**DECISION OF MUNICIPAL TAX HEARING OFFICER**

Decision Date: April 18, 2013
Decision: MTHO # 744
***Taxpayer:***
Tax Collector: City of Phoenix
Hearing Date: None

## DISCUSSION

### Introduction

On August 24, 2012, a letter of protest was filed by ***Taxpayer*** of a tax assessment made by the City of Phoenix ("City"). At the request of Taxpayer, this matter was classified as a redetermination. After submission of all memoranda by the parties, the Municipal Tax Hearing Officer ("Hearing Officer") closed the record on March 6, 2013 and indicated a written decision would be issued on or before April 18, 2013.

## DECISION

The City issued a tax assessment to Taxpayer for the period of January 2007 through December 2010. The assessment was for additional taxes in the amount of $733,830.19. The assessment did not include interest since the assessment was the result of a joint managed audit. Taxpayer appealed the portion of the assessment related to the taxation under the rental of tangible personal property classification in the amount of $665,133.37 for non-tuition related charges to students by the ***University of Learning for All ("ULA"),*** a wholly owned subsidiary of Taxpayer. The City had assessed Taxpayer pursuant to City Code Section 14-450(a) ("Section 450") on the gross income from the business of leasing, licensing for use, or renting tangible personal property for a consideration.

***ULA*** is a private post-secondary university that provides degreed educational services. Students that enroll in courses in ***ULA*** online or on-campus educational programs are charged a tuition fee and a separate fee to access information, services and course materials ("Site Fee") through ***ULA*** websites. Taxpayer referred to the fee as the "rEsource fee". The City taxed the rEsource fee pursuant to Section 450, City Code Section 14-115 ("Section 115"), and City Regulation 14-115 ("Regulation 115"). Regulation 115 provides that the transfers of title and possession of computer hardware or storage media, and computer software which is not custom computer programming, are deemed sales of tangible personal property and any other transfer of title, possession, or right to use for a consideration of computer hardware or storage media and computer

software which is not custom computer programming are deemed rentals, leasing, or licensing of tangible personal property.

Taxpayer argued that whether or not the rEsource fee was taxable was a scope issue and must be strictly construed against the City, According to Taxpayer; the City Code does not directly address the sale of digital products. Taxpayer asserted the rEsource fee was not for tangible personal property. Secondly, Taxpayer argued that if the digital products were considered to be tangible personal property, then the tax was incorrectly assessed as a rental. Taxpayer cited City of Phoenix v. Actuate Corporation, TX 2010-000518 (2011) for support of its position. Taxpayer asserted that the dominant purpose of the Site Fee is determined by looking at what percentage of the digital products is responsible for making up the Site Fee. Taxpayer cited Val-Pak East Valley, Inc. v. Arizona Department of Revenue for support of its position.

The City argued that all gross income is taxable until the contrary is established by Taxpayer as set forth in City Code Section 14-400 ("Section 400"). The City cited Section 115 and Regulation 115 for support that the transfers of the computer software for the Site Fee was defined and was taxable as the rental, lease, or licensing of tangible personal property. The City acknowledged there was no sale. The City argued that Actuate wasn't relevant to this matter and that even if it was, the facts were different. The City acknowledged the relevance of the dominant purpose/common understanding test but argued for a different conclusion than Taxpayer. According to the City, the main purpose of the rEsources fee was to provide students digital goods including books and other written materials.

Section 450 imposes a tax on the gross income from the business activity of leasing, licensing for use, or renting of tangible personal property for a consideration. Clearly, the use of the information and materials by the students was not a sale. City Code Section 14-100 ("Section 100") defines "licensing for use" to be an agreement which does not qualify as a "sale" or "rental agreement". We conclude the use of the information and materials would be licensing for use for consideration. The primary issue was whether the computer software involved would be tangible personal property. "Computer software" is defined in Section 115 to mean any computer program. Custom software which is not "custom computer programming" is deemed to be tangible personal property, regardless of the method by which title, possession, or right to use the software is transferred to the user. Based on the definitions set forth in Sections 100 and 115, the Site Fee would be tangible personal property and thus taxable as licensing for use for consideration pursuant to Section 450. While some of the fee may constitute non-taxable services, the students are charged a single charge. We agree with the City that the primary purpose of the Site Fee is to allow the students to have access to the books and other written materials. Section 400 provides that "it shall be presumed that all gross income is subject to the tax until the contrary is established by the taxpayer." Taxpayer has failed to meet its burden of proof to demonstrate how much, if any, of the Site Fee is for non-taxable services. As to the Actuate case, we conclude the facts were different than in this case as it involved the sales of prewritten software and not the licensing for use. Based on all the above, we conclude Taxpayer's August 24, 2012 protest should be denied, consistent with the

Discussion, Findings, and Conclusions, herein.

## FINDINGS OF FACT

1. On August 24, 2012, Taxpayer filed a protest of a tax assessment made by the City.

2. At the request of Taxpayer, this matter was classified as a redetermination.

3. Taxpayer was assessed additional taxes in the amount of $733,830.19.

4. The assessment did not include interest since the assessment was the result of a joint managed audit.

5. Taxpayer appealed the portion of the assessment related to the taxation under the rental of tangible personal property classification in the amount of $665,133.37 for non-tuition related charges to students by ***ULA***, a wholly owned subsidiary of Taxpayer.

6. ***ULA*** is a private post-secondary university that provides degreed educational services.

7. Students that enroll in courses in ***ULA*** online or on-campus educational programs are charged a tuition fee and a separate fee to access information, services and course materials through ***ULA*** websites.

8. Taxpayer referred to the fee as the rEsource fee.

9. The Site Fee (rEsource) covers access to ***ULA's*** learning management website that includes the following: a) application service provider computer simulation programs and virtual environments from third-party vendors; b) student tutorial services in math and writing; c) library content; d) electronic textbooks and materials for the enrolled course; d) course syllabus and required reading assignments.

10. Students access the ***ULA*** website using their own computers and web browser software.

11. ***ULA*** does not separately itemize the charges accessed as a Site Fee.

12. The primary purpose of the Site Fee (rEsources) was to provide students with digital goods including books and other written course materials.

.

## 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 of leasing, licensing for use, or renting tangible personal property for a consideration.

3. Regulation 115 states that the transfers of title and possession of computer software which is not custom computer programming is deemed to be sales of tangible personal property or the right to use for a consideration of computer software which is not custom computer programming is deemed to be a rental, leasing, or licensing of tangible personal property.

4. Regulation 115 defines computer software as "any computer programs part of such a program, or any sequence of instructions for automatic data processing equipment."

5. Section 100 defines "licensing for use" to be an agreement which does not qualify as a "sale" or "lease" or "rental agreement".

6. The use of the information and materials for payment of the Site Fee would constitute "licensing for use" of tangible personal property for consideration.

7. Taxpayer's gross income was taxable pursuant to Section's 100, 115, and 450 as licensing for use for consideration.

8. Section 400 provides that 'it shall be presumed that all gross income is subject to the tax until the contrary is established by the taxpayer."

9. Taxpayer has failed to meet its burden of proof to demonstrate how much, if any, of the Site Fee is for non-taxable services.

10. While the Actuate case is non-binding, we conclude the facts and circumstances were different than in this case.

11. Based on all the above, Taxpayer's protest should be denied, consistent with the Discussion, Conclusions, and Findings, herein.

12. The parties have timely rights of appeal to the Arizona Tax Court pursuant to Model City Tax Code Section-575.

## ORDER

It is therefore ordered that the August 24, 2012 protest by ***Taxpayer*** of a tax assessment made by the City of Phoenix is hereby denied, consistent with the Discussion, Findings, and Conclusions, herein.

It is further ordered that this Decision is effective immediately.

***Municipal Tax Hearing Officer***