DECISION OF MUNICIPAL TAX HEARING OFFICER

Decision Date: September 28, 2010
Decision: MTHO # 573
Taxpayer:
Tax Collector: City of Scottsdale
Hearing Date: July 28, 2010

DISCUSSION

Introduction

On March 1, 2010, a letter of protest was filed by ***Taxpayer*** of a tax assessment made by the City of Scottsdale ("City"). A hearing was commenced before the Municipal Tax Hearing Officer ("Hearing Officer") on July 28, 2010. Appearing for Taxpayer was ***Taxpayer's Representatives***, their ***CPA***, the ***owner***, and another ***CPA***. Appearing for the City were the ***Deputy City Attorney***, the ***Tax and License Supervisor***, and the ***Tax Auditor.***. At the conclusion of the July 28, 2010 hearing, the parties agreed on a briefing schedule. On September 10, 2010, the Hearing Officer closed the record and indicated a written decision would be issued on or before October 25, 2010.

DECISION

The City conducted an audit of Taxpayer for the period of August 2005 through July 2009 for ***Account #1*** and for the period December 2008 through July 2009 for ***Account #2***. The City concluded that Taxpayer was in the business of "licensing for use" pursuant to City Tax Code Section 450 ("Section 450"). Taxpayer was in the tanning salon business. The City assessed ***Account #1*** for additional taxes in the amount of $43,078.90, penalties in the amount of $4,342.48, and interest up through December 2009 in the amount of $6,136.88. The City assessed ***Account #2*** for additional taxes in the amount of $1,556.43, penalties in the amount of $155.64, and interest in the amount of $33.84 up through December 2009.

During the audit periods, Taxpayer owned and operated tanning salons in the City. Taxpayer's customers would pay to use Taxpayer's specific tanning equipment (tanning beds or booths) during an agreed upon allotted period of time. The City asserted that Taxpayer's business constitutes "licensing for use" of tangible personal property as defined in City Tax Code Section 100 ("Section 100"). Section 100 contains the following definition: "Licensing (for Use)" means any agreement between the user ('licensee') and the owner or the owner's agent ('licensor') for the use of the licensor's

property whereby the licensor receives consideration, where such agreement does not qualify as a 'sale' or 'lease' or 'rental' agreement."

Taxpayer asserted that the assessments in question were improperly imposed and the assessments are inconsistent with the holding in Energy Squared, Inc. v. Arizona Department of Revenue, 203 Ariz. 507, 56 P.3d 686 (App. 2002). The activities of Taxpayer in this matter were the identical items considered in Energy Squared to be non-taxable personal services. The Court held that the taxpayer's business of operating tanning salons did not constitute engaging in the business of renting tanning beds and booths within the meaning of the applicable state statute. While the language of Section 450 does not exactly track the state statute, Taxpayer argued that if the noscitur a sociis doctrine was applied, there is no substantive difference between a rental, a lease, or a licensing for use of tangible personal property.

Taxpayer noted that the auditor for the City testified that the business classification assigned by the City on Taxpayer's preprinted tax forms identified Taxpayer as either "all consumer goods rental" or "all professional, scientific and technical services". Further, the auditor placed a code on the audit assessments that indicated Taxpayer's business was "other personal services". Taxpayer concluded the City's use of the aforementioned codes strongly supports the conclusion that tanning salon and tanning booth activities are exempt "personal service" activities rather than taxable "licensing for use" of tangible personal property. The City asserted that the numeric codes relied on by Taxpayer were from the NAICS (North American Industry Classification System) and have no relevance to the City's Tax Code.

Taxpayer also argued that the City should be estopped from assessing Taxpayer because Taxpayer was given verbal representations from City personnel that the activities in question were considered as non-taxable professional or personal services. Taxpayer provided sworn testimony from a bookkeeper and a CPA that each had contacted the City on different occasions (during period of 2006 through 2009) and had been verbally informed that the City considered tanning salon activities to be non-taxable services. The bookkeeper acknowledged that she became aware that the City of Chandler was taxing the tanning activity as a result of a City of Chandler audit of Taxpayer in 2005. Taxpayer did not dispute that there was a City recording that informed the caller that the City was not bound by verbal representations. Taxpayer asserted that City Code Section 541 (Section 541") requires that "Each employee of the Tax Collector, at the time any oral advice is given to any person, shall inform the person that the Tax Collector is not bound by such oral advice." Taxpayer argued that the recording did not take the place of the employee warning requirement of the Code.

Based on the evidence presented, Taxpayer's customers lacked exclusive control over the tanning beds/booths. The operator remained in control over the tanning equipment to insure the safety of the customers. As a result, Taxpayer's business was not taxable under the renting or leasing classifications as set forth in Section 450. Such a result is consistent with the holding in the Energy Squared case. Unlike the State Statute in Energy Squared, Section 450 also includes the taxation of the activity of licensing for use of tangible

personal property. ARS Section 42-6005(D) (Section 6005") and City Code Section 500 ("Section 500") recognize that there may be differences between the State and City tax codes. Sections 6005 and 500 do provide that when the State Statute and City Code Section are the same and the State has issued written guidance, the State's interpretation is binding on the Cities. Clearly, the State Statutes and the City Code differ on the taxation of the licensing for use of tangible personal property and the written guidance criteria of Sections 6005 and 500 does not apply. Based on the facts of this case, Taxpayer receives consideration from its customers for the use of Taxpayer's tangible personal property. Since the agreement between Taxpayer and its customers does not qualify as a "sale" or "lease" or "rental agreement", it constitutes a "licensing for use" pursuant to Section 100. While Taxpayer cited the doctrine of noscitur a sociis for the proposition that there is no distinction between rental or leasing of tangible personal property, we must disagree. The definition of "licensing for use" is not unclear or ambiguous but is clearly defined in Section 100. We conclude that Taxpayer's activities were taxable as licensing for use pursuant to Sections 100 and 450.

It is not clear why the City utilized NAICS codes on the preprinted tax forms or the audit assessments that may have identified Taxpayer's business as being "rental, professional services, and or personal services". However, there was no evidence that Taxpayer ever relied on the NAICS codes to determine the taxability of its business activities. As a result, we conclude the NAICS codes are not relevant to our determination that Taxpayer's activities were taxable pursuant to Section 450.

Next, we have the issue of whether or not the City should be estopped from assessing Taxpayer because Taxpayer was given verbal representations from City personnel that Taxpayer's activities were not taxable. We believe that Taxpayer did call the City on several occasions and based on the verbal conversations believed the City representatives had indicated Taxpayer's business activities were not taxable. Unfortunately, Section 541 does provide that the City is not bound by oral advice. We believe the rationale behind that provision is because we can never be sure exactly what question was asked by a taxpayer and what question the City representative was answering. It is especially difficult in this case since the City representative(s) is unidentified. Section 541 also requires that each employee of the City, at the time any oral advice is given to any person shall inform the person that the City is not bound by such oral advice. In this case, the City utilized a recording to inform Taxpayer that it was not bound by any oral advice. After the recording, Taxpayer would talk to an actual person that would provide the oral advice. The issue is whether or not a recorded warning prior to Taxpayer talking to a City employee would meet the requirements of Section 541 of having each employee shall inform the person. While the actual employee that gave the advice did not give the warning, we believe the recorded warning is still sufficient if it resulted in Taxpayer being notified. In this case, we conclude it was sufficient because Taxpayer's representatives acknowledged they had heard the recording. We do acknowledge that we are troubled by the totality of the circumstances in this case where Taxpayer called the City on several occasions for guidance and always received the same answer regarding tanning salon activities not being taxable as well the City's own confusion on what codes to classify Taxpayer's business activities. However, we also heard testimony that

Taxpayer became aware in the summer of 2005 that the City of Chandler was taxing the same business activity. We conclude that a reasonably prudent business person would have utilized the provisions of City Code Section 597 ("Section 597") and requested a written ruling from the City regarding the taxability of its activities. If that would have occurred, we would not have to guess what questions were asked and what question was answered. Unfortunately, no request for a written ruling was made. Based on all the above, we conclude there has not been sufficient misleading guidance by the City to this Taxpayer such that all interest or penalties should be abated pursuant to Section 541.

Since Taxpayer failed to timely pay taxes, the City was authorized pursuant to City Code Section 12-540 ("Section 540") to impose penalties. We note there was also one penalty assessed for the late filing by one day of the June 2008 report for ***Account #1***. Those penalties may be abated for reasonable cause. Based on the circumstances previously discussed, we conclude Taxpayer has demonstrated reasonable cause to have all penalties waived in this matter.

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FINDINGS OF FACT

1. On March 1, 2010, Taxpayer filed a protest of a tax assessment made by the City.

2. The City conducted an audit of Taxpayer for the period of August 2005 through July 2009 for ***Account #1*** and for the period December 2008 through July 2009 for ***Account #2***.

3. The City assessed ***Account #1*** for additional taxes in the amount of $43,078.90, interest up through December 2009 in the amount of $6,136.88, and penalties totaling $4,342.48.

4. The City assessed ***Account #2*** for additional taxes in the amount of $1,556.43, interest up through December 2009 in the amount of $33.84, and penalties in the amount of $155.64.

5. Taxpayer was in the tanning salon business.

6. Taxpayer's customers would pay to use Taxpayer's specific tanning equipment (tanning beds or booths) during an agreed upon allotted time.

7. The business classification assigned by the City on Taxpayer's preprinted forms identified Taxpayer as either "all consumer goods rental" or "all professional, scientific and technical services".

8. The auditor placed a code on the audit assessments that indicated Taxpayer's business was "other personal services".

9. Taxpayer received verbal representations from City personnel regarding whether or not Taxpayer's activities were taxable.

10. Taxpayer's customers lacked exclusive control over the tanning beds/booths.

11. Taxpayer's operators remained in control over the over the tanning equipment to insure the safety of the customers.

12. Unlike the State Statute in Energy Squared, Section 450 also includes the taxation of the activity of licensing for use of tangible personal property.

13. Taxpayer never requested written guidance from the City regarding the taxation of Taxpayer's activities.

14. The City utilized a recording to warn Taxpayer that verbal representations may not be relied upon.

15. Taxpayer became aware in the summer of 2005 that the City of Chandler was taxing the business activities of Taxpayer.

16. Taxpayer's representatives heard the recorded warnings prior to talking to the City.

17. Taxpayer did not request a written ruling from the City pursuant to Section 597.

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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. Section 450 imposes a tax on the business activity of leasing, licensing for use, or renting of tangible personal property for a consideration.

3. Section 100 defines "licensing for use" to mean any agreement between the user ('licensee') and the owner ('licensor') for the use of the licensor's personal

property and the agreement does not qualify as a sale or lease or rental agreement.

4. The use of Taxpayer's tangible personal property by Taxpayer's customers falls within the business activity as set forth in Sections 100 and 450.

5. The definition of "licensing for use" is not unclear or ambiguous but is clearly defined in Section 100.

6. There was no evidence that Taxpayer ever relied on the NAICS codes to determine the taxability of its business activities.

7. Section 541 provides that the City is not bound by verbal advice.

8. Section 541 provides that the City employee shall inform the person that the City is not bound by verbal advice.

9. Taxpayer's representatives were notified on each occasion that the City was not bound by verbal advice.

10. Based on the totality of the circumstances, there was not sufficient misleading guidance by the City to Taxpayer such that all interest or penalties assessed should be abated pursuant to Section 541.

11. The City was authorized to assess penalties for Taxpayer's failure to timely file tax reports and failure to timely pay taxes pursuant to Section 540.

12. Taxpayer has demonstrated reasonable cause to have all penalties waived.

13. Taxpayer's protest should be denied with the exception of the penalties, consistent with the Discussion, Findings, and Conclusions, herein.

ORDER

It is therefore ordered that the March 1, 2010 protest by ***Taxpayer*** of a tax assessment made by the City of Scottsdale is hereby partly denied and partly granted, consistent with the Discussion, Findings, and Conclusions, herein.

It is further ordered that the City of Scottsdale shall remove all penalties assessed in this matter.

It is further ordered that this Decision is effective immediately.

Municipal Tax Hearing Officer