DECISION OF MUNICIPAL TAX HEARING OFFICER

November 28, 2015

Taxpayer's Representative
Address of Representative

Taxpayer
MTHO # 889

Dear Taxpayer's Representative:

We have reviewed the evidence and arguments submitted for redetermination by ***Taxpayer*** and the City of Phoenix Tax Collector (Tax Collector or City). The refund period covered is December 1, 2010 through December 31, 2013. Taxpayer's position, Tax Collector's response and our findings and ruling follow.

Taxpayer's Position

Taxpayer provides computer program licenses to its Customer. The licenses are used at all of the Customers sites, including sites that are not within Arizona. Taxpayer paid sales tax in error on separately stated leases of software where a percentage of the users were located outside Arizona and outside the country. Taxpayer's gross receipts from software leased to out-of-state sites are not subject to the City sales tax. Taxpayer is entitled to a refund of the taxes paid on such leases.

Tax Collector's Response

The Customer does not use the software exclusively outside Arizona. The Customer received the software in Phoenix by electronic means and it was accessed and stored on computers in Phoenix. Taxpayer has not met its burden to show it is entitled to a refund. In addition, Taxpayer's claim for refund for December 2010 is outside the refund statute of limitations.

Discussion

Taxpayer framed the questions presented as follows:

1. Is Taxpayer's licensing of computer software to Customer subject to tax when the software is temporarily download to the Customer's computer system at its Phoenix headquarters and subsequently distributed to users outside of the country?
2. Is the claim for refund for the tax period December 1, 2010 through December 31, 2010 outside the four-year statute of limitations for filing a claim for refund and therefore should be denied.

Taxpayer is contending it is entitled to a refund because the software at issue is used at sites outside the City. Taxpayer cites two Arizona Department of Revenue Letter Rulings (LR09-001 and LR10-007) arguing that the location of the server that houses the software is not

determinative; it is the location of the user where the software is executed. Because the licenses are used exclusively outside the City, those leases are not taxable.

Taxpayer misconstrues the letter rulings. LR09-001 set out the following two scenarios that summarized the Department's position:

1. *Scenario 1*: A lessor hosts software on servers in Arizona and licenses the software applications on an annual basis to an out-of-state lessee. Every year, the lessee can pay to renew or choose to cancel. If the lessee chooses to cancel, it must return any copies of the software and can no longer use the software.

   Tax consequence for Scenario 1: The lessor's gross income from the software licenses for the out-of-state lessee is *nontaxable* because the lessee uses the software exclusively outside the state.

2. *Scenario 2*: A lessor hosts software on out-of-state servers and licenses the software applications on an annual basis to an Arizona lessee. Every year, the lessee can pay to renew or choose to cancel. If the lessee chooses to cancel, it must return any copies of the software and can no longer use the software.

   Tax consequence for Scenario 2: The lessor's gross income from the software licenses for the Arizona lessee is *taxable* because the lessee uses the software in Arizona on a non-temporary basis.

The server referenced in the Letter Ruling refers to the server of the lessor, not the server of the lessee after the lessee downloads the software onto its server.

LR10-007 provided that the taxpayer was subject to tax on the entire amount of its gross receipts derived from activities associated with leases to an Arizona customer. Here, Taxpayer transferred the software to an Arizona Customer. The software was not on Taxpayer's server in Arizona and used by the Customer exclusively outside the City. The City's denial of Taxpayer's claim for refund is presumed correct and Taxpayer must present substantial credible and relevant evidence sufficient to establish that the denial was erroneous. Taxpayer has not presented such evidence and has not established entitlement to a refund. Based on the above, the City's denial of Taxpayer's claim for refund is upheld. Because we have upheld the City's denial of Taxpayer's claim for refund, it is not necessary to address the statute of limitations question.

Findings of Fact

1. Taxpayer leased computer software to a Customer located in the City.
2. The software was downloaded to the Customer's server located in the City.
3. After modification, the software was distributed to users outside the City.
4. Taxpayer filed a claim for refund for City privilege taxes paid on the sale of software accessed by users outside the City.
5. The City denied Taxpayer's claim for refund because the City concluded that the software was installed on computers located in the City. While the software may be accessed by company employees in and outside of Arizona, the software operates out of the main hardware system located in Phoenix.

6. Taxpayer timely protested the City's denial of its claim for refund.

7. The record before the Hearing Office does not contain copies of contracts, agreements or other documents detailing the transaction between Taxpayer and its Customer and the Customer's use of the software and any servers and other computer equipment in Phoenix.

Conclusions of Law

1. The presumption is that an assessment of additional income tax is correct. A*rizona State Tax Commission v. Kieckhefer,* 67 Ariz. 102, 191 P.2d 729 (1948).

2. Once the presumption of correctness attaches, the taxpayer must present substantial credible and relevant evidence sufficient to establish that the assessment was erroneous. *U.S. v. McMullin,* 948 F.2d 1188 (10th Cir.,1991); *Anastasato v. C.I.R.*, 794 F.2d 884 (3rd Cir.,1986).

3. The same presumption of correctness applies to a tax agency's determination to deny a taxpayer's claim for refund. *See, Bubble Room, Inc. v. United States,* 159 F.3d 553, 561 (Fed.Cir.1998).

4. A general denial of liability is not sufficient to overcome the presumption of correctness. *Avco Delta Corp. Canada Ltd. v. U.S.,* 540 F.2d 258 (7th Cir., 1976).

5. The record in this case does not established that Taxpayer is entitled to a refund of privilege taxes paid during the refund period.

6. The City's denial of Taxpayer's claim for refund is upheld.

Ruling

The protest by Taxpayer of the City's denial of its claim for refund for the period December 1, 2010 through December 31, 2013 is denied.

The City's denial of Taxpayer's claim for refund for the period December 1, 2010 through December 31, 2013 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: ***City Attorney***
Municipal Tax Hearing Office