

## **DECISION OF MUNICIPAL TAX HEARING OFFICER**

Decision Date: June 9, 2005  
Decision: MTHO #184  
Tax Collector: City of Phoenix  
Hearing Date: September 1, 2004

### **DISCUSSION**

#### **Introduction**

On April 2, 2004, *Taxpayer* Hotel (“Taxpayer”) filed a protest of a tax assessment made by the City of Phoenix (“City”). After review, the City concluded on April 5, 2004, that the protest was timely and in the proper form. On April 14, 2004, the Municipal Tax Hearing Officer (“Hearing Officer”) ordered the City to file a response to the protest on or before May 31, 2004. On May 4, 2004, the Taxpayer filed additional documentation and requested the matter be reclassified as a redetermination. On May 7, 2004, the Hearing Officer reclassified this matter as a redetermination. On May 11, 2004, the City filed a response to the protest. On May 13, 2004, the Hearing Officer ordered the Taxpayer to file a reply on or before June 14, 2004. On June 9, 2004, the Taxpayer requested the matter be reclassified to a hearing. On June 10, 2004, the Hearing Officer reclassified the matter to a hearing and extended the Taxpayer’s reply deadline to July 1, 2004. On June 29, 2004, the Taxpayer sent an email requesting an extension until July 15, 2004. On June 30, 2004, the Hearing Officer granted the Taxpayer’s extension. On July 6, 2004, a Notice of Tax Hearing (“Notice”) scheduled the matter for hearing on August 30, 2004. Subsequently, the Taxpayer sent another email requesting an extension until July 30, 2004 which was granted by the Hearing Officer on July 26, 2004. On July 27, 2004, a Notice rescheduled the hearing until September 1, 2004. On July 30, 2004, the Taxpayer filed its reply. Both parties appeared and presented evidence at the September 1, 2004 hearing. On September 3, 2004, the Hearing Officer indicated the parties had agreed to the following schedule: the Taxpayer shall provide additional documentation requested by the City on or before October 1, 2004; the City would file a closing brief on or before November 1, 2004; and the Taxpayer would file a reply brief on or before December 1, 2004. The Taxpayer filed its additional information on September 22, 2004. On October 29, 2004, the City sent an email requesting an extension for its closing brief. On November 2, 2004, the Hearing Officer revised the City’s deadline to November 22, 2004 and the Taxpayer’s deadline for its reply brief to December 22, 2004. On November 16, 2004, the City sent an email requesting an extension for its closing brief. On November 18, 2004, the Hearing Officer revised the City’s deadline to December 22, 2004 and the Taxpayer’s deadline for its reply brief to February 7, 2005. On December 15, 2004, the City sent an email requesting another extension. On December 15, 2004, the Hearing Officer revised the City’s deadline to January 21, 2005 and the Taxpayer’s deadline for its reply brief to March 9, 2005. On January 20, 2005, the City again sent an email requesting an extension. On January 21, 2005, the Hearing Officer extended the City’s deadline to January 28, 2005 and the Taxpayer’s deadline to March 16, 2005. The City filed its closing brief on January 28, 2005. On March 10, 2005, the

Taxpayer sent an email requesting an extension for its reply brief. On March 14, 2005, the Hearing Officer extended the Taxpayer's deadline until April 15, 2005. On April 14, 2005, the Taxpayer filed its reply brief. On April 20, 2005, the Hearing Officer indicated the record was now closed and a written decision would be issued on or before June 6, 2005.

### **City Position**

#### **City Code Section 14-560 (c)**

In response to the Taxpayer's argument that City Code Section 14-560 (c) ("Section 560 (c)") has been rendered ineffective by Arizona Department of Revenue v. Canyoners, Inc., 200 Ariz. 139, 23 p. 3d 684 (2001), the City argued the City's provisions are not similar and the reasoning of Canyoners, supra, does not apply. The City indicated that Section 560 (c) does not permit a refund of taxes to a taxpayer unless the taxpayer can show that it will refund customers who have been charged the tax amounts refunded within 60 days. In this case, the City argued that the Taxpayer has provided no evidence that any taxes refunded will be returned to guests within sixty days of any refund by the City.

#### **Records**

The City asserted that City Code Section 14-350 ("Section 350"), 14-360 ("Section 360"), and City Regulation 14-350.1 ("Regulation 350.1") provide specific guidance as the requirements for record keeping by taxpayers. Further, City Code Section 14-460 (b) ("Section 460 (b)") provides that the burden of proving that a sale of tangible personal property is not a taxable retail sales in on the person who made the sale. The City argued that in this case with regard to the refunds recommended for denial, the Taxpayer has not provided documentation to meet its burden of proof.

#### **Cancellation and Attrition Fees**

These charges occur when groups contract with the Taxpayer for a block of rooms and fail to cancel by an agreed upon time in order to avoid the charge or when groups only use a portion of the rooms agreed upon, and held. City Code Section 14-200 ("Section 200") defines "gross income" to include all receipts. The City argued that the Code definitions of "business," "hotel," and "occupancy" set forth in City Code Section 14-100 ("Section 100") supports the City's argument that the cancellation and attrition fees were taxable under the hotel activity pursuant to City Code Section 14-444 ("Section 444") and the transient hotel activity pursuant to City Code Section 14-447 ("Section 447"). The City extracted the following from copies of Letters of Agreements ("Agreements") between the Taxpayer and group customers: "From the moment this contract is accepted, the room nights set forth above are sold to you and held for the use of the attendee." As a result, the City argued it is clear that the rooms were sold to the respective groups. The City also noted that the Agreements contained language under "Attrition" indicating that taxes will be charged on any attrition fees. According to the City, a review of invoice copies substantiated that a separate tax was charged on attrition fees. As a result, the City asserted attrition and cancellation fees are taxable pursuant to Sections 100, 200, 444, and 447. The City indicated that the Taxpayer improperly reported these revenues under the retail classification and as a result not only should the refund be denied but the fees are subject to the additional transient lodging tax of three percent for an additional tax of \$71,756.79 in unreported tax.

### Interest

The City concurred that the interest income would not be subject to the transaction privilege tax. However, the City indicated the documentation provided by the Taxpayer only represented \$313.61 of the refund request for interest income of \$148,207.00. On May 11, 2004, the City requested detailed documentation from the Taxpayer to support the refund amount. The City asserted the Taxpayer never supplied the requested documentation. As a result, the City recommended the refund of tax in the area of interest be denied.

### Miscellaneous Income From Commission Revenue

The City concurred that referral commissions received from an off-site vendor are not subject to the transaction privilege tax. On May 11, 2004, the City requested documentation which included copies of agreements with off-site vendors, billings from the Taxpayer to the off-site vendors for the commissions, and check copies and/or deposit documentation to verify accounts. Subsequently, the Taxpayer provided additional documentation. After review of the documentation, the City determined the Taxpayer was requesting a refund in the amount of \$45,030.73 greater than the documentation supported. As a result, the City concluded that the variance was too great to allow the refund.

### Long Distance Telecommunication Commissions

The City concurred that commissions received based on long distance usage and not for equipment located on the Taxpayer's property is not subject to the tax. On May 11, 2004, the City requested a copy of the **Company A** commission agreement to verify the nature of the commission revenue. Subsequently, the Taxpayer provided a May 12, 2003 agreement with **Company B**. The City indicated the **Company B** agreement was for the period May 2002 through July 2003. As a result, the City recommended the refund request for these revenues be denied.

### Interstate Long Distance Telecommunication Revenue

The City concurred that interstate long distance charges are exempt from the telecommunications tax. After review of the Taxpayer's documentation, the City recommended a refund amount of \$30,762.37 as long as the Taxpayer's customers were not separately charged a telecommunications tax on the interstate long distance charges. Subsequently, the Taxpayer provided sufficient documentation to demonstrate the tax was not separately charged or collected on the long distance charges. Accordingly, the City recommended a refund of \$30,762.37.

### Meeting Rooms

The Taxpayer has reported revenue from meeting rooms under the restaurant/bar classification for the refund period. This revenue is taxable under Code Section 14-445 and 446 as rental, leasing and licensing for the use of real property. Because of the Taxpayer's misclassification of this revenue, an additional .1% of tax is due. For the refund period, this is an additional \$427.46 in tax due.

### Laundry

The Taxpayer has reported revenue from laundry under the retail classification. This revenue is normally not taxable, and based on the Taxpayer's tax worksheets \$969.10 in tax has been overpaid. As a result, the City recommended a refund in the amount of \$969.10.

### Valet Parking

The Taxpayer has reported revenue from valet parking under the retail classification. A review of the Taxpayer's website showed that valet parking is a complementary guest service. Therefore, if this revenue represents the tips collected by the valets and not a charge for a parking space, it would not be taxable. The over reported tax would be \$36,017.58. The City recommended a refund in the amount of \$36,017.58.

### Taxpayer Position

The Taxpayer protested the denial by the City of a refund request in the amount of \$74,698.62 for the period October 1999 through October 2003. The refund request was for cancellation and attrition revenue, interest income, miscellaneous income from commission revenue, long distance telecommunications commissions, and interstate long distance revenues. The refund requests for the respective revenues were \$35,633.06, \$2,526.48, \$5,415.22, \$317.58, and \$30,806.27.

### Cancellation and Attrition Fees

The cancellation fees are charged when a group reserves a block of rooms and then cancels the entire block of rooms after a specified date. According to the Taxpayer, the fee is usually based on the number of unsold room nights multiplied by the contracted group room rate. The Taxpayer indicated the cancellation fee may be adjusted if the Taxpayer is able to rent the previously reserved rooms to any new prospective guests.

The attrition fees are charged to a client when the actual number of rooms rented for a contracted event is less than the number originally specified by a contract. The fee is based on the number of unsold room nights multiplied by the contracted group room rate. The attrition fee may be adjusted if the Taxpayer is able to rent the rooms to any new prospective guests.

The Taxpayer noted that City Tax Section 14-400 ("Section 400") levies a privilege tax directly on the person engaging in a taxable business within the City. Further, Section 444 imposes a privilege tax on the gross income from the business activity upon every person engaging in the business activity of operating a hotel charging for lodging and/or lodging space furnished to any transient. The Taxpayer argued in order for a room to be furnished to a person that a person must have the right to occupy and use the room. The Taxpayer asserted that both the attrition and cancellation fees are considered as penalties or liquidated damages for a group that fails to act upon its commitment to the Taxpayer. The Taxpayer argued the charges are not for guaranteeing lodging space or use of lodging space. According to the Taxpayer, the Agreement entered into with groups contain language in the event of a group cancellation that liquidated damages will be imposed. Similarly, there was language in the Agreement regarding attrition provisions whereby the rooms are placed back into general room inventory and held for sale to other prospective guests. As a result, the Taxpayer argued the rooms were not guaranteed to a group or transient. In response to the City, the Taxpayer asserted the City's privilege license tax is a transactional tax and not a gross receipts tax.

In response to the City's argument that a refund is precluded for those taxes separately identified and charged to customers the Taxpayer argued that the determination in Canyoneers overruled

the City's argument. In addition, the Taxpayer asserted that many of the groups were billed a lump sum (tax not separately charged).

#### Interest Income

During the refund period, the Taxpayer reported and paid transaction privilege tax on interest earned from its bank account. The Taxpayer had reported the interest income under the retail tax classification. The Taxpayer indicated City Code Section 460 (a) ("Section 460 (a)") imposes a tax on the business activity of selling tangible personal property at retail. The Taxpayer argued that the interest income was not derived from the sale of tangible personal property and as a result the taxes paid should be refunded. Pursuant to the City's request for additional documentation, the Taxpayer provided bank reconciliations, bank statements, profit and loss statements, and general ledger detail for the period June and July of 2000 and 2001.

#### Miscellaneous Income From Commission Revenue

During the refund period, the Taxpayer received commissions from various off site vendors, such as *Company C*, *Company D*, *Company E*, and other transportation and amusement companies. The Taxpayer indicated the commissions were as a result of business referrals to the vendors. The Taxpayer reported the commissions under the retail tax classification. The Taxpayer argued the commissions were not derived from the sale of tangible personal property and as a result the taxes paid should be refunded. In response to the City's concerns of large variance for the period of January 2003 through July 2003, the Taxpayer explained that in May 2003 it had recognized two months of back commissions from *Company C* totaling \$4,000. In addition, the Taxpayer had miscoded \$6,700 of attrition fees to commission revenue. The Taxpayer indicated that it had incorrectly reported in June of 2003 a payment from *Company A* of \$30,720 which should have been reported under the commercial real estate classification. The Taxpayer asserted the above explanations rectify the majority of the variance noted by the City.

#### Long Distance Telecommunication Commissions

During the refund period, the Taxpayer received a monthly commission from *Company A* based on hotel guest's long distance usage. The Taxpayer reported the commissions under the business of providing telecommunications pursuant to City Code Section 14-470 (a) ("Section 470 (A)"). The Taxpayer argued it did not provide telecommunications service and as a result the taxes paid should be refunded.

#### Interstate Long Distance Telecommunication Revenue

According to the Taxpayer, telecommunication services provided within the City are taxable pursuant to Section 470 (a). The Taxpayer asserted that interstate long distance charges are exempt pursuant to Section 470 (c). During the refund period, the Taxpayer paid transaction privilege tax on both intrastate and interstate long distance revenue. As a result, the Taxpayer requested a refund for taxes paid on interstate long distance revenue. In addition, the Taxpayer argued it was entitled pursuant to the Canyoneers case to refunds of the tax, whether separately stated or not.

#### Meeting Rooms

The Taxpayer concurred with the City's determination that a tax of \$427.46 is owed the City for the refund period.

### Laundry

The Taxpayer concurred with the City's determination that the Taxpayer should receive a refund of \$969.10 for taxes overpaid on laundry revenue during the refund period.

### Valet Parking

During the audit period, the Taxpayer reported revenue from valet parking under the retail classification. The revenues represented tips collected by the valets and not a charge for a parking space. The Taxpayer concurred with the City's recommended refund of overpaid taxes for valet parking in the amount of \$36,017.58.

## **ANALYSIS**

### Cancellation and Attrition Fees

We concur with the City that these charges are properly taxable. Whether or not a customer uses a room or not, they have paid for the right to have lodging space available. The nature of the hotel business is such that if the business loses a night of rental they can never recover those lost revenues. As a result, hotels like the Taxpayer utilize various charges such as cancellation and attrition charges to minimize the potential for lost revenues. While the Taxpayer argued these fees were penalties or liquidated damages, it is clear from the evidence that the fees were normally calculated utilizing a per room charge. While there was evidence that the fees may be reduced, it is clear they would only be reduced if the Taxpayer had an opportunity to recover the revenues from other customers. Clearly these fees are an integral part of the business of operating a hotel and as such would be taxable pursuant to Sections 100, 200, 444, and 447. As a result, any refund is denied and the Taxpayer owes additional taxes in the amount of \$71,756.79 for the transient lodging tax during the refund period. We also conclude that even if these fees were not taxable the Taxpayer would not be eligible for a refund because there was no evidence that the separate tax charged would be returned to customers pursuant to Section 560 (c).

### Interest

We concur with the Taxpayer that the interest income would not be subject to the transaction privilege tax. We also find that the Taxpayer has provided sufficient documentation to support its refund request. Accordingly, the request for a refund on taxes paid on interest income is approved in the amount of \$2,526.48.

### Miscellaneous Income From Commission Revenue

We concur with the Taxpayer that the commissions from various off site vendors are not subject to the transaction privilege tax. Further, we find the Taxpayer has provided a reasonable explanation for the discrepancies in the documentation provided. Accordingly, we will approve the requested refund of overpaid taxes in the amount of \$5,415.22 for the refund period.

### Long Distance Telecommunication Commissions

We concur with the Taxpayer that the commissions received based on long distance usage was not subject to the transaction privilege tax. We also concur with the City that the burden of proof is on the Taxpayer to provide sufficient documentation to support the amount of the refund. In

this case, the City's request for a copy of the *Company A* commission agreement was a reasonable request which the Taxpayer never complied with. Accordingly, we find the Taxpayer has failed to meet its burden of proof of providing sufficient documentation to support its refund. The refund request is denied.

#### Interstate Long Distance Telecommunication Revenue

We concur with the Taxpayer that interstate long distance charges are exempt from the telecommunications tax. Based on the documentation provided by the Taxpayer, we will approve a refund in the amount of \$30,762.37.

#### Meeting Rooms

We concur with the City that revenue from meeting rooms would be taxable pursuant to Section 445 and 446. Since the Taxpayer misclassified this revenue during the refund period, the Taxpayer has underpaid its tax obligation. As a result, the Taxpayer owes an additional \$427.46 for underpaid taxes.

#### Laundry

We concur with the City that revenue from laundry would not be taxable under the retail classification. As a result, the Taxpayer has overpaid taxes in the amount of \$969.10 which should be refunded.

#### Valet Parking

We concur with the City that revenue from valet parking would not be taxable under the retail classification. As a result, the Taxpayer has overpaid taxes in the amount of \$36,017.58 which should be refunded.

### **FINDINGS OF FACT**

1. On April 2, 2004, the Taxpayer filed a protest of a tax assessment made by the City.
2. After review, the City concluded on April 5, 2004 that the protest was timely and in proper form.
3. On April 14, 2004, the Hearing Officer ordered the City to file a response to the protest on or before May 31, 2004.
4. On May 4, 2004, the Taxpayer filed additional documentation and requested that the matter be reclassified as a redetermination.
5. On May 7, 2004, the Hearing Officer reclassified the matter as a redetermination.
6. On May 11, 2004, the City filed its response to the protest.
7. On May 13, 2004, the Hearing Officer ordered the Taxpayer to file a reply on or before June 14, 2004.

8. On June 9, 2004, the Taxpayer requested the matter be reclassified to a hearing.
9. On June 10, 2004, the Hearing Officer reclassified the matter to a hearing and extended the Taxpayer's reply deadline to July 1, 2004.
10. On June 29, 2004, the Taxpayer sent an email requesting an extension until July 15, 2004.
11. On June 30, 2004, the Hearing Officer granted the Taxpayer's extension.
12. On July 6, 2004, a Notice scheduled the matter for hearing on August 30, 2004.
13. Subsequently, the Taxpayer sent another email requesting an extension until July 30, 2004 which was granted by the Hearing Officer on July 26, 2004
14. On July 27, 2004, a Notice rescheduled the hearing until September 1, 2004.
15. On July 30, 2004, the Taxpayer filed its reply.
16. Both parties appeared and presented evidence at the September 1, 2004 hearing.
17. On September 3, 2004, the Hearing Officer indicated the parties had agreed to the following schedule: the Taxpayer shall provide additional documentation requested by the City on or before October 1, 2004; the City would file a closing brief on or before November 1, 2004; and the Taxpayer would file a reply brief on or before December 1, 2004.
18. The Taxpayer filed its additional documentation on September 22, 2004.
19. On October 29, 2004, the City sent an email requesting an extension for its closing brief.
20. On November 2, 2004, the Hearing Officer revised the City's deadline to November 22, 2004 and the Taxpayer's reply deadline to December 22, 2004.
21. On November 16, 2004, the City sent an email requesting an extension for its closing brief.
22. On November 18, 2004, the Hearing Officer revised the City's deadline to December 22, 2004 and the Taxpayer's deadline for its reply brief to February 7, 2004.
23. On December 15, 2004, the City sent an email requesting another extension.
24. On December 15, 2004, the Hearing Officer revised the City's deadline to January 21, 2005 and the Taxpayer's deadline for its reply brief to March 9, 2005.



25. On January 20, 2005, the City again sent an email requesting an extension.
26. On January 21, 2005, the Hearing Officer extended the City's deadline to January 28, 2005 and the Taxpayer's deadline to March 16, 2005.
27. The City filed its closing brief on January 28, 2005.
28. On March 10, 2005, the Taxpayer sent an email requesting an extension for its reply brief.
29. On March 14, 2005, the Hearing Officer extended the Taxpayer's deadline until April 15, 2005.
30. On April 14, 2005, the Taxpayer filed its reply brief.
31. On April 20, 2005, the Hearing Officer indicated the record was now closed and a written decision would be issued on or before June 6, 2005.
32. Cancellation fees are charged when a group reserves a block of rooms and then cancels the entire block of rooms after a specific date.
33. Cancellation fees are usually based on the number of unsold room nights multiplied by the contracted group room rate.
34. Attrition fees are charged to a client when the actual number of rooms rented for a contracted event is less than the number originally specified by a contract.
35. Attrition fees are based on the number of unsold room nights multiplied by the contracted group room rate.
36. A separate tax was charged on the cancellation and attrition fees.
37. The Taxpayer has provided a reasonable explanation for the discrepancies in the documentation for miscellaneous income from commissions from various off site vendors.
38. The Taxpayer failed to provide a copy of the *Company A* commission agreement.
39. The Taxpayer did not separately charge a tax on the interstate long distance charges.
40. The Taxpayer did not separately charge a tax on valet parking charges.
41. The Taxpayer requested a refund of taxes paid for the period October 1999 through October 2003.

## 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. Cancellation and attrition fees are an integral part of the business of operating a hotel and as such would be taxable pursuant to Sections 100, 200, 444, and 447.
3. The Taxpayer's request for a refund of taxes paid on cancellation and attrition fees should be denied.
4. The City's assessment for additional taxes in the amount of \$71,756.79 for the transient lodging tax should be approved.
5. Pursuant to Section 560 (c), no refunds are to be paid when the Taxpayer has collected, by separately stated itemization, the amount of such tax; unless the taxpayer can present documentation satisfactory to the City that the taxes will be refunded to customers within sixty days of receipt of the refund.
6. The Taxpayer has presented no documentation to demonstrate any itemized taxes would be refunded to customers.
7. The burden is on the Taxpayer pursuant to Sections 350, 360, 460 (b), and Regulation 350.1 to maintain and provide suitable books and records to support any refund request.
8. The Taxpayer has failed to meet its burden of proof by not providing suitable documentation to support a refund of taxes paid on long distance telecommunication commissions.
9. The Taxpayer's protest should be denied, in part, and granted, in part, consistent with the Discussion, Findings, and Conclusions, herein.

## ORDER

It is therefore ordered that the April 2, 2004 protest by *Taxpayer* Hotel of a denial of a refund claim by the City of Phoenix is hereby denied, in part, and granted, in part, consistent with the Discussion, Findings, and Conclusions, herein.

It is further ordered that the City of Phoenix shall calculate the net amount of refund and additional tax assessment for *Taxpayer* consistent with the Discussion, Findings, and Conclusions, herein.

It is further ordered that this Decision is effective immediately.