

## DECISION OF MUNICIPAL TAX HEARING OFFICER

October 27, 2010

*Taxpayer's Representative*  
*Representative's Address*

*Taxpayer*  
MTHO #588

*Dear Taxpayer's Representative:*

We have reviewed the evidence submitted for redetermination by *Taxpayer* and the City of Prescott (Tax Collector or City). The review period covered was January 2005 through December 2008. Taxpayer's protest, Tax Collector's response, and our findings and ruling follow.

### Taxpayer's Protest

Taxpayer was assessed City of Prescott privilege tax under the retail classification for Taxpayer's photography business. The City's position that photography is taxable is inconsistent with the City's prior written position. Taxpayer has been hired by the City to do photography and Taxpayer did not charge tax on the invoice. The City did not bring this error to Taxpayer's attention. Taxpayer's photographs are in a digital format. Digital image files are not tangible personal property. Taxpayer is being singled out by the City for the imposition of the privilege tax on photographers. Even if Taxpayer were taxable on its photography business, the estimate used by the City to calculate the tax due was not reasonable. Finally, the City did not transmit Taxpayer's petition to the Municipal Tax Hearing Office within twenty days after receipt of the petition and therefore the audit must be dismissed.

### Tax Collector's Response

Taxpayer operates a photography business. Taxpayer's photography business is subject to the City privilege tax under the retail classification. Pictures sold in any form, whether digital or physical print, constitute the transfer of tangible personal property. The tax is measured by the income from the business. Taxpayer did not have records available for the audit period. The documentation Taxpayer did provide did not appear reliable. The Tax Collector therefore based the assessment on a monthly estimated amount that would allow for the business to be profitable while meeting the estimated expenses during any given month. Taxpayer was chosen for audit because the annual taxable gross receipts reported by Taxpayer appeared low. Finally, there are no provisions in the code to negate an assessment based on two parties trying to resolve the issue before a hearing is requested.

## Discussion

Taxpayer is an irrevocable trust that operates a photography business. The Tax Collector conducted an audit assessment of Taxpayer for the period January 2005 through December 2008 and issued an assessment under the retail classification. The assessment was based on an estimate of income because Taxpayer did not have the required records for the audit period.

Taxpayer timely protested the assessment raising the following issues:

- Is the business of photography subject to privilege tax under the retail classification.
- Was Taxpayer improperly singled out for audit,
- Was the Tax Collector's estimate of gross receipts reasonable,
- Must the assessment be dismissed because Taxpayer's petition was not forwarded to the Municipal Tax Hearing Office within twenty days of receipt, and
- Was the assessment inconsistent with prior written statements concerning Taxpayer's tax liability?

### **Is photography subject to the City's privilege tax?**

The Prescott City Code imposes a privilege tax on persons engaging in certain businesses, including selling tangible personal property at retail. Taxpayer argues that when it sells photographs on a digital medium, such as a compact disk (CD), it is selling computer code, not tangible personal property.

The fact that Taxpayer provides photographs in a digital format on a CD does not exclude the activity from the City's privilege tax. The City code provides that when the state statutes and model city tax code are the same and where the department of revenue has issued written guidance, the department's interpretation is binding on cities and towns. Both the state and the City impose their privilege tax on the business of selling tangible personal property at retail. The Arizona Department of Revenue has promulgated an administrative rule relating to the taxation of photography. (*See*, Arizona Administrative Code (A.A.C.) R15-5-150.)

A.A.C. R15-5-150.A.3 defines photography as the process of taking and supplying images to customers, using film, video, or another data storage medium. A.A.C. R15-5-150.B. provides that the sale of photography is subject to tax as a retail sale.

The fact that the photographs are in a digital format is not relevant. There are other examples where the sale of an item in a digital format is taxable as the sale of tangible personal property, such as computer software. (*See*, A.A.C. R15-5-154.B., gross receipts derived from the sale of computer software programs are taxable, regardless of the method that a retail business uses to transfer the programs to its customers; Prescott City Code (PCC) § 4-1-115(a), computer software which is not "custom computer programming" is deemed to be tangible personal property for the purposes of this Chapter, regardless of the method by which title, possession, or right to use the software is transferred to the user.)

Taxpayer argued that its preparation of digital image files is no different from digital files prepared by attorneys or accountants. However, the business of photography is not a professional or personal service occupation such as an attorney or accountant. (*See*, Transaction Privilege Ruling (TPR) 90-2; Decision of Director of Department of Revenue Case No. 200500067S-REV.) A photographer does not enter into the business by virtue of a state

sanctioned or state-issued license. The dominant purpose for hiring an event photographer is to have the right to purchase the photographs, whatever the medium. That is different from hiring an attorney to prepare a will or other legal document. Therefore Taxpayer's photography business is subject to tax under the retail classification. PCC § 4-1-460; Regulation § 4-1-100.2(d)(4).

### **Was Taxpayer improperly singled out for an audit?**

Taxpayer argued that it was singled out for audit, and the City has not audited or taxed other similar businesses. The Tax Collector audited Taxpayer because its audit staff noticed that Taxpayer was reporting an average of \$2,676.64 per year as taxable receipts. Because Taxpayer advertised its photography business in the City, the Tax Collector considered the amount reported by Taxpayer to be low. The Tax Collector had a reasonable basis to audit Taxpayer to determine whether the correct amount of City privilege taxes was paid.

Taxpayer presented no evidence to show that it was chosen for audit for some improper reason or that the Tax Collector systematically and deliberately discriminated against Taxpayer. The Tax Collector cannot audit every taxpayer, and there is no requirement that it audit every taxpayer. The Tax Collector has the discretion to use its limited resources in the most efficient way. It is no defense to an audit that another Taxpayer may not have been audited. *Tucson Mechanical Contracting, Inc. v. Arizona Department of Revenue*, 175 Ariz. 176, 854 P.2d 1162 (1992). The Tax Collector did not improperly chose Taxpayer for an audit.

### **Was the City's estimate of gross receipts reasonable?**

The privilege tax is measured by gross income from the business. Taxpayer was required to keep the necessary books and records showing Taxpayer's gross income attributable to its activities in the City. Taxpayer did not have the required records for the audit period. Because Taxpayer did not have the required records, PCC § 4-1-555(e) authorized the Tax Collector to estimate Taxpayer's income on a reasonable basis to determine the correct tax.

Taxpayer argued that the assessment should have been based on invoices Taxpayer provided to the Tax Collector. The Tax Collector did not consider Taxpayer's invoices reliable to estimate Taxpayer's income. Many of the invoices were dated outside the audit period, some were undated, the invoices were not sequentially numbered, some were not numbered and some had duplicate numbers. The Tax Collector therefore estimated Taxpayer's gross receipts on a monthly amount that would allow for the business to be profitable while meeting the estimated expenses during any given month. Under the circumstances, the Tax Collector's method of estimating Taxpayer's gross receipts was reasonable.

It is the responsibility of the taxpayer to prove that the Tax Collector's estimate is not reasonable and correct. While Taxpayer argued that the Tax Collector's estimate was too high, Taxpayer did not provide any evidence or detailed information to prove that the Tax Collector's estimate was not reasonable or correct or that would establish the reliability of the records that were produced.

### **Must the audit be dismissed because the City did not transmit Taxpayer's petition to the Municipal Tax Hearing Office within twenty days after receipt of the petition?**

PCC § 4-1-570(b)(4) provides that the Tax Collector "... shall forward any petition to the Municipal Tax Hearing Officer within twenty days after receipt." The Tax Collector received Taxpayer's protest on April 1, 2010. The Tax Collector sent Taxpayer a letter dated April 22,

2010 to discuss some of the issues raised in Taxpayer's protest. By April 22<sup>nd</sup>, the twenty-day period to forward the protest had already passed. Taxpayer submitted a Motion to Dismiss the Audit dated May 26, 2010 because the Tax Collector did not timely transmit Taxpayer's protest to the Municipal Tax Hearing Office. The Tax Collector forwarded Taxpayer's protest to the Municipal Tax Hearing Office on June 9, 2010.

PCC § 4-1-570 does not state what result will follow if a petition is not timely forwarded to the Municipal Tax Hearing Office. The question presented is whether the requirement to forward the protest within twenty days is mandatory so that the assessment must be vacated, or directory so that the Municipal Tax Hearing Office may still considered the matter?

Generally, statutes directing the mode of proceeding by public officer, designed to promote method, system, uniformity and dispatch in such proceeding, will be regarded as directory if disregarding the statute will not injure the rights of the parties, and the statute does not declare what result will follow noncompliance, or contain negative words importing a prohibition of any other mode of proceeding than that prescribed. *Maricopa County v. Garfield*. 109 Ariz. 503, 513 P.2d 932 (1973); 67 C.J.S. *Officers* § 238.

PCC § 4-1-570(b)(4) serves as a procedural directive intended to give method, system, uniformity and dispatch to the processing of protests. It does not state the consequences of noncompliance with the twenty-day requirement. Finally, the Tax Collector's delay did not interfere with Taxpayer's protest rights. Taxpayer's protest was forwarded to the Municipal Tax Hearing Office, and Taxpayer's request for a redetermination proceeded. We hold that the requirement to forward the protest within twenty days is directory, and the Tax Collector's non-compliance does not void the assessment.

**Was the deficiency attributable to erroneous written advice by the Tax Collector?**

PCC § 4-1-541(a)(1) provides that the Tax Collector cannot assess interest or penalty on a deficiency if the deficiency assessed is directly attributable to erroneous written advice furnished to the taxpayer by an employee of the City acting in an official capacity in response to a specific request from the taxpayer.

Taxpayer argued that the deficiency was due to its reliance on erroneous statements made by the City. Taxpayer raises two items:

- The City used Taxpayer's services and Taxpayer's invoice to the City did not show a charge for tax. The City should have informed Taxpayer it was not charging tax correctly.
- The City had indicated on a return (Exhibit D to Taxpayer's Reply) that Taxpayer overpaid its taxes and showed on another return (Exhibit E to Taxpayer's Reply) that Taxpayer had a positive balance.

There is no evidence that Taxpayer made a specific request to the City for advice regarding the taxability of the business of photography or that a tax official of the City furnished any erroneous written advice in response to a request by Taxpayer. Taxpayer's invoice to the City cannot be considered a request for advice.

Taxpayer's Exhibit D is a copy of a privilege tax return for the period January through December 2007. The return does not on its face specify that a refund is being issued or the reason for any refund. Exhibit E is a privilege tax return for the period January through December 2009. It shows a prior account balance of \$3.67. Neither return contains any erroneous or misleading

statement regarding the taxability of photography, or in any way addresses photography. The Tax Collector's assessment of interest and penalty cannot be abated pursuant to PCC § 4-1-541.

### Findings of Fact

1. Taxpayer is an irrevocable trust.
2. Taxpayer operates a photography business.
3. Taxpayer's activities include wedding and event photography, photography of persons, groups or items and providing re-prints.
4. Taxpayer provides photographs as prints or as digital files on a compact disc (CD).
5. Taxpayer paid privilege tax on its re-print activities.
6. Taxpayer did not pay privilege tax on its other photography activities.
7. Taxpayer on occasion provided photography services to the City.
8. Taxpayer did not separately charge the City a tax for its photography activities performed for the City.
9. City did not contact Taxpayer that no tax was charged.
10. During the audit period Taxpayer reported an average of \$2,676.64 per year as taxable receipts.
11. The Tax Collector considered the amount of annual income reported by Taxpayer to be low.
12. The Tax Collector conducted an audit assessment of Taxpayer for the period January 2005 through December 2008.
13. Taxpayer did not have records available for the audit period of January 2005 through December 2008.
14. Taxpayer provided copies of invoices for months subsequent to the audit period.
15. Some of the invoices were not dated.
16. The invoices were not sequentially numbered.
17. Some of the invoices were not numbered and some had duplicate numbers.
18. The Tax Collector did not consider the copies of invoices reliable on which to base the assessment.
19. The Tax Collector estimated Taxpayer's gross income for the assessment on a monthly estimated amount that would allow for the business to be profitable while meeting the estimated expenses during any given month.
20. The Tax Collector issued an assessment for additional city privilege tax of \$6,878.88, penalties of \$1,382.18 and interest through January 31, 2009 of \$ 860.53.
21. Taxpayer timely protested the assessment contending:
  - a. its photography business is not subject to the privilege tax;

- b. even if Taxpayer's business were taxable, the Tax Collector's estimate of income was unreasonable;
  - c. it was improperly singled out for audit;
  - d. the assessment must be dismissed because Taxpayer's petition was not forwarded to the Municipal Tax Hearing Office within twenty days of receipt; and
  - e. the assessment is inconsistent with prior written statements concerning Taxpayer's tax liability.
- 22. The Tax Collector received taxpayer's protest on April 1, 2010.
  - 23. The Tax Collector sent Taxpayer a letter dated April 22, 2010 to discuss some of the issues raised in Taxpayer's protest.
  - 24. Taxpayer submitted a Motion to Dismiss the Audit dated May 26, 2010 because the Tax Collector did not transmit Taxpayer's protest to the Municipal Tax Hearing Office within twenty days of receiving the protest.
  - 25. The Tax Collector forwarded Taxpayer's protest to the Municipal Tax Hearing Office on June 9, 2010.
  - 26. There have been no rulings on Taxpayer's Motion to Dismiss.
  - 27. Taxpayer has not submitted additional documents addressing the Tax Collector's estimate of Taxpayer's gross income for the audit period.

#### Conclusions of Law

- 1. The City imposes a privilege tax on the activity of selling tangible personal property at retail. PCC § 4-1-460.
- 2. When the state statutes and model city tax code are the same and where the department of revenue has issued written guidance, the department's interpretation is binding on cities and towns. A.R.S. § 42-6005.D.; PCC § 4-1-500(e)(2).
- 3. State statutes impose the transaction privilege tax on selling tangible personal property at retail. A.R.S. § 42-5061.A.
- 4. The business of photography is subject to the state privilege tax under A.R.S. § 42-5061.A. A.A.C. R15-5-150; Decision of Director of Department of Revenue Case No. 200500067S-REV.
- 5. The business of photography is not a professional or personal service occupation such as a lawyer. TPR 90-2; Decision of Director of Department of Revenue Case No. 200500067S-REV.
- 6. Photography means the process of taking and supplying images to customers, using film, video, or another data storage medium. A.A.C. R15-5-150.A.3.
- 7. Sales of photographs are sales of tangible personal property taxable under the retail classification. Regulation § 4-1-100.2(d)(4); Arizona Administrative Code A.A.C. R15-5-150.

8. Taxpayer's photography business is subject to tax under the retail classification. PCC § 4-1-460; Regulation § 4-1-100.2(d)(4).
9. The privilege tax is measured by Taxpayer's gross income from the taxable business activity. PCC § 4-1-460.
10. Gross income includes the total amount of the value proceeding or accruing from the sale of property and the providing of a service. PCC § 4-1-200(a)(1).
11. Taxpayers are required to maintain records showing the gross income of the taxpayer attributable to any activity occurring in whole or in part in the City. Regulation 350.1(a).
12. The books and records of the taxpayer are required to indicate both individual transaction amounts and totals for each reporting period for each category of taxable, exempt, and excluded income. Regulation 350.1(g).
13. Taxpayer did not have the required records for the audit period showing Taxpayer's income attributable to its activities in the City.
14. The Tax Collector was authorized to estimate Taxpayer's income to determine the correct tax. PCC § 4-1-555(e).
15. The Tax Collector's estimate is required to be made on a reasonable basis. PCC § 4-1-545(b).
16. The Tax Collector's method for determining Taxpayer's gross receipts based on a monthly estimated amount that would allow for the business to be profitable while meeting the estimated expenses during any given month was reasonable.
17. It is the responsibility of the taxpayer to prove that the Tax Collector's estimate is not reasonable and correct. PCC § 4-1-545(b).
18. Taxpayer did not prove that the Tax Collector's estimate of gross receipts was not reasonable and correct.
19. The Tax Collector may examine the books and records of a taxpayer if he is not satisfied with a return and payment of the amount of tax required by the tax code. PCC § 4-1-545(a)(1).
20. The Tax Collector was authorized to audit Taxpayer's books and records to determine whether the correct amount of taxes had been paid.
21. The Tax Collector is not required to audit every taxpayer. *Tucson Mechanical Contracting, Inc. v. Arizona Department of Revenue*, 175 Ariz. 176, 854 P.2d 1162 (1992).
22. The Tax Collector may use his discretion to select some taxpayers for audit. *Tucson Mechanical Contracting, Inc. v. Arizona Department of Revenue, supra*.
23. The fact that the Tax Collector subjects one taxpayer to an audit and assessment but not another does not establish a denial of equal protection absent a showing that the action was based upon an unjustifiable standard, such as race, religion or some other arbitrary classification. *Tucson Mechanical Contracting, Inc. v. Arizona Department of Revenue, supra*.

24. The Tax Collector's reason for selecting Taxpayer for an audit was not based on an unjustifiable standard.
25. PCC § 4-1-570(b)(4) provides that the Tax Collector shall forward any petition to the Municipal Tax Hearing Officer within twenty days after receipt.
26. PCC § 4-1-570 does not state what result will follow if a petition is not forwarded to the Municipal Tax Hearing Office within twenty days after receipt.
27. Generally, statutes directing the mode of proceeding by public officer, designed to promote method, system, uniformity and dispatch in such proceeding, will be regarded as directory if a disregard thereof will not injure the rights of the parties, and the statute does not declare what result shall follow noncompliance therewith, or contain negative words importing a prohibition of any other mode of proceeding than that prescribed. *Maricopa County v. Garfield*. 109 Ariz. 503, 513 P.2d 932 (1973); 67 C.J.S. *Officers* § 238.
28. PCC § 4-1-570(b)(4) serves as a procedural directive intended to give method, system, uniformity and dispatch to the processing of assessments and is therefore directory, not mandatory.
29. The Tax Collector's delay in forwarding Taxpayer's petition to the Municipal Tax Hearing Office did not interfere with Taxpayer's protest rights.
30. The Tax Collector's assessment is not void because Taxpayer's petition was not forwarded to the Municipal Tax Hearing Office within twenty days of receipt.
31. The Tax Collector may not assess interest or penalty on a deficiency if the deficiency assessed is directly attributable to erroneous written advice furnished to the taxpayer by an employee of the City acting in an official capacity in response to a specific request from the taxpayer. PCC § 4-1-541(a)(1).
32. There is no evidence that Taxpayer made a specific request to the City for advice or that a tax official of the City furnished any erroneous written advice in response to Taxpayer's request.
33. The Tax Collector may not assess interest or penalty on a deficiency if the deficiency is directly attributable to a tax return form prepared by the Tax Collector which contains a statement that, if followed by a taxpayer, would cause the taxpayer to misapply the tax. PCC § 4-1-541(a)(2).
34. There is no evidence that a tax return form prepared by the Tax Collector contained an erroneous statement regarding the taxability of photography.
35. The Tax Collector's assessment of interest and penalty cannot be abated pursuant to PCC § 4-1-541.
36. The City's privilege tax assessment against Taxpayer was proper.

### Ruling

Taxpayer's protest of an assessment made by the City of Prescott for the period January 2005 through December 2008 is denied.



The Tax Collector's Notice of Assessment to Taxpayer for the period January 2005 through December 2008 is upheld.

The Taxpayer has timely rights of appeal to the Arizona Tax Court pursuant to Model City Tax Code Section -575.

Sincerely,

Hearing Officer

HO/7100.doc/10/03

c: ***Tax and Licensing Supervisor***  
Municipal Tax Hearing Office