

# STATE OF ARIZONA

Department of Revenue  
Office of the Director  
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Janet Napolitano  
Governor

Gale Garriott  
Director

## CERTIFIED MAIL

The Director's Review of the Decision )  
of the Administrative Law Judge Regarding: )  
[REDACTED], )  
ID No. [REDACTED] )  
\_\_\_\_\_ )

## ORDER

Case No. 200500005-S

On November 23, 2005 the Administrative Law Judge issued a decision regarding the protest of [REDACTED]. ("Taxpayer"). The Taxpayer timely appealed this decision on December 29, 2005. The appeal being timely, the Director of the Department of Revenue ("Director") issued a notice of intent to review the decision.

In accordance with the notice given the parties, the Director has reviewed the Administrative Law Judge's decision and now issues this order.

### STATEMENT OF CASE

The Transaction Privilege and Use Tax Section ("Section") of the Audit Division of the Department audited Taxpayer for the period [REDACTED]. In the audit, the Section determined that there were under reported receipts for personal property rental, for transient lodging, and for use taxes. The Section determined there were over reported, or erroneously reported, receipts for restaurants (nontaxable gratuity charges for honor bar and room service), for amusements and for retail. The Taxpayer also filed claims for refund that covered some of the audit periods.

### FINDINGS OF FACT

The Director adopts from the findings of fact in the decision of the Administrative Law Judge and makes additional findings of fact based on the record as set forth below:

1. Taxpayer is engaged in the business activity of transient lodging and operates a [REDACTED] guest rooms.

2. Along with providing transient lodging, Taxpayer provides a variety of goods and services including restaurant and bar services, retailed items, rentals of meeting rooms (commercial leases) and rental of tangible personal property.
3. Taxpayer filed claims for refund in [REDACTED]. These five refund claims addressed various items for which Taxpayer believed it had overpaid transaction privilege (or use) taxes or had reported and paid taxes on receipts which it believed were not taxable.
4. The Section audited Taxpayer for the audit period from [REDACTED], and issued its Notice of Proposed Assessment (“Assessment”) on September 5, 2002.
5. Taxpayer protested the Assessment and the denied refund claim(s) and requested a refund in the amount of \$[REDACTED] plus interest.
6. Taxpayer’s Appeal to the Director raises the question whether receipts from the following are subject to the transaction privilege tax:
  - a. Providing audiovisual services and equipment,
  - b. Providing telecommunications in guest rooms, meeting rooms, banquet rooms and other rooms,
  - c. Providing high-speed internet access in the convention and meeting areas,
  - d. Providing laundry services to its guests and patrons of the facility, and
  - e. Cancellation fees and no-show charges.
7. Taxpayer also challenged taxes imposed on purchases from vendors which it argues have a presence in Arizona.
8. The Section agreed that no use taxes are due on purchases from Arizona vendors and made appropriate adjustments where sufficient accurate information was presented or was available to determine whether Arizona nexus existed at the time of Taxpayer’s purchases.

## CONCLUSIONS OF LAW

The Director adopts from the conclusions of law in the decision of the Administrative Law Judge and makes additional conclusions of law as follows:

1. A.R.S. § 42-5070 imposes the transaction privilege tax on persons engaging in the business of operating, for occupancy by transients, certain facilities, including hotels and resorts.
2. The transaction privilege tax is measured by the amount or volume of business transacted, and the tax base is the gross proceeds of sales or gross income derived from the business. A.R.S. § 42-5008; A.R.S. § 42-5070.
3. The transaction privilege tax is measured by all of the business activity of the taxpayer and not merely a part of it. *Duhamel v. State Tax Commission*, 65 Ariz. 268, 276, 179 P.2d 252 (1947).
4. All gross proceeds of sales and gross income derived by a person from business activity classified under a taxable business classification is presumed to comprise the tax base for the business until the contrary is established. A.R.S. § 42-5023.
5. Activities that are incidental in the sense that they are inseparable from the principal business and interwoven in the operation thereof to the extent that they are in effect an essential part of the major business cannot be taxed as a separate business. *Trico Electric Cooperative, Inc. v. State*, 79 Ariz. 293, 297, 288 P.2d 782 (Ariz. 1955).
6. A person's activities may constitute more than one business and the taxpayer will be obligated to pay the appropriate tax on each business. *Trico Electric Cooperative v. State Tax Commission, supra*.
7. Whether activities constitute a separate business depends on whether (1) the portions of the separate activities can be readily ascertained without substantial difficulty, (2) the amounts in relation to the company's total taxable Arizona business

- are not inconsequential, and (3) those services cannot be said to be incidental to the principal business. *State Tax Commission of Arizona v. Holmes & Narver, Inc.*, 113 Ariz. 165, 548 P.2d 1162 (1976); *City of Phoenix v. Arizona Rent-A-Car Syst.*, 182 Ariz. 75, 893 P.2d 75 (1995). ("Three part Holmes & Narver test")
8. Generally, providing services that are part and parcel of the taxpayer's principal business are included in the principal activity. *Tucson Electric Power Company v. Arizona Department of Revenue*, 170 Ariz. 145, 822 P.2d 498 (App. 1991).
  9. Income from isolated services that may be concededly non-taxable if carried on by a business that is not otherwise taxable under the transient lodging classification may be a part of a taxpayer's gross income from a taxable activity that is the basis of the taxpayer's principal activity. *Walden Books Company v. Arizona Department of Revenue*, 198 Ariz. 584, 12 P.3d 809 (2000).
  10. Taxpayer's principal business is transient lodging, the proceeds of which are taxable under A.R.S. § 42-5070.
  11. The Department issued Transaction Privilege Tax Ruling TPR 92-3 ("Ruling") addressing what services are incidental to transient lodging activity. That ruling was in effect during the periods involved here.
  12. An administrative construction of the then applicable statutes, the Ruling is entitled to considerable weight. *Miami Copper Co. v. State Tax Commission*, 121 Ariz. at 150, 153 (1978).
  13. A use tax is a complementary tax; it complements a sales or privilege tax.
  14. Arizona law imposes an excise tax on the storage, use or consumption in Arizona of tangible personal property purchased from a retailer.<sup>1</sup> See A.R.S. § 42-5155. The use tax amount is a percentage of the purchase price.

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<sup>1</sup> The use tax also applies to any purchaser who originally purchased an item for resale but subsequently uses or consumes the item. See A.R.S. § 42-5155(B).

15. A taxpayer requesting a refund has the burden of showing that the gross income in question is not taxable. *State Tax Comm'n v. Graybar Electric Co.*, 86 Ariz. 283,344 P.2d 1008 (1959).
16. If a taxpayer does not maintain control over equipment used by its customers, the use constitutes rental of tangible personal property, which is taxable under A.R.S. § 42-5071. See, *Energy Squared, Inc. v. Ariz. Dep't of Revenue*, 203 Ariz. 507, 56 P.3d 686 (App. 2002).
17. Fees for the set-up of tangible personal property leased by a taxpayer are included in the gross income of the business and are taxable under A.R.S. § 42-5071. A.A.C. R15-5-1502.D.
18. Receipts from providing the audiovisual services and equipment are subject to tax under the personal property rental classification.
19. Receipts from providing telecommunications in guest rooms, meeting rooms, banquet rooms and other rooms are taxable under the transient lodging classification.
20. Receipts from providing high-speed internet access in the convention and meeting areas are taxable under the commercial lease classification. A.R.S. § 42-5069.
21. Receipts from providing laundry services to guests and patrons of the facility are taxable under the transient lodging classification facility.
22. Cancellation fees and no-show charges are taxable under the transient lodging classification.
23. Purchases from vendors who have no nexus in Arizona are subject to the use tax.

## **DISCUSSION**

This Appeal involves both transaction privilege taxes, and use taxes. The issues related to

those taxes will be addressed separately below.

**Transaction Privilege Taxes:**

Taxpayer's principal activity in this case is taxable under the transient lodging classification. The transient lodging classification consists of engaging in the business of operating, for occupancy by transients, certain facilities, including hotels and resorts. The tax base is the gross proceeds of sales or gross income derived from the business of operating the facility. The first question therefore is which of the activities constitute a part of operating the facility for occupancy by transients.

The activity of operating the facility for occupancy by transients encompasses more than the mere act of renting the room to the transient. It may encompass activities such as telephones, laundry service and other activities undertaken primarily for the benefit or convenience of the hotel guest. It may encompass receipts that would not have been received but for the Taxpayer being engaged in the transient lodging business.

Arizona law provides that all gross proceeds of sales and gross income derived by a person from business activity classified under a taxable business classification is presumed to comprise the tax base for the business until the contrary is established. A.R.S. § 42-5023. Therefore, it is the obligation of the Taxpayer here to establish that the receipts at issue are not part of the transient lodging tax base, either because they are exempt or should be classified under another business classification.

The receipts at issue in this appeal fall into the following categories:

1. Providing audiovisual services and equipment,
2. Providing telecommunications in guest rooms, meeting rooms, banquet rooms and other rooms,
3. Providing high-speed internet access in the convention and meeting areas,
4. Providing laundry services to its guests and patrons of the facility is taxable under the transient lodging facility, and

5. Cancellation fees and no-show charges.

This matter was heard by an Administrative Law Judge at the Office of Administrative Hearings (OAH). The decision of the Administrative Law Judge indicates that when the hearing record and the available revenue information was reviewed, the Administrative Law Judge was simply unable to apply the three part Holmes & Narver test with respect to Taxpayer's revenues and its business operations. Even if the at-issue charges were separately stated, thus meeting the first part of the *Holmes & Narver* test, the hearing record did not have sufficient facts to demonstrate that Taxpayer's various receipts (guest room telephone charges, laundry and cancellation and no-show fees) are separable from its primary business of transient lodging. The Administrative Law Judge concluded that, except where exempted by statute, case law, rule or policy, Taxpayer's receipts from its resort operations, including among others the charges for guest room telephone services, for guest laundry services and from cancellations and no-shows, are taxable under the transient lodging classification.

Taxpayer did not provide the necessary factual information at the administrative hearing. The Director is not inclined to dispute the determination of the Administrative Law Judge made on the basis of the record. The at-issue services and amenities provided by Taxpayer are part and parcel of the Taxpayer's transient lodging business activity. *Tucson Electric Power Company v. Arizona Department of Revenue, supra*, (the providing of numerous services necessary to deliver the electricity to customers was included in the business of producing and furnishing electricity

Receipts from charges for Internet access in the convention areas of the resort were determined by the Administrative Law Judge to be taxable under the commercial lease classification. Providing Internet access in the convention areas is part and parcel of leasing the convention center and meeting rooms, which activity is taxable under the commercial lease classification. The Director thus concurs in the Administrative Law Judge's decision.

Providing audiovisual equipment and services was determined by the Administrative Law

Judge to be taxable under the rental of personal property classification. If, once the equipment is in place, the equipment does not need an operator to physically control the equipment, then a taxpayer is not providing a service, but is renting the equipment. This is true even if the equipment was initially set up by Taxpayer. A.A.C. R15-5-1502.D. provides:

Gross income from the rental of tangible personal property includes charges for installation, labor, insurance, maintenance, repairs, ***pick-up, delivery, assembly, set-up***, personal property taxes, and penalty fees even if these charges are billed as separate items, unless a specific statutory exemption, exclusion, or deduction applies. (Emphasis added.)

There is no indication in the record that Taxpayer retained the type of control over the continued operation of the equipment as was shown by the taxpayer in *Energy Squared, Inc. v. Ariz. Dep't of Revenue, supra*, with respect to equipment it simply set up at the request or direction of the customer. The Director concurs in the Administrative Law Judge's decision.

The Director notes that control by the customer does not mean the customer must be able to himself physically operate the property. If the customer can direct the property's location, placement, duration and other similar elements, the customer is exercising control over the property. On page 3 of its Response the Section stated that it will make the appropriate adjustments to reflect that only the property controlled by customers is subject to tax under the personal property rental classification. The Section shall make the adjustments accordingly.

**Use tax:**

Some of Taxpayer's purchases were determined by the Section to be exempt from use tax. As to other purchases, the dispute at the hearing and continuing into the appeal is whether sufficient documentation was provided by Taxpayer to establish that the vendors of the items in question had transaction privilege or use tax nexus during the times purchases were made by Taxpayer.



At the hearing Taxpayer did not present any information with regard to the items that had been purchased from the at-issue vendors with the exception of [REDACTED]. As the Administrative Law Judge indicated, however, the record did not reflect what items were purchased from this company, concluding that Taxpayer did not establish entitlement to an exemption from use tax. Based on the record, the Director concurs with the decision of the Administrative Law Judge.

### **ORDER**

The Section shall make the appropriate adjustments to reflect that only the property controlled by customers is subject to tax under the personal property rental classification. The Administrative Law Judge's decision is affirmed in all other respects.

This decision is the final order of the Department of Revenue. The Taxpayer may contest the final order of the Department in one of two manners. The Taxpayer may file an appeal to the State Board of Tax Appeals, 100 North 15<sup>th</sup> Avenue, Suite 140, Phoenix, AZ 85007 or may bring an action in Tax Court (125 West Washington, Phoenix, Arizona 85003) within sixty (60) days of the receipt of this order. For appeal forms and other information from the Board of Tax Appeals, call (602) 364-1102. For information from the Tax Court, call (602) 506-3763.

Dated this September 22, 2006.

ARIZONA DEPARTMENT OF REVENUE

Gale Garriott  
Director

Certified original of the foregoing  
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