DECISION OF MUNICIPAL TAX HEARING OFFICER

Decision Date: December 20, 2004
Decision: MTHO #182
Tax Collector: City of Flagstaff
Hearing Date: August 27, 2004

DISCUSSION

Introduction

On February 25, 2004, ***Taxpayer*** ("Taxpayer") filed a protest of a tax assessment made by the City of Flagstaff ("City"). After review, the City concluded on March 16, 2004, the protest was timely and in the proper form. On March 22, 2004, the Municipal Tax Hearing Officer ("Hearing Officer") ordered the City to file a response to the protest on or before May 6, 2004. On May 6, 2004, the City filed a response. On May 12, 2004, the Hearing Officer ordered the Taxpayer to file any reply on or before June 2, 2004. On May 27, 2004, the Taxpayer filed a reply. On June 3, 2004, the Hearing Officer sent a copy of the reply to the City. On June 21, 2004, a Notice of Hearing ("Notice") was issued setting the matter for hearing commencing on August 27, 2004. Both parties appeared and presented evidence at the August 27, 2004 hearing. On August 30, 2004, the Hearing Officer set forth the following brief schedule: the City would file a post hearing memorandum on or before September 27, 2004; the Taxpayer would file a reply memorandum on or before October 11, 2004; the City would file proposed findings of Fact ("Findings") and Conclusions of Law ("Conclusions") on or before October 25, 2004; and, the Taxpayer would file any disagreement with the City's proposal Findings and Conclusions on or before November 8, 2004. On September 27, 2004, the City notified the Hearing Officer that it was having major computer problems and needed an extension. On September 29, 2004, the Hearing Officer extended the schedule as follows: the City memorandum would be filed on or before October 4, 2004; the Taxpayer reply memorandum would be filed on or before October 18, 2004; the City's proposed Findings and Conclusions would be filed on or before November 1, 2004; and, the Taxpayer's disagreements with the City's proposed Findings and Conclusions would be filed on or before November 15, 2004. On October 4, 2004, the City filed a post hearing memorandum. On October 15, 2004, the Taxpayer filed a reply memorandum. On October 29, 2004, the City filed proposal Findings and Conclusions. On November 11, 2004, the Taxpayer filed disagreements to the City's proposed Findings and Conclusions. On November 18, 2004, the Hearing Officer indicated the record was closed and a written Decision would be issued on or before January 4, 2005.

City Position

The Taxpayer is in the business of selling motorcycles and off road vehicles. The City conducted an audit of the Taxpayer for the period December 1999 through November 2002. The City assessed the Taxpayer for additional taxes in the amount of $14,653.12 plus interest of $4,052.01. The City also assessed penalties for late payment and late filing in the amount of $1,465.35 which was subsequently waived by the City.

The City disagreed with the Taxpayer's protest that set-up/labor charges are non-taxable fees. The City asserted that City Code Section 3-05-004-0465 ("Section 465") provides that charges for delivery, installation or other direct customer services may be exempt from the City's tax on retail sales if the charges come within the scope of regulations applicable to exempt charges. City Regulation 3-5-100.2 ("Regulation 100.2") defines exempt "direct customer services" to mean "services other than repair rendered directly to the customer. Services or labor provided by any person prior to the transfer of tangible personal property to the customer or consumer are not included in this definition."

According to the City, it is quite clear that the exempt services do not include services provided prior to the transfer of tangible personal property. The City argued that the set-up charges are: (1) in connection with vehicle assembly, (2) are required by the manufacturer to be performed before the warranty will attach to the goods, and (3) are for work performed before the customer obtains possession of the vehicle. As a result the City argued these charges do not come within the exemption because they are performed before the transfer of the property to the customer. The City noted that "sale" is defined in City Code Section 3-5-100 ("Section 100") as "any transfer of title or possession, or both… of property for a consideration." "Sale" includes any transaction whereby the possession of such property is transferred but the seller retains the title as security for the payment of the price." Based on the testimony at the hearing, the City asserted that the motor vehicles were not delivered to the customer until all the manufacturer-required set-up tasks were completed by the Taxpayer.

The City opposed the Taxpayer's protest of taxes assessed on freight charges. The City asserted that pursuant to City Regulation 3-5-100.2 (a) ("Regulation 100"), freight charges are taxable unless they are separate delivery charges to the ultimate customer. The City argued that delivery charges incurred by the Taxpayer for delivery from the manufacturer are classified as "Freight, In" The City noted that Regulation 100 clearly includes these charges as part of taxable income. While the Taxpayer provided evidence at the hearing that "freight" charges were itemized on the customer's bill, the evidence also demonstrated that the "freight" charge was the same whether the vehicle was picked up at the Taxpayer's location or the vehicle was delivered to the customer's address. The auditor for the City provided evidence that at the time of the audit, the Taxpayer described the "freight" charges on the vehicle order form as covering freight-in from the manufacturer. The City also noted that the Taxpayer did not charge any freight charges to purchasers of used vehicles. As a result, the City concluded that the freight charges to purchasers of new vehicle were to recover the freight-in costs from the manufacturers. Based on all the above, the City argued the Taxpayer has failed to meet its burden of proof that the set-up charges and freight charges should not be included as part of the taxable income.

Taxpayer Position

The Taxpayer argued that the set-up/labor charges are non-taxable fees that are charged by the Taxpayer for the time spent in preparing the vehicle for the buyer to take possession. According to the Taxpayer, the set-up work is done after the sale has occurred. The Taxpayer argued that the charges for this work are exempt from taxation because they are performed after and only after the customer signs a purchase agreement along with signing finance contracts or paying cash for the unit. According to the Taxpayer, a receipt of purchase is given to the customer as proof of the sales transaction. The Taxpayer acknowledged they stated at the hearing that the risk of loss or damage to the vehicle would remain with the Taxpayer. However, the Taxpayer asserted this was only done as a courtesy to the buyer. The Taxpayer asserted that at the time the customer signs the purchase agreement, the customer receives a temporary title and registration and the customer is free to remove the vehicle from the premises at that time. The Taxpayer acknowledged they provided testimony at the hearing that the unit would not be delivered until the Taxpayer completes all the manufacturer-required set-up tasks. The Taxpayer indicated they complete all the manufacturer-required set-up tasks merely as a service for the customer and it is not required in order for there to be a sale. The Taxpayer argued that the set-up charges are: (1) not in connection with vehicle assembly, (2) are required by the manufacturer to be performed before the warranty will attach to the goods, but are not required to sell the unit and are performed at the customer's preference, (3) are not for work performed before the customer obtains title or possession of the vehicle. As a result, the Taxpayer argued the set-up charges are exempt pursuant to Regulation 100.2.

The Taxpayer argued that they have customarily charged a delivery charge (freight) to the customer to account for the delivery expenses incurred as a result of the Taxpayer delivering units to the location designated by the customer. According to the Taxpayer, they deliver 99 percent of the units. The Taxpayer indicated they considered it to be a delivery when they simply loaded the unit onto a customer's private vehicle/trailer. The Taxpayer acknowledged that a customer would have to pay the delivery charge whether the vehicle was delivered to the customer's home or whether the customer picked up the unit at the Taxpayer's location. According to the Taxpayer, it is not known during the sales negotiations whether a delivery will be necessary so a delivery charge is always included to cover the likely event a delivery will be necessary. The Taxpayer asserted the delivery charges are billed separately and shown on the Taxpayer's books and records. As a result, the Taxpayer argued the charges are not taxable pursuant to Regulation 100.2. The Taxpayer informed the City at the time of audit that the freight charge on the purchase agreement covered freight-in from the manufacturer. The Taxpayer asserts this information was wrong as the Taxpayer representative only worked in the industry for a year and made an incorrect assumption. In response to an argument made by the City, the Taxpayer asserted the freight cost from the vendor is posted in the cost column across from the customer's charge column on the Taxpayer's Deal Profitability Sheet simply because the Taxpayer's computer system limits where the entries can be made. Also in response to the City, the Taxpayer indicates no delivery charges are shown on the purchase of used vehicles because these charges are added to the value of the unit when it is being traded in. Based on the above, the Taxpayer argued they had met the burden of proving that freight charged billed to its customers were exempt from taxation as "delivery" charges.

ANALYSIS

The first issue is whether or not the set-up/labor activities on new vehicles that occurred after a customer has signed a purchase agreement and financing contract, if any, and/or paid cash is a taxable activity. City Code Section 3-5-004-0465 ("Section 465") provides an exemption for retail sales for direct customer service charges as prescribed by Regulation. Regulation 100.2 makes it clear that services or labor provided by any person prior to the transfer of tangible personal property to the customer are not included in the definition of "direct customer services." City Code Section 100 ("Section 100") defines "sale" as "any transfer of title or possession, or both … of property for a consideration." It is clear that the Taxpayer still has possession of the new vehicle while performing the set-up/labor activities. As to transfer of title, both parties cited ARS Section 47-2401 (2) ("Section 2401") to support their respective positions. Section 2401 provides that "title passes to the buyer at the time and place at which the seller completes his performance with reference to the physical delivery of the goods… ." It is clear from the evidence that the set-up/labor activities are required by the manufacturer to be performed before the warranty will attach to the goods. As a result, we must conclude that the Taxpayer has not completed his performance with reference to the physical delivery of the goods until the warranty work has been completed. While the Taxpayer argued the work is not necessary to sell the unit, there was no evidence to support a statement that customers would be willing to pay full price for a vehicle without any warranty. We also agree with the City that the Taxpayer's testimony that the risk of loss or damage remains with the Taxpayer until the vehicle is actually transferred further supports the conclusion that there can be no "sale" until the warranty work is completed. Based on all the above, the Hearing Officer concludes that the Taxpayer has failed to demonstrate they are entitled to an exemption pursuant to Section 465 and Regulation 100.2 for the set-up/labor activities.

The second issue is whether the freight charges itemized to the customers of the Taxpayer are exempt from taxation. Section 465 provides that "charges for delivery, installation, or other direct customer services as prescribed by Regulation" are exempt from the tax on retail sales. Regulation 100.2 exempts "delivery charges" when they are separately charged to the customer. Regulation 100.2 also makes clear that delivery charges from the manufacturer to the vendor are deemed "freight-in" and are not considered delivery. We find the burden of proof is on the Taxpayer to demonstrate that the itemized charges were for charges for delivery to the ultimate consumer. In this case, we conclude the Taxpayer failed to meet its burden of proof. While the charges are separated stated as "delivery charges" we can find no relationship to actual charges for delivery to the ultimate consumer. The evidence demonstrates that the same amount is charged for each customer of a new vehicle whether there is a delivery to a customer home or whether the new vehicle is picked up by the customer from the Taxpayer's location. In addition, the evidence, including the Taxpayer's own admission to the auditor, and the fact used vehicles are not charged a delivery charge when sold supports the City's argument that the itemized freight charges are actually "freight in" charges assessed to the Taxpayer's customers. Based on all the evidence, we find the Taxpayer has failed to demonstrate the itemized charges were for charges for delivery to the ultimate consumer.

FINDINGS OF FACT

1. On February 25, 2004, the Taxpayer filed a protest of a tax assessment made by the City.

2. After review the City concluded on March 16, 2004, that the protest was timely and in proper form.

3. On March 22, 2004, the Hearing Officer ordered the City to file a response to the protest on or before May 6, 2004.

4. On May 6, 2004, the City filed a response.

5. On May 12, 2004, the Hearing Officer ordered the Taxpayer to file any reply on or before June 2, 2004.

6. On May 27, 2004, the Taxpayer filed a reply.

7. On June 3, 2004, the Hearing Officer sent a copy of the reply to the City.

8. On June 21, 2004, a Notice was issued setting the matter for hearing commencing on August 27, 2004.

9. Both parties appeared and presented evidence at the August 27, 2004 hearing.

10. On August 30, 2004, the Hearing Officer set forth the following briefing schedule: the City would file a post hearing memorandum on or before September 27, 2004; the Taxpayer would file a reply memorandum on or before October 11, 2004; the City would file proposed Findings and Conclusions on or before October 25, 2004; and the Taxpayer would file any disagreement with the City's proposed Findings and Conclusions on or before November 8, 2004.

11. On September 27, 2004, the City notified the Hearing Officer that it was having major computer problems and needed an extension.

12. On September 29, 2004, the Hearing Officer extended the schedule as follows: the City memorandum would be filed on or before October 4, 2004; the Taxpayer reply memorandum would be filed on or before October 18, 2004; the City's proposed Findings and Conclusions would be filed on or before November 1, 2004; and, the Taxpayer's disagreements with the City's proposed Findings and Conclusions would be filed on or before November 15, 2004.

13. On October 4, 2004, the City filed a post hearing memorandum.

14. On October 15, 2004, the Taxpayer filed a reply memorandum..

15. On October 29, 2004, the City filed proposed Findings and Conclusions.

16. On November 11, 2004, the Taxpayer filed disagreements to the City's proposed Findings and Conclusions.

17. On November 18, 2004, the Hearing Officer indicated the record was closed and a written Decision would be issued on or before January 4, 2004.

18. The Taxpayer is in the business of selling motorcycles and off road vehicles.

19. The City conducted an audit of the Taxpayer for the period December 1999 through November 2002.

20. The City assessed the Taxpayer for additional taxes in the amount of $14,653.12 plus interest of $4,052.01.

21. The City also assessed penalties for late payment and late filing in the amount of $1,465.35 which was subsequently waived by the City.

22. The Taxpayer incurs set-up and labor charges while performing a number of tasks on new vehicles before the customer receives possession of the vehicle.

23. The set-up/labor work is required by the manufacturer to be performed before the warranty will attach to the vehicles.

24. The risk of loss or damage to the vehicle remains with the Taxpayer until the vehicle is transferred to the buyer.

25. No set-up charges were included in the sales of used vehicles because they were already assembled.

26. The Taxpayer charges all purchases of new vehicles the same delivery charge whether the Taxpayer delivers the vehicle to the customer location or whether the customer picks up the vehicle at the Taxpayer's business location.

27. The Taxpayer did not charge any delivery charge to purchasers of used vehicles.

28. During the audit, the Taxpayer informed the auditor that the "freight charges" covered freight-in from the manufacturer.

29. The set-up/labor activities were required by the manufacturer to be performed before any warranty will attach to the goods.

CONCLUSIONS OF LAW

1. Pursuant to ARS Section 42-6056, the Municipal Tax Hearing Officer is to hear all reviews of petitions for hearing or redetermination under the Model City Tax Code.

2. The Taxpayer had taxable retail sales during the audit period pursuant to City Code Section 3-5-460.

3. The set-up/labor activities on new vehicles sold by the Taxpayer occurred prior to any transfer of title or possession to the ultimate customer.

4. The "delivery charges" separately charged to the ultimate customer are not related to actual charges for delivery to the customer.

5. The Taxpayer has the burden of proof to demonstrate that they are entitled to specific exemptions.

6. The Taxpayer has failed to meet its burden of proof of demonstrating that they are entitled to an exemption for set-up charges or delivery charges.

7. The Taxpayer demonstrated reasonable cause for failing to timely file and failing to timely pay.

8. The Taxpayer's protest, with the exception of the penalties, should be denied.

ORDER

It is therefore ordered that the February 25, 2004 protest of ***Taxpayer*** of a tax assessment by the City of Flagstaff is hereby denied, with the exception of the removal of all penalties.

It is further ordered that the City of Flagstaff shall remove the failure to timely file and failure to timely pay penalties from the assessment.

It is further ordered that this Decision is effective immediately.