent an email requesting an extension for the closing brief. On February 3, 2006, the Hearing Officer granted an extension for the Cities of Phoenix and Peoria until March 6, 2006, and the Taxpayer until April 6, 2006. On March 6, 2006, the City of Phoenix filed a closing brief. On March 30, 2006, the Taxpayer requested an extension for filing a reply brief. On April 5, 2006, the Hearing Officer granted the Taxpayer an extension until May 22, 2006. On May 22, 2006, the Taxpayer filed a reply brief. On May 26, 2006, the Hearing Officer closed the record and indicated a written decision would be issued on or before

July 10, 2006.

City of Peoria Position

The City of Peoria performed an account review of the Taxpayer for the period January 1999 to December 2003. The City of Peoria concluded the Taxpayer's alarm monitoring charges were taxable telecommunication services pursuant to Peoria Code Section 12-470(a)(2)(D) ("Peoria 470(a)"). The Taxpayer was assessed taxes in the amount of \$5,968.29, penalties in the amount of \$1,492.12, and interest up through October 2005 in the amount of \$2,876.73. Peoria 470(a) provides for a tax on the business activity of "charges for monitoring services relating to a security or burglar alarm system located within the City whose such system transmits or receives signals of data over a communications channel."

According to the City of Peoria, the Taxpayer provided residential and business security alarm systems to its customers, but retained ownership of the systems. The City indicated the Taxpayer charged an installation fee and fees for monitoring the system from the monitoring center located at its headquarters in "*City, Non-Arizona State*". In response to the Taxpayer's argument that the charges would be exempt pursuant to Peoria Code Section 12-470(c) ("Peoria 470(c)"), the City of Peoria asserted the Taxpayer derived its income from the business of monitoring using a telephone line and not from the business of providing telephone service. The City indicated their conclusion was consistent with Sonitrol of Maricopa County v. Phoenix, 181 Ariz. 413, 891 P.2d 880 (Ariz. App. Div. 1 Aug. 11, 1994) (NO. 1 CA-TX 92-0015). The Court concluded in Sonitrol that "charges for transmissions" and "charges for monitoring services" are two separate and distinct items of "gross income" under Section 470(a). The Court further concluded that if the city had intended subsection(c) to apply to monitoring services, they would have said so.

The City of Peoria argued that People's Choice TV Corporation (PCTV) v City of Tucson, 202 Ariz. 401, 46 P.4d 412 (2002) does not apply to this matter. The Court in People's Choice held that cities may not tax the gross income of a provider of microwave pay television services received from connection, access, subscription, or membership fees for its programming packages that included both local and out-of-state programs. The City of Peoria states that the Court distinguished, but did not overrule, the Sonitrol case. The City of Peoria indicated that if the Taxpayer had separately charged for interstate telecommunications services (and could demonstrate a reasonable allocation of costs between monitoring and telecommunications charges), the City would have only taxed that portion attributable to monitoring.

City of Phoenix Position

The City of Phoenix performed an account review of the Taxpayer for the period December 1998 to October 2004. The City of Phoenix concluded that the Taxpayer's alarm monitoring charges were taxable pursuant to Phoenix Code Section 14-470(a) (2) (D) ("Phoenix 470(a)"). The Taxpayer was assessed taxes in the amount of \$169,912.23, penalties of \$16,991.25, and interest up through December 2004 in the amount of \$54,796.59. The City of Phoenix asserted they were not taxing the business activity of transmitting a signal interstate, but were taxing the business activity of monitoring for security in Phoenix.

The City of Phoenix noted that the Taxpayer provides alarm monitoring and customer services to customers all over the world from the Taxpayer headquarters in “*City, Non-Arizona State*”. Based on testimony provided at the hearing, the City indicated the subscriber’s individual monitoring systems send electronic signals from a monitor panel to the Taxpayers headquarters in “*City, Non-Arizona State*” via a telephone line. The monitoring professionals for the Taxpayer then notify the appropriate authorities in Arizona. The Taxpayer customers were charged provider and fixed charges regardless of whether the central monitoring station receives no calls or many calls from a customer during a billing period. The City also noted that hot buttons were standard on home security systems which would directly call the local police or fire department without any transmissions to the “*City, Non-Arizona State*” headquarters.

The City asserted that Sonitrol makes it clear that Section 470(c) does not apply to charges for monitoring services. According to the City, the treatment of monitoring services in Sonitrol is consistent with the treatment of telecommunications by federal legislation which treats alarm monitoring service providers as entities which use telecommunications in providing services but are not telecommunications providers. The City indicated that in City of Tucson v. Tucson Hotel Equity, 196 Ariz 551 2 P. 3d 110(2000), the Arizona Court of Appeals affirmed that the Court of Appeals in Sonitrol held that Section 470(c) did not exempt income from monitoring services. The Court stated:

Sonitrol nevertheless held only that section 14-470(c) did not exempt income from security alarm monitoring services because that income did not come from “charges for transmissions of any kind.”

As a result, the City concluded these two Court of Appeals decisions in Arizona hold that Section 470(c) does not apply to the business of alarm monitoring.

The City noted that the federal government enacted The 1996 Telecommunications Act (“Act”) in 1996. In reaction to the Act, they City asserted ARS Section 42-6004 (A) (“Section 6004”) was enacted in 1998. According to the City, the Act divided the telecommunication carriers into four classifications: general telecommunications providers; Bell Operating Companies; Local Exchange Carriers; and, Incumbent Local Exchange Carriers. The City concluded the Taxpayer would not qualify under any of the four classifications. Section 6004 prohibits municipalities from levying a tax on:

Interstate telecommunications services, which include that portion of telecommunications services, such as subscriber line service, allocable by federal law to interstate telecommunications service.

The City concluded that the Taxpayer could not come within Section 6004’s prohibition on municipal taxation.

The City asserted the Taxpayer’s reliance on People’s Choice is unfounded. According to the City, there was nothing in the opinion that suggests either implied or directly that the Court intended to overrule the opinion in Sonitrol that alarm monitoring businesses are not exempt from taxation because they are not engaged in the business of interstate or interstate

transmissions. The City indicated that the holding of the Supreme Court in People's Choice was limited to whether or not the gross income that interstate businesses receive from sales, tolls, subscriptions, and subscriber services are included in the prohibition of Section 6004(A).

Taxpayer Position

According to the Taxpayer, its customers in the City of Peoria and Phoenix were provided security system monitoring from the Taxpayer's headquarters in "City, Non-Arizona State". The Taxpayer argued the gross income from this service is exempt from taxes pursuant to Phoenix/Peoria Code Section 470(c) which provides as follows: "Charges by a provider of Telecommunications services for transmission originating in the City and terminating outside the State are exempt from the tax imposed by this Section." The Taxpayer asserted that the heart of its business is the transmitting and receiving of information via electromagnetic means across state borders. The Taxpayer argued that its business constitutes "interstate telecommunications services" within the meaning of Section 6004 and People's Choice. According to the Taxpayer, the Court in People's Choice concluded Section 6004 prohibits the Cities from taxing the gross income that businesses engaged in interstate telecommunications services receive "for sales, tolls, subscriptions, and subscriber services." In reply to the Cities argument that the business of monitoring security systems does not come within the definition of "telecommunications services" as set forth in subsections (A) through (F) of Section 470, the Taxpayer asserted that if the Cities were correct the Taxpayer could not be taxed pursuant to Section 470. The Taxpayer argued that the only type of entity taxed by Section 470 is a tax on a "person engaging or continuing in the business providing telecommunication services." As a result, the Taxpayer concluded that if it is not in the business of providing telecommunications services then Section 470 is wholly inapplicable to the Taxpayer. If the Taxpayer is in the business of providing telecommunications services, the Taxpayer argued the Supreme Court in People's Choice has concluded that Section 6004 prohibits the Cities from taxing gross income that the Taxpayer receives from sales, tolls, subscriptions, and subscriber services. The Taxpayer asserted that the Supreme Court in People's Choice held that "interstate telecommunications services" as used in Section 6004 involved "the 'transmitting' of information by electromagnetic means." According to the Taxpayer, its monitoring services for its Arizona customers involve just such transmission of information by electromagnetic means and such transmission occurs in interstate communication.

The Taxpayer indicated the Supreme Court in People's Choice made it clear that Sonitrol was inapposite because that case "involved a cities taxation of interstate telecommunications services, and thus did not concern, as here, the prohibition in Section 42-6004(A)(2) against taxing interstate telecommunications services." The Taxpayer argued that Phoenix/Peoria 470(c) is irrelevant in this case because Section 6004 prohibits the Cities from taxing the Taxpayer.

The Taxpayer disputed the City of Phoenix argument that no entity can come within Section 6004's prohibition on municipal taxation unless it also falls within one of the four types of telecommunications providers that are regulated by the Act. The Taxpayer asserted the City has provided no evidence that the Arizona legislature somehow made regulation under the Act a prerequisite to the applicability of Section 6004. The Taxpayer indicated the Court of Appeals has previously rejected the argument that the City now makes. According to the Taxpayer, the

Court in Tucson Hotel dismissed the theory as follows: “The City cites no authority for the proposition that an entity cannot be an interstate telecommunications services provider within the meaning of Code section 19-470 unless it is also licensed as such by a state or federal regulatory agency. We are likewise aware of no such authority.” The Taxpayer also noted the entity in People’s Choice that the Court held was exempt from taxation under Section 6004 was a company that provides microwave television services. The Taxpayer argued that a provider of television services would not fall under the regulation of the Act which was directed at telephone companies.

The Taxpayer noted that the Supreme Court in People’s Choice pointed out that in order for a state to tax interstate telecommunications services the following would have to be shown:

- 1) The state would have to have a “substantiated nexus with the telecommunications reached by the tax”
- 2) The tax would have to be “fairly apportioned”
- 3) The tax could “not discriminate against interstate commerce”
- 4) The tax would have to relate to services that the state provides to the taxpayer”

The Taxpayer asserted that neither of the Cities ever contended that the tax they were attempting to impose on the Taxpayer’s “interstate Telecommunications Services” could pass constitutional muster under that test.

ANALYSIS

It is clear that the Taxpayer transmits and receives information via electromagnetic means across state borders. As a result, we conclude that the Taxpayer is in the business of providing telecommunications services pursuant to Sections 100 and 470(a). While we understand the Cities argument that they are taxing monitoring services, there can not be a tax on monitoring services if the Taxpayer was not in the business of telecommunications services. We do not find that the exemption in Section 470(c) applies because the Taxpayer did not charge for transmissions. That leads us to whether or not the Cities were prohibited pursuant to Section 6004 from taxing interstate telecommunications services. In order to make that determination, we must review People’s Choice. While the Court in Sonitrol had made a distinction between interstate “transmissions” of information from “services ancillary to the interstate transmissions of signals,” the Supreme Court in People’s Choice rejected the distinction.

We find that the Supreme Court in People’s Choice concluded that the business must be viewed as a whole and that “gross income that such interstate businesses receive for sales, tolls, subscriptions, and subscriber services” cannot be taxed pursuant to Section 6004. Our overall conclusion in this matter is that the Taxpayer was in the business of providing interstate telecommunications services pursuant to Section 6004 and that the charges for the peripheral business of providing alarm monitoring services would not be taxable based on the Supreme Court’s conclusions in People’s Choice. Accordingly, the Taxpayer’s protests should be granted. We note that the Taxpayer has requested attorney fees be granted. We have not issued a discussion on that request as we find it should be presented to the Cities respective Taxpayer Problem Resolution Officers pursuant to Phoenix/Peoria Code Section 578.

FINDINGS OF FACT

- 1) On August 20, 2004, the Taxpayer filed a protest of a tax assessment made by the City of Peoria.
- 2) After review, the City of Peoria concluded on August 26, 2004 that the protest was timely and in the proper form.
- 3) On October 4, 2004, the Hearing Officer ordered the City of Peoria to file a response to the protest on or before November 18, 2004.
- 4) On November 16, 2004, the City of Peoria filed a response to the protest.
- 5) On December 4, 2004, the Hearing Officer ordered the Taxpayer to file any reply on or before December 27, 2004.
- 6) On December 21, 2004, the Taxpayer filed a reply to the City of Peoria.
- 7) On January 13, 2005, a Notice scheduled the matter for hearing commencing on February 16, 2005.
- 8) On January 28, 2005, the Taxpayer requested the hearing be continued.
- 9) On January 28, 2005, the Taxpayer filed a protest of a tax assessment by the City of Phoenix.
- 10) After review, the City of Phoenix concluded on February 2, 2005 that the protest was timely and in the proper form.
- 11) On February 5, 2005, the Hearing Officer continued the hearing scheduled for February 16, 2005.
- 12) On February 10, 2005, the Hearing Officer ordered the City of Phoenix to file any response to the protest on or before March 28, 2005.
- 13) On February 10, 2005, the Hearing Officer consolidated the two protests.
- 14) On March 23, 2005 the City of Phoenix filed a response to the protest.
- 15) On March 28, 2005, the Hearing Officer ordered the Taxpayer to file any reply on or before April 18, 2005.
- 16) On April 29, 2005, the Taxpayer requested a continuance to file a reply.
- 17) On May 2, 2005, the Hearing Officer granted the Taxpayer an extension until May 20,

2005 to file a reply.

- 18) On May 20, 2005, the Taxpayer filed a reply.
- 19) On June 14, 2005, a Notice scheduled the consolidated hearing commencing on July 8, 2005.
- 20) On June 20, 2005, a Notice rescheduled the consolidated hearing to commence on July 7, 2005.
- 21) On June 20, 2005, the Taxpayer requested the hearing to be continued.
- 22) On July 2, 2005, the Hearing Officer continued the hearing.
- 23) A Notice rescheduled the hearing to commence on October 17, 2005.
- 24) Both parties appeared and presented evidence at the October 17, 2005 hearing.
- 25) On October 24, 2005, the Hearing Officer indicated the closing briefs from the Cities of Phoenix and Peoria would be filed on or before December 19, 2005 and the Taxpayer's reply brief would be filed on or before January 19, 2006.
- 26) On December 16, 2005 the City of Phoenix sent an email requesting a continuance for the closing brief.
- 27) On December 17, 2005, the Hearing Officer granted an extension for the Cities of Phoenix and Peoria until February 2, 2006, and the Taxpayer until March 6, 2006.
- 28) On December 19, 2006, the City of Peoria filed a closing brief.
- 29) On January 31, 2006, the City of Phoenix sent an email requesting an extension for the closing brief.
- 30) On February 3, 2006, the Hearing Officer granted an extension for the Cities of Phoenix and Peoria until March 6, 2006, and the Taxpayer until April 6, 2006.
- 31) On March 6, 2006, the City of Phoenix filed a closing brief.
- 32) On March 30, 2006, the Taxpayer requested an extension for filing a reply brief.
- 33) On April 5, 2006, the Hearing Officer granted the Taxpayer an extension until May 22, 2006.
- 34) On May 22, 2006, the Taxpayer filed a reply brief.
- 35) On May 26, 2006, the Hearing Officer closed the record and indicated a written decision

would be issued on or before July 10, 2006.

- 36) The City of Peoria performed an account review of the Taxpayer for the period January 1999 to December 2003.
- 37) The City of Peoria assessed the Taxpayer for taxes in the amount of \$5,968.29, penalties in the amount of \$1,492.12, and interest up through October 2005 in the amount of \$2,876.73.
- 38) The Taxpayer provided residential and business security alarm systems to its customers, but retained ownership of the systems.
- 39) The Taxpayer charged an installation fee and fees for monitoring the system from the monitoring center located at its headquarters in "*City, Non-Arizona State*".
- 40) The City of Phoenix performed an account review of the Taxpayer for the period December 1998 to October 2004.
- 41) The City of Phoenix assessed the Taxpayer for taxes in the amount of \$169,912.23, penalties of \$16,991.25, and interest up through December 2004 in the amount of \$54,796.59.
- 42) The subscribers' individual monitoring systems send signals from a monitor panel to the Taxpayers headquarters in "*City, Non-Arizona State*" via a telephone line.
- 43) The Taxpayer customers were charged provider and fixed charges regardless of whether the central monitoring station receives no calls or many calls from a customer during a billing period.
- 44) Hot buttons were standard on home security systems which would directly call the local police or fire department without any transmissions to the "*City, Non-Arizona State*" headquarters.
- 45) The Act was enacted in 1996.
- 46) Section 6004 was enacted in 1998.
- 47) The Taxpayer's business resulted in the transmitting and receiving of information via electromagnetic means across state borders.

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) The Taxpayer is in the business of providing telecommunications services pursuant to Sections 100 and 470(a).
- 3) There cannot be a tax on monitoring services if the Taxpayer was not in the business of providing telecommunications services.
- 4) Section 470(c) does not apply because the Taxpayer did not charge for transmissions.
- 5) The Supreme Court in People's Choice rejected the distinction set forth in Sonitrol between interstate "transmissions" of information from "services ancillary to the interstate transmissions of signals."
- 6) The Supreme Court in People's Choice concluded that the business must be viewed as a whole and that "gross income that such interstate businesses receive for sales, tolls, subscriptions, and subscriber services" cannot be taxed pursuant to Section 6004.
- 7) The charges for the peripheral business of providing alarm monitoring services would not be taxable based on the Supreme Court's conclusion in People's Choice.
- 8) The Taxpayer's protests should be granted consistent with the Discussion, Findings, and Conclusions, herein.

ORDER

It is therefore ordered that the August 20, 2004 and January 28, 2005, protests by ***Company ABC*** of tax assessments made by the Cities of Peoria and Phoenix, respectively, are herein granted consistent with the Discussion, Findings, and Conclusions, herein.

It is further ordered that the Cities of Peoria and Phoenix should revise their assessments 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