DECISION OF MUNICIPAL TAX HEARING OFFICER

September 5, 2012

Taxpayers POA
POA's Address

Taxpayer
MTHO #713

Dear Taxpayer's POA:

We have reviewed the evidence submitted for redetermination by ***Taxpayer*** and the City of Tucson (Tax Collector or City). The review period covered was July 2007 through June 2011. Taxpayer's protest, Tax Collector's response and our findings and ruling follow.

Taxpayer's Protest

Taxpayer is a landscape and tree service company. Taxpayer's activities include removing trees. Taxpayer did not pay privilege tax on its receipts from tree removals. Taxpayer was assessed City of Tucson privilege tax under the construction contracting classification based on its receipts. Taxpayer's activity of removing trees does not fall within the definition of "contractor" in Tucson Tax Code (TCC) § 19-100. Even if the activity were taxable, the assessment is overstated because the Tax Collector did not exclude clearly exempt activity.

Tax Collector's Response

Taxpayer was a construction contractor subject to tax on its taxable receipts. The definition of construction contracting is broad enough to include the removal of trees. The tax is on the full amount of Taxpayer's income. The Tax Collector reviewed the invoices and allowable deductions were allowed such as for out of city activity and subcontracting activity. There is no statutory exclusion for other charges such as fuel surcharges and dumping fees. Taxpayer is liable for the tax that was assessed.

Discussion

Taxpayer is in the landscape and tree service business, including the removal of trees and cleaning up the debris. The Tax Collector conducted an audit assessment of Taxpayer for the period July 2007 through June 2011 and issued an assessment under the construction contractor classification. The audit included as taxable Taxpayer's gross receipts from tree removal.

Taxpayer protested the assessment stating that its tree removal activity is not taxable as a contracting activity. Taxpayer further contends that even if tree removal were taxable, the assessment did not exclude charges for non-taxable activities.

Is tree removal taxable as construction contracting?

TCC § 19-415 imposes the City privilege tax on every construction contractor engaging or continuing in the business activity of construction contracting within the City. Construction contractor is defined in relevant part by TCC § 19-100 as:

> … a person who undertakes to or offers to undertake to, or purports to have the capacity to undertake to, or submits a bid to, or does himself or by or through others, construct, alter, repair, add to, subtract from, improve, move, wreck, or demolish any building, highway, road, railroad, excavation, or other structure, project, development, or improvement to real property, or to do any part thereof. …

The definition does not specifically address landscaping or tree removal. The Tax Collector referenced A.R.S. § 42-5075 and argued that the state taxes landscaping, including the removal of trees. A.R.S. § 42-5075 imposes the state transaction privilege tax on prime contracting. The Tax Collector also contended that the City code is broader than the state statute because it applies to the alternation of real property.

Taxpayer argued that the state statute specifically includes landscaping and the removal of trees while the City code does not. If the City wishes to tax landscaping and the removal of trees it should specifically include that activity in the code.

Lawn maintenance services and landscaping are addressed in A.R.S. § 42-5075.I. and J. Those subsections provide in relevant part:

> I. The gross proceeds of sales or gross income derived from a contract for lawn maintenance services are not subject to tax under this section if the contract does not include landscaping activities. Lawn maintenance service … includes lawn mowing and edging, weeding, repairing sprinkler heads or drip irrigation heads, seasonal replacement of flowers, refreshing gravel, lawn de-thatching, seeding winter lawns, leaf and debris collection and removal, tree or shrub pruning or clipping, garden and gravel raking and applying pesticides, as defined in section 3-361, and fertilizer materials, as defined in section 3-262.
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> J. The gross proceeds of sales or gross income derived from landscaping activities are subject to tax under this section. Landscaping includes installing lawns, grading or leveling ground, installing gravel or boulders, planting trees and other plants, felling trees, removing or mulching tree stumps, removing other imbedded plants, building or modifying irrigation berms, repairing sprinkler or watering systems, installing railroad ties and installing underground sprinkler or watering systems.

Before subsections I. and J. were added, A.R.S. § 42-5075 did not specifically address landscaping or tree removal. Subsections I. and J. were added in 2002 by House Bill 2242 (Laws 2002, Ch. 307, § 1.) The legislative Fact Sheets provide that House Bill 2242 was in response to Arizona Transaction Privilege Tax Ruling (TPR) 01-1, released in May 2001 by the Arizona department of revenue, that provided interpretive guidance to clarify lawn maintenance activities that constitute nontaxable service activities, taxable retail sales and taxable prime contracting activities. The bill clarified that receipts from landscaping activities, including felling trees, are subject to the prime contracting classification.

TPR 01-1 was rescinded by the department of revenue by Notice dated February 9, 2004. The Notice stated that the TPR was being rescinded because after the amendment to A.R.S. § 42-5075, the clarifications made in TPR 01-1 were now clear in statute. Because House Bill 2242 was a clarification of existing law, landscaping, including planting and removing trees and tree stumps, had been subject to the state prime contracting classification before House Bill 2242 was enacted.

When House Bill 2242 was enacted, A.R.S. § 42-5075 defined contractor in relevant part as follows:[1]

> "Contractor" is synonymous with the term "builder" and means any person, firm, partnership, corporation, association or other organization, or a combination of any of them, that undertakes to or offers to undertake to, or purports to have the capacity to undertake to, or submits a bid to, or does personally or by or through others, construct, alter, repair, add to, subtract from, improve, move, wreck or demolish any building, highway, road, railroad, excavation, manufactured building or other structure, project, development or improvement, or to do any part of such a project,…

The operative language of the definition of construction contractor in TCC § 19-100 and the definition of contractor in A.R.S. § 42-5075 are virtually identical. The City code provides that when the state statutes and model city tax code are the same and where the department of revenue has issued written guidance, the department's interpretation is binding on cities and towns. The department had interpreted A.R.S. § 42-5075 to include landscaping activities, including felling trees. That interpretation received legislative approval in House Bill 2242. We must therefore conclude that the removal of trees and tree stumps is taxable as construction contracting under TCC § 19-415.

Was some of Taxpayer's activities exempt service?

Taxpayer also contends that the audit failed to delineate clearly invoiced items as taxable and non-taxable. Taxpayer attached to its reply representative invoices that Taxpayer believes clearly show items specifically described in the Description of the work done which are non-taxable under the City Code. The sample invoices listed fuel surcharges, dumping fees and charges for thinning and pruning trees.

The Tax Collector's response states that the audit allowed deductions for activities such as tree trimming. The question therefore is whether fuel surcharges and dumping fees may be excluded from the tax.

The privilege tax is measured by a Taxpayer's gross income from its taxable business activity. Here the fuel charges and dumping fees are incidental to Taxpayer's taxable landscape activity. There is no contention that Taxpayer is engaged in separate businesses of selling fuel or trash hauling. Therefore those charges are subject to the tax as part of the income from Taxpayer's construction contracting business. *See e.g., Walden Books Co. v. Department of Revenue,* 198 Ariz. 584, 12 P.3d 809 (Ariz. App., 2000); *ADVO System, Inc. v. City of Phoenix,* 942 P.2d 1187, 189 Ariz. 355 (Ariz. App. Div. 1, 1997)

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[1] The definition of contractor in A.R.S. § 42-5075 was amended to its current form in 2007 by House Bill 2627 (Laws 2007, Ch. 188, § 1.

Whether the City is liable for a part of the tax?

Taxpayer contends that some of its work was done for the City. To the extent those transactions are taxable, Taxpayer contends the City is responsible for the tax. The City privilege tax is a tax on the person engaging in business and not a tax on the customer. While a business may pass the cost of the tax onto its customers, a business remains liable for the tax whether or not the cost of the tax was passed on. The question here is whether Taxpayer is taxable on its tree removal activities. Whether Taxpayer can recoup the cost of the tax from its customers under an agreement, including from the City, is not a question before the Hearing Office.

Taxpayer's protest of the Notice of Audit Assessment for the period July 2007 through June 2011 is denied.

Findings of Fact

1. Taxpayer is a landscape and tree service company.
2. Taxpayer's activities include removing trees, grinding stumps and cleaning up the debris.
3. The Tax Collector conducted an audit assessment of Taxpayer for the period July 2007 through June 2011 and issued an assessment for City privilege tax under the construction contracting classification in the amount of $2,759.10 and interest through February 29, 2012 in the amount of $290.54.
4. The Tax Collector did not assess penalties.
5. Taxpayer protested the assessment contending that
    a. activity such as removing trees and stumps is not a construction contracting activity under the Tucson City Code.
    b. even if the activity were taxable, the Tax Collector did not exclude non-taxable charges on invoices.
    c. Taxpayer did not charge tax on work performed for the City. The City should be liable for the tax on those charges.
6. Taxpayer attached to its reply selected invoices describing work performed that Taxpayer contends are not taxable under the City Code:
    a. Invoice # 5516 to fell three trees and chip and haul away the debris for $14,500. The price included crane service. The invoice did not separately state the price for each activity.
    b. Invoice # 5763 to remove and grind two tree stumps for $1,400. The invoice included a separate fuel surcharge of $25.
    c. Invoice # 5788 for emergency storm damage clean-up and removal for $10,000. The invoice included a separate charge of $2,000 for dumping fees.
    d. Invoice # 5803 to remove and grind a tree and remove and chip a small brush pile for a total charge of $225. The invoice did not separately state the price for each activity.
    e. Invoice # 6710 to remove and grind a tree stump for $2,500 and to thin and prune two trees for $1,000.

7. The Tax Collector stated in its response that the audit allowed deductions for activities such as tree trimming.

8. The record before the Hearing Office does not show how the invoices attached to Taxpayer's protest were treated in the audit.

Conclusions of Law

1. TCC § 19-415 imposes the City privilege tax on every construction contractor engaging or continuing in the business activity of construction contracting within the City.

2. The term "Construction Contractor" means a person who undertakes to or offers to undertake to, or purports to have the capacity to undertake to, or submits a bid to, or does himself or by or through others, construct, alter, repair, add to, subtract from, improve, move, wreck, or demolish any building, highway, road, railroad, excavation, or other structure, project, development, or improvement to real property, or to do any part thereof.

3. TCC § 19-415 does not specifically address the activity of felling or removing trees.

4. When the state statutes and model city tax code are the same and where the department of revenue has issued written guidance, the department's interpretation is binding on cities and towns. A.R.S. § 42-6005.D.; PCC § 4-1-500(e)(2).

5. State statutes impose the transaction privilege tax on prime contracting. A.R.S. § 42-5075.

6. A.R.S. § 42-5075 was amended in 2002 by House Bill (H.B.) 2242 (Laws 2002, Ch. 307, § 1) adding subsections I. and J. relating to the taxability of landscaping and lawn maintenance services.

7. H.B. 2242 was in response to Arizona Transaction Privilege Tax Ruling (TPR) 01-1, released in May 2001, that provided interpretive guidance by the department of revenue to clarify lawn maintenance activities that constitute nontaxable service activities, taxable retail sales and taxable prime contracting activities. Legislative Fact Sheets for H.B. 2242.

8. The term "contractor" was defined at that time as any person, firm, partnership, corporation, association or other organization, or a combination of any of them, that undertakes to or offers to undertake to, or purports to have the capacity to undertake to, or submits a bid to, or does personally or by or through others, construct, alter, repair, add to, subtract from, improve, move, wreck or demolish any building, highway, road, railroad, excavation, manufactured building or other structure, project, development or improvement, or to do any part of such a project. A.R.S. § 42-5075.J.2.

9. The operative language at that time of the definitions of construction contractor in TCC § 19-100 and of contractor in A.R.S. § 42-5075 were virtually identical.

10. TPR 01-1 was rescinded by the Department of Revenue by Notice dated February 9, 2004. The Notice stated that the TPR was being rescinded because after the amendment to A.R.S. § 42-5075, the clarifications made in TPR 01-1 were now clear in statute.

11. H.B. 2242 was a clarification that receipts from landscaping activities are subject to the prime contracting classification. Legislative Fact Sheets for H.B. 2242.[2]

12. Landscaping activities were defined to include repairing sprinkler or watering systems and installing gravel or boulders, along with planting and removing trees. A.R.S. § 42-5075.J.

13. A construction contractor is subject to the City privilege tax on its landscaping activities, including felling trees and removing and grinding stumps.

14. TCC § 19-400(c) provides that it shall be presumed that all gross income is subject to the tax until the contrary is established by the taxpayer.

15. The privilege tax is measured by a Taxpayer's gross income from its business activity. TCC §§ 19-400(a) and 19-415(a).

16. Gross income includes the total amount of the value proceeding or accruing from the sale of property and the providing of a service. TCC § 19-200(a)(1).

17. Every person subject to the City privilege tax is required to keep and preserve suitable records and such other books and accounts as may be necessary to determine the amount of tax for which such person is liable. MTC § 5-10-350(a).

18. Taxpayer is required to maintain books and records that indicate both individual transaction amounts and totals for each reporting period for each category of taxable, exempt, and excluded income. Regulation § 5-10-350.1(g).

19. The City privilege tax is a tax on the person engaging in business and not a tax on the customer. *See, Arizona Department of Revenue v. Action Marine, Inc.* 218 Ariz. 141, 181 P.3d 188 (2008).

20. A business may, but is not required to, pass the cost of the tax onto its customers. *Arizona Department of Revenue v. Action Marine, Inc., supra.*

21. A taxpayer is liable for the tax whether or not the taxpayer passes the cost of the tax onto its customers. *Arizona Department of Revenue v. Action Marine, Inc., supra.*

22. Taxpayer is liable for the City privilege tax on its sales of tangible personal property even though Taxpayer did not pass the cost of the tax onto its customers.

23. There is no authority that would allow the Hearing Officer to authorize the credit sought by Taxpayer.

24. The City's assessment of privilege tax and interest against Taxpayer for the period July 2007 through June 2011 was proper.

Ruling

Taxpayer's protest of an assessment of privilege tax and interest made by the City of Tucson for the period July 2007 through June 2011 is denied.

[2] As introduced, H.B. 2242 related to the due dates of privilege tax returns. The amendment to A.R.S. § 42-5075 was added by a strike-all amendment in the House Ways and Means Committee.

The Tax Collector's Notice of Assessment to Taxpayer for the period July 2007 through June 2011 is upheld.

Taxpayer has timely rights of appeal to the Arizona Tax Court pursuant to Model City Tax Code Section –575.

Sincerely,

Hearing Officer

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c: ***Tax Audit Administrator***
Municipal Tax Hearing Office