DECISION OF MUNICIPAL TAX HEARING OFFICER

February 21, 2013

Taxpayer's Representative
Representative's Address

Taxpayer
MTHO #753

Dear Taxpayer's Representative:

We have reviewed the evidence submitted for redetermination by ***Taxpayer*** and the City of Scottsdale (Tax Collector or City). The review period covered was July 2005 through April 2012. Taxpayer's protest, Tax Collector's response, and our findings and ruling follow.

Taxpayer's Protest

The Tax Collector assessed Taxpayer for renting searchlights. Taxpayer does not rent searchlights but is in the business of providing searchlight services to its customers. The customer does not assume control of or operate the equipment. Taxpayer is responsible for providing a trained operator, delivering, setting up, operating and removing the equipment. Taxpayer is not subject to the City privilege tax. In addition, the Tax Collector should not have assessed any tax, penalty or interest before addressing the underlying issue whether Taxpayer is subject to tax. Finally, the audit period included periods before which Taxpayer's directors and officers moved to Arizona.

Tax Collector's Response

Taxpayer's business is to provide searchlights to customers on an hourly basis, including delivery, setup and removal of the equipment. Taxpayer's website and the invoice in the record refer to the activity as the rental of searchlights. Customers contracting with Taxpayer expect a particular piece of equipment to be parked at the place of their choosing for the agreed upon period. The Tax Collector therefore assessed privilege taxes against Taxpayer for renting or licensing tangible personal property. Taxpayer has not provided books and records requested by the Tax Collector. The assessment was therefore based on an estimate. Taxpayer was incorporated in the State of Arizona on November 24, 2003. Taxpayer's submission of its and its principal's income tax returns is not sufficient evidence to support Taxpayer's claim that no business was conducted before August 2008. The assessment should be upheld.

Discussion

During the audit period Taxpayer entered into agreements with customers.[1] The agreement is labeled "Rental Agreement/Invoice". The agreement specifies the "Rental Dates" and the time period, "Service Location", "Rental Price" and the "Total Due" The agreement in the record also provided:

> Notes: Service is for one 4 beam Skytracker unit, self-contained with generator.
> Price includes delivery, set-up, fuel, operation and pick-up.

[1] A copy of one agreement was submitted into the record.

The City considers the activity under the agreement to be taxable as the rental or licensing of tangible personal property. Taxpayer argues it is providing a service not subject to the tax.

The Tax Collector contacted Taxpayer and requested records so an audit could be conducted. Taxpayer declined to provide any records arguing that the question whether it is taxable should be first determined. The Tax Collector did not issue an Administrative Request for the attendance of witnesses or for the production of documents but issued an estimated assessment based on the one invoice in the record. Taxpayer timely protested raising the following issues:

- Is Taxpayer engaged in providing a service to its customers as opposed to renting tangible personal property?
- Should the City have assessed tax, penalty and interest before the City addressed the underlying issue of whether or not Taxpayer was engaged in a rental activity?
- Did the audit period include periods before Taxpayer moved to Arizona?

Taxpayer Was Taxable under STC § 450.

Taxpayer first argues that its business is not the rental or licensing of personal property but the rendering of a searchlight service. The searchlight is simply a tool Taxpayer uses in providing the service. However, the agreement does not specify a service to be provided by Taxpayer but specifies a particular item of personal property to be delivered to a specified location. The services mentioned in the agreement relate to the transportation, setting up and operation of the equipment. The stated object of the transaction was the searchlight, not some service to be performed through the use of a searchlight. In contrast, the facts in *City Of Phoenix v. Bentley-Dille Gradall Rentals, Inc.*, 665 P.2d 1011136 Ariz. 289 (App. 1983) showed that the object of the transaction was excavation.

The code defines a license for use as an agreement for the use of the owner's property where the agreement does not qualify as a sale, lease or rental agreement. Since Taxpayer maintained control of the equipment, the agreement does not qualify as a sale, lease or rental. But Taxpayer does provide to its customers the use of the personal property. Taxpayer delivers the property to the customer's location and sets it up. During the agreement period no other customer or Taxpayer would be able to remove the property or use it elsewhere. That constitutes a licensed use pursuant to STC § 100 and thus taxable pursuant to STC § 450 and Regulation §§ 450.1. and 450.3.

Taxpayer submitted a copy of a letter ruling from the Texas Comptroller, Tax Policy Division, holding that providing of searchlights for nighttime promotion by a company engaged in the business of promoting business sales and grand openings through various forms of promotional advertising was a non-taxable service. First, even if such ruling were authoritative, it is clear that the Texas company was in the business of providing various promotional services. Second, Texas by administrative rule provides that the furnishing of tangible personal property with an operator for which a single charge is made to the customer is presumed to be the performance of a service. Tex. Admin. Code §3.294(c)(2). The City has not adopted a similar rule.

Because Taxpayer did not provide the requested books and records, the Tax Collector issued an estimated assessment. *See,* STC § 555(e). The estimate was based on the one invoice in the record. That invoice was for one 4 beam unit for a three hour period. The Tax Collector estimated revenues based on the rental of one unit for three hours on each day of the audit

period. The Tax Collector also stated that Taxpayer's website shows that other items are also available so its estimate may be low.

An estimate by the Tax Collector is to be made on a reasonable basis and it is the responsibility of the taxpayer to prove that the Tax Collector's estimate is not reasonable and correct by providing sufficient documentation of the type and form required by the Code or satisfactory to the Tax Collector. Based on the facts of this case, we hold that the Tax Collector's estimate was made on a reasonable basis. Because Taxpayer has not provided documentation to prove that the estimate was not correct, the Tax Collector's estimate is upheld.

Taxpayer Cannot Prevent the Tax Collector from Issuing the Assessment.

Taxpayer contends that the Tax Collector's request for books and records necessary for an audit was premature. The existence of taxability is necessary before any calculation of the tax can be determined. The Tax Collector should not have assessed any tax, penalty or interest before addressing the underlying issue whether Taxpayer is subject to tax.

Similar arguments by taxpayers have been rejected by the courts. The courts have held that decisions concerning a person's tax liability are entrusted to the taxing agency. The agency has the authority and expertise to make the necessary factual investigations. The administrative decision whether a person owes taxes is within the primary jurisdiction of the taxing agency. *See,* STC §§545 and 555. A person is subject to an audit to determine his or her tax liability and is required to submit his books, records, papers and other data to the taxing agency for its examination for the purpose of making an assessment. *See, Smotkin v. Peterson*, 73 Ariz. 1, 236 P.2d 743 (1951); *The Original Apartment Movers, Inc., v. Paul Waddell,* 179 Ariz. 419, 880 P.2d 639 (App. 1993). Because Taxpayer did not provide the requested records, the Tax Collector had the authority to issue an estimated assessment. STC § 555(e).

Taxpayer was not Engaged in Business During the Entire Audit Period?

The audit period covered was July 2005 through April 2012. Since Taxpayer had not filed privilege tax returns, no audit statute of limitations are involved. The Tax Collector issued the assessment for nearly a seven-year period. Taxpayer contends it did not start business in the City until August 29, 2008.

The City submitted a copy of Arizona Corporation Commission record showing that Taxpayer was incorporated in Arizona on November 24, 2003, before the beginning of the audit period. The address listed for Taxpayer is its statutory agent's address.[2] Taxpayer contends, however, that it did not begin business until 2008. Taxpayer submitted the sworn affidavit of its president, a copy of its Arizona Subchapter S Corporate return and a copy of the individual return for Taxpayer's incorporators. The affidavit and returns indicated that Taxpayer first started business and earning income in Arizona on August 29, 2008 and the incorporators became Arizona residents on August 29, 2008.

The Tax Collector did not present any evidence showing that Taxpayer conducted business in Arizona before August 2008. While the fact Taxpayer was incorporated in Arizona before August 2008 may lead to the inference or presumption that some business activity took place

[2] The address listed for Taxpayer's directors and officers by the Arizona Corporation Commission record attached to the City's response was in Scottsdale, Arizona. The record also reflects however that it was last updated December 21, 2009. From the record presented we do not know what address was listed for the directors and officers at the time of incorporation.

before August 2008, Taxpayer rebutted that inference or presumption through the sworn affidavit and copies of the returns. Absent any evidence that Taxpayer conducted business in the City for periods before August 2008, the assessment must be modified to exclude tax for periods before August 29, 2008.

Findings of Fact

1. Taxpayer is in the business of providing searchlights to customers.
2. Taxpayer's agreement specifies the searchlight to be provided, the location, date and time period or duration.
3. The agreement also provides that the price includes delivery, set-up, fuel, operation and pick-up.
4. The customer does not physically take possession of or operate the searchlights.
5. Taxpayer was incorporated in Arizona on November 24, 2003.
6. Taxpayer was not licensed by the City prior to the initiation of the audit and had not filed privilege tax returns with the City.
7. Taxpayer filed an Arizona Subchapter S Corporation return that indicated Taxpayer started business in Arizona on August 29, 2008.
8. Taxpayer's directors and officers filed Arizona individual income tax returns indicating that they became Arizona residents on August 29, 2008.
9. Taxpayer's president submitted an affidavit stating that Taxpayer first started business and earned income in Arizona on August 29, 2008 and the directors and officers of Taxpayer became Arizona residents on August 29, 2008.
10. The Tax Collector considered Taxpayer's activity to be the rental or licensing of tangible personal property.
11. The Tax Collector requested Taxpayer to provide books and records so the Tax Collector could conduct an audit.
12. Taxpayer declined to provide any books and records requested by the Tax Collector.
13. The Tax Collector issued an estimated assessment for the period July 2005 through April 2012 under STC §§ 450 and 540.
14. The Tax Collector's estimate was based on one invoice in the record. That invoice was for one 4 beam unit for a three hour period. The Tax Collector estimated revenues based on the rental of one unit for three hours on each day of the audit period.
15. Taxpayer timely protested the assessment.
16. Taxpayer did not present evidence relating to its gross receipts for the audit period.

Conclusions of Law

1. STC § 450 imposes the city privilege tax on the business activity of renting, leasing or licensing for use tangible personal property for a consideration measured by the income from the activity.

2. STC § 100 defines "Licensing (for Use)" as 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.

3. The agreement between Taxpayer and its customers allows the customers the use of the property.

4. A person does not have to have physical possession or control of property to use or derive benefit from the use of the property.

5. Allowing its customers to have the searchlights located at the customers location for a set period of time is a license within the meaning of STC § 100

6. Taxpayer has not provided the required records for the audit period showing Taxpayer's income attributable to its activities in the City.

7. The Tax Collector was authorized to estimate Taxpayer's income to determine the correct tax. STC § 555(e).

8. The Tax Collector's estimate is required to be made on a reasonable basis. STC § 545(b).

9. The Tax Collector's estimate based on an invoice from Taxpayer during the audit period was reasonable.

10. It is the responsibility of the taxpayer to prove that the Tax Collector's estimate is not reasonable and correct by providing sufficient documentation of the type and form required by the Tax Code or satisfactory to the Tax Collector. STC § 545(b).

11. Taxpayer did not prove that the Tax Collector's estimate of gross receipts was not reasonable and correct.

12. The Tax Collector may require a taxpayer to provide and may examine any books, records, or other documents of any person who, in the opinion of the Tax Collector, might be liable for any tax under this Chapter, for any periods open to audit. STC § 555(a).

13. In order to perform any authorized examination, the Tax Collector may also issue an Administrative Request for the attendance of witnesses or for the production of documents. STC § 555(b).

14. A person is subject to an audit to determine his or her tax liability and is required to submit his books, records, papers and other data to the taxing agency for its examination for the purpose of making an assessment. *See, Smotkin v. Peterson*, *supra.*; *The Original Apartment Movers, Inc., v. Paul Waddell, supra.*

15. A taxpayer cannot prevent the Tax Collector from examining its records by contending that its activity is not taxable. *See, Smotkin v. Peterson*, *supra.*; *The Original Apartment Movers, Inc., v. Paul Waddell, supra.*

16. The Tax Collector did not present evidence to establish that Taxpayer was engaged in a taxable business for periods before August 29, 2008.

17. Taxpayer's protest is upheld in part and denied in part.

Ruling

It is therefore ordered that Taxpayer's protest to the City's audit assessment for the period July 2005 through April 2012 is upheld in part and denied in part.

The Tax Collector shall remove from the assessment any tax and related interest and penalty for periods before August 29, 2008.

The Tax Collector's assessment for periods from and after August 29, 2008 is affirmed in all respects.

The parties have 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: ***Senior Tax Auditor***
Municipal Tax Hearing Office