STATE OF ARIZONA

Department of Revenue
Office of the Director
(602) 716-6090

Janet Napolitano
Governor

Gale Garriott
Director

CERTIFIED MAIL [REDACTED]

The Director's Review of the Decision of the Administrative Law Judge Regarding:	)	**O R D E R**
[REDACTED] [REDACTED]	)	**Case No. 200500065-S**
ID No. [REDACTED]	)	

On March 27, 2006, the Administrative Law Judge issued a decision regarding the protest of [REDACTED] ("Taxpayer"). Taxpayer timely appealed this decision on April 27, 2006. 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's business for periods June 2000 through August 2002. The Section determined that Taxpayer had underreported its retail sales subject to tax under A.R.S. § 42-5061. Following an informal process, the Section issued an Amended Assessment. Taxpayer argued that the transactions at issue were not taxable retail sales, but an investment arrangement, whereby the investor would tender money to Taxpayer in exchange for the right to share in the profit when the work of art was sold to the final purchaser. Taxpayer argued that the investor did not receive possession of the work of art. The Section argued that the transactions at issue were retail sales, and were subject to the transaction privilege tax.

Findings of Fact

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

1. Taxpayer is an Arizona corporation that operates a fine art gallery in [REDACTED], Arizona.

2. On or about March 25, 2003, the Section issued a Notice of Proposed Assessment ("Assessment"), imposing additional retail transaction privilege taxes, associated county taxes and interest. No penalties were imposed.

3. The total amount of taxes imposed was $[REDACTED], with interest calculated through June 2003 of $[REDACTED].

4. On May 13, 2003, Taxpayer protested the majority of the Section's Assessment. In its protest, Taxpayer indicated that it would provide documents showing out-of-state sales to non-Arizona residents.

5. The Section conducted an informal hearing. As a result of the informal process the Section issued an Amended Assessment of tax in the amount of $[REDACTED], interest in the amount of $[REDACTED] calculated through December 2003.

6. Taxpayer disagreed with the Amended Assessment, and the matter was scheduled for a hearing before the Office of Administrative Appeals (OAH).

7. The parties requested that the hearing before OAH be conducted through written memoranda and a stipulation of facts.

8. In the stipulation of facts submitted to OAH, Taxpayer acknowledged that it was "liable to pay tax on the portions of the Amended Assessment involving disallowed sales for resale and out of state sales." The record however does not specify the amount of the assessment Taxpayer agreed was due and the amount that was still remaining at issue.

9. The OAH decision states that the record is sparse regarding the exact steps entailed in the transactions at issue. Taxpayer's Opening Memorandum before OAH described the transactions at issue on pages 1-2 as follows:

> Petitioner is a [REDACTED], Arizona art gallery representing an international array of well recognized artists, of whom some consign their work to Petitioner and some sell to Petitioner for resale. As the artworks are frequently costly, for a gallery to purchase and maintain in its inventory, Petitioner has on numerous occasions throughout the audit period in question … arranged with investors **to fund the acquisition of paintings**, with the agreed upon understanding that **half of the profit on the sale of the artwork, if any, will be paid to the investor** along with the amount of his original investment.
>
> **All artworks, both those on consignment from the artists and those owned by the gallery, appear on the gallery's price list.** The artworks remained in the gallery until being sold to customers and Petitioner's insurance policy covered them. … **Any unsold artwork might be returned to the artist or might, as agreed with the investor, be delivered to the investor instead of a cash repayment of principal.**

(Emphasis added.)

10. Taxpayer's Reply Memorandum before OAH further provided on pages 1-2:

> Petitioner, a [REDACTED] art gallery, occasionally needed extra cash **to purchase a new work of art from an artist** for resale. To obtain this money cash, Petitioner arranged for a private party to advance Petitioner money in exchange for the opportunity to share in the appreciation of the work of art's value (if any) **between the time it was purchased from the artist and the time it was sold by Petitioner. No promises were made or requested concerning the amount of appreciation that would occur, or whether there would be appreciation at all. Petitioner and the private party were simply agreeing to share the risk and the reward.**
>
> Because the forms were at hand, the cash advances were recorded on the same form Petitioner uses **when it agrees to sell an artist's work of art on consignment**.

> Petitioner's use of the wrong form is what appears to have caused Respondent to reach the erroneous conclusion that the private parties were purchasing the works of art at retail from Petitioner and then consigning them to Petitioner. The attached declarations by two of the private parties and Petitioner's president show that there are no facts to support Respondent's conclusions.
>
> The agreements between Petitioner and the private parties neither transferred ownership nor transferred possession of any work of art. Instead, the **agreements allowed Petitioner to purchase the works of** art and the private parties to share in their appreciation.

(Emphasis added.)

11. Taxpayer did not present any properly completed resale or exemption certificates regarding the transactions at issue.

Conclusions of Law

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

1. The Arizona legislature has imposed a privilege tax on persons engaging in certain businesses in the state measured by the gross proceeds of sales or gross income derived from the business activities. A.R.S. § 42-5008, *State Tax Comm'n v. Garrett Corporation*, 79 Ariz. 389, 291 P.2d 208 (1955); *State Tax Comm'n v. Quebedeaux Chevrolet*, 71 Ariz. 280, 226 P.2d 549 (1951).

2. The transaction privilege tax is imposed on the business of selling tangible personal property at retail. A.R.S. § 42-5061.

3. The transaction privilege tax is measured by all of the business activity of the taxpayer and not merely a part if it. *Duhame v. State Tax Commission*, 65 Ariz. 268, 276, 179 P.2d 252 (1947).

4. Taxpayer is engaged in the business of selling tangible personal property at retail.

5. The retail tax base is the "gross proceeds of sales or gross income derived from the business". There are various exemptions from taxation under the retail classification.

6. Gross income is defined as the gross receipts of a taxpayer derived from trade, business, commerce or sales and the value proceeding or accruing from the sale of tangible personal property or service, or both, and without any deduction on account of losses. A.R.S. § 42-5001(4).

7. Sale for transaction privilege tax purposes is defined as any transfer of title or possession, or both, exchange, barter, lease or rental, conditional or otherwise, in any manner or by any means whatever, including consignment transactions and auctions, of tangible personal property or other activities taxable under this chapter, for a consideration. A.R.S. § 42-5001(13).

8. An incident of ownership of an asset is the right to profit. *Hopper v. Daniel,* 72 Ark.App. 344, 38 S.W.3d 370 (2001); *Cal-American Income Property Fund II v. County of Los Angeles,* 208 Cal.App.3d 109, 256 Cal.Rptr. 21 (1989).

9. The transactions at issue transferred title to the property to the private party purchasers and therefore constituted sales of the artwork by Taxpayer for transaction privilege tax purposes.

10. A sale is considered a retail sale unless it is for resale in the ordinary course of business. A.R.S. § 42-5061.V.3. The subject sales are not sales for resale in the ordinary course of business of the private party purchaser.

11. The burden is on the retailer to show that a sale was not a retail sale, unless the retailer has taken a proper resale exemption certificate. A.R.S. § 42-5022.

12. The sales at issue were retail sales subject to the Arizona transaction privilege tax.

13. A person's gross proceeds are presumed to be the tax base for the taxable business activity until the contrary is established by that person. A.R.S. § 42-5023.

14. There is no double taxation in this case. Double taxation occurs when the same property or person is taxed twice for same purpose for same taxing period by same taxing authority. *Miami Copper Co. Division, Tennessee Corp. v. State Tax Commission,* 121 Ariz. 150, 154, 589 P.2d 24, 28 (App. 1978). Here different transactions are the subjects of the tax.

Discussion

In its pleadings Taxpayer has admitted it is engaged in the business of selling tangible personal property at retail, an activity subject to the transaction privilege tax. The question presented is whether the transactions at issue should be included in the measure of the tax.

Taxpayer labels these transactions as simply investments made by a private party, and therefore do not constitute sales transactions. Whether a transaction is a retail sale is determined by the nature of the transaction and the documents produced, not by labels used by Taxpayer to describe the transactions. As the Arizona Supreme Court observed in *Moore v. Smotkin,* 79 Ariz. 77, 79 283 P.2d 1029, 1030 (1955):

> …. we are not so much concerned with what label appellees use to describe their business activity, being inclined to agree with Shakespeare:
>
> 'What's in a name? That which we call a rose
>
> By any other name would smell as sweet.'

It does not appear these were mere investments or loans by the private party to the Taxpayer. In return for providing funds to the Taxpayer, the private party got to share in the appreciation of the work of art, if any. The private party shared in any profits as well as the risk that there would be no profits. As Taxpayer further points out in its memoranda, any unsold artwork might be delivered to the investor instead of a cash

repayment of principal. The right and obligation to share in any profits or risks, and the possibility of receiving the painting in lieu of repayment are indicators of ownership interests held by the private party. Taxpayer has not established that the funds it received from the private parties did not constitute gross proceeds of sales or gross income derived from its retail business.

Taxpayer also argues that the sale to the private party was a sale for resale not subject to the transaction privilege tax. Taxpayer did not present any exemption or resale certificates regarding the transactions at issue. Therefore the burden is on the Taxpayer to prove that the sales were not sales at retail.

A.R.S. § 42-5061.V.3. defines "selling at retail" as a sale for any purpose other than for resale in the regular course of business. There is no indication in the record that any of the private party purchasers were licensed retailers, or that the private party purchasers were purchasing the paintings for resale in the regular course of the purchasers' business, or that the purchasers were engaged in the business of selling artwork. Taxpayer has therefore not met its burden of proving the sales were not at retail.

Finally, Taxpayer argues that taxing both the transaction whereby the artwork is sold to the private party, and also taxing a later sale of the painting to other customers constitutes double taxation. Double taxation occurs when the same property or person is taxed twice for the same purpose for the same taxing period by same taxing authority. *Miami Copper Co. Division, Tennessee Corp. v. State Tax Commission,* 121 Ariz. 150, 154, 589 P.2d 24, 28 (App. 1978). Here different transactions are the subjects of the tax, the transactions will likely take place in different taxing periods, and as Taxpayer has indicated, a subsequent sale to a customer may never take place. Therefore there is no double taxation in this case.

O R D E R

The Administrative Law Judge's decision is affirmed.

This decision is the final order of the Department of Revenue. Taxpayer may contest the final order of the Department in one of two manners. Taxpayer may file an appeal to the State Board of Tax Appeals, 100 North 15th 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 23rd day of March, 2007.

ARIZONA DEPARTMENT OF REVENUE

Gale Garriott
Director

Certified original of the foregoing
mailed to:

[REDACTED]

[REDACTED]

GG:st

cc: Transaction Privilege and Use Tax Audit Section
Office of Administrative Hearings
Transaction Privilege Tax Appeals Section
Audit Division