

**Jerry Rudibaugh
Municipal Tax Hearing Officer**

DECISION OF MUNICIPAL TAX HEARING OFFICER

Decision Date: February 24, 2004
Decision: MTHO #142
Tax Collector: City of Tempe
Hearing Date: February 5, 2004

DISCUSSION

Introduction

On August 25, 2003, *Taxpayer* (“Taxpayer”) filed a protest of a tax assessment made by the City of Tempe (“City”). After review, the City concluded on October 2, 2003 that the protest was timely and in proper form. On October 15, 2003, the Municipal Tax Hearing Officer (“Hearing Officer”) ordered the City to file a response to the protest on or before December 1, 2003. On December 1, 2003, the City filed a response to the protest. On December 4, 2003, the Hearing Officer ordered the Taxpayer to file any reply on or before December 29, 2003. On December 17, 2003, a Notice of Tax Hearing (“Notice”) was issued scheduling the hearing for February 5, 2004. Both parties appeared and presented evidence at the February 5, 2004 hearing. On February 5, 2004, the Hearing Officer closed the record and indicated a written decision would be issued on or before March 25, 2004.

The Taxpayer designs and manufactures injection molds that are sold to manufacturers for their use. The City conducted a privilege and use tax audit for the period of May 1, 1994 through June 30, 2000. On July 28, 2003, the City issued an assessment for taxes in the amount of \$2,062.64, penalties of \$497.76, licensing fees of \$285.00, and interest up through June 30, 2003 of \$1,488.54.

City Position

The City asserted that the Taxpayer routinely provides its customers with an agreed upon number of samples of the end product to be produced by the mold. The samples are for the customers use in determining that the mold will meet their need. While the molds represent income producing capital equipment, the City argued the samples are not income producing capital equipment. According to the City, the samples are not incorporated into the molds, nor are they resold. The City noted that while the Taxpayer did not itemize such charges on the customer invoices, it did give separate accounting in its books and records.

The City assessed a use tax on the purchase of two “Hopper/Dryer Stands” (“Stands”). At the time of the assessment, the City argued the Stands were not used directly in the manufacturing process and cannot be considered income producing capital equipment. Based on testimony at

the hearing, the City agreed the Stands were used directly in the manufacturing process and thus exempt from taxation.

The City agreed with the Taxpayer that \$45.00 in application and licensing fees for the year 2000 had already been paid. As a result, the City agreed the assessment should be reduced to reflect the \$45.00 already paid.

The City assessed penalties for late filing and late payments. The City argued the penalties were appropriate since the Taxpayer did not challenge the majority of the use tax assessed and because the Taxpayer was unlicensed with the City until notified at the time of the audit.

Taxpayer Position

The Taxpayer argued that its sampling income was not taxable. According to the Taxpayer, the sampling income was part of the sale of the mold that becomes machinery and equipment to the customer. The Taxpayer also asserted that it had received a written opinion from the Arizona Department of Revenue (“ADOR”) that the sampling income was exempt.

The Taxpayer argued the Stands are not taxable because they are part of the complete molding machine. According to the Taxpayer, the molding machine required a Stand in order to feed material into the press.

The Taxpayer asserted that the City had assessed \$45.00 in application and licensing fees. The Taxpayer provided evidence the \$45.00 in fees had already been paid.

The Taxpayer requested waiver of the late filing and late payment penalties on the sampling income. The Taxpayer argued it had demonstrated reasonable cause to believe the sampling income was part of the sale of the mold, which is used directly in the manufacturing process.

ANALYSIS

Based on the circumstances and information available in this case, we must conclude that the Taxpayer was selling samples of the end product to be produced by the mold. The Taxpayer acknowledged that the overall price would vary depending on the number of samples requested by a customer. We also conclude that the ADOR opinion did not refer to the sample of the end product from the mold. As a result, we will uphold the City’s assessment for the sampling income during the test year. With that said, we believe in the future it would be more appropriate for the Taxpayer to pay a use tax on the cost of materials used in the samples.

Since the City agreed with the Taxpayer that the Stands were used directly in the manufacturing process, the assessment should be revised to remove the tax on the Stands. Similarly, the application and licensing fees for the year 2000 should be removed since the City agrees the Taxpayer had already paid those fees.

As to the penalties, we do find the Taxpayer has demonstrated reasonable cause for failing to pay

taxes on the sampling income. As a result, we find that all penalties on the sampling income should be waived. It was unclear why the Taxpayer failed to report or pay taxes on the remainder of the use tax not protested. For that reason, we do not find the Taxpayer has demonstrated reasonable cause for failing to report or pay taxes on the remainder of the use tax not protested. Accordingly, those penalties cannot be waived. The Taxpayer also requested the interest be waived. The Hearing Office does not have the authority to waive any interest unless the underlying taxes are found not to be owing. In this case that would only apply to the taxes on the Stands.

FINDINGS OF FACT

1. On August 25, 2003, the Taxpayer filed a protest of a tax assessment made by the City.
2. After review, the City concluded on October 2, 2003 that the protest was timely and in the proper form.
3. On October 15, 2003, the Hearing Officer ordered the City to file a response to the protest on or before December 1, 2003.
4. On December 1, 2003, the City filed a response to the protest.
5. On December 4, 2003, the Hearing Officer ordered the Taxpayer to file any reply on or before December 29, 2003.
6. On December 17, 2003, a Notice was issued scheduling the hearing for February 5, 2004.
7. Both parties appeared and presented evidence at the February 5, 2004 hearing.
8. On February 5, 2004, the Hearing Officer closed the record and indicated a written decision would be issued on or before March 25, 2004.
9. The Taxpayer designs and manufactures injection molds, which are sold to manufacturers for their use.
10. The City conducted a privilege and use tax audit for the period of May 1, 1999 through June 30, 2000.
11. On July 28, 2003, the City issued an assessment for taxes in the amount of \$2,062.64, penalties of \$497.76, licensing fees of \$285.00, and interest up through June 30, 2003 of \$1,488.54.
12. The Taxpayer routinely provides its customers with an agreed upon number of samples of the end product to be produced by the mold.

13. The samples are for the customers use in determining that the mold will meet their need.
14. The samples are not income producing capital equipment.
15. The samples are not incorporated into the molds, nor are they resold.
16. While the Taxpayer did not itemize such charges on the customer invoices, it did maintain separate accounting in its books and records.
17. The Stands were used directly in the manufacturing process.
18. The City assessed penalties for late filing and late payments.
19. The Taxpayer did not challenge the majority of the use tax assessed.
20. The Taxpayer was unlicensed with the City until notified at the time of the audit.
21. The Taxpayer had previously paid \$45.00 in application fees and licensing fees for the year 2000.

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. City Code Section 16-460 imposes a tax on retail sales within the City.
3. Based on the circumstances and information available in this case, the Taxpayer was selling samples of the end product to be produced by the mold.
4. In the future, it would be more appropriate for the Taxpayer to pay a use tax on the cost of materials used in the samples.
5. The Stands were used directly in the manufacturing process and thus exempt from taxation.
6. The Taxpayer was assessed for application and licensing fees for the year 2000 which were previously paid.
7. City Code Section 540(b) authorizes the City to impose late filing and late payment penalties.
8. The late filing and late payment penalties can be waived for reasonable cause.

9. The Taxpayer has demonstrated reasonable cause for failing to report and pay taxes on the sampling income.
10. The penalties on the sampling income should be waived.
11. The Hearing Officer does not have the authority to waive interest unless the underlying taxes are found not be proper.
12. The Taxpayer's protest should be partly granted and partly denied consistent with the discussion herein.

ORDER

It is therefore ordered that the protest of *Taxpayer* of a tax assessment made by the City of Tempe is partly denied and partly granted consistent with the Discussion herein.

It is further ordered that the City of Tempe shall revise its assessment by removing the tax, interest, and penalties on the Stands.

It is further ordered that the City of Tempe shall revise its assessment by removing the application and licensing fees for the year 2000.

It is further ordered that the City of Tempe shall revise its assessment by removing all penalties assessed on the sampling income.

It is further ordered that this Decision shall be effective immediately.

Jerry Rudibaugh
Municipal Tax Hearing Officer