Jerry Rudibaugh
Municipal Tax Hearing Officer

DECISION OF MUNICIPAL TAX HEARING OFFICER

Decision Date: April 14, 2003
Decision: MTHO #67
Tax Collector: City of Tucson
Hearing Date: February 26, 2003

DISCUSSION

Introduction

On September 6, 2002, ***Taxpayer*** ("Taxpayer") filed a protest of a City of Tucson ("City") tax assessment. After review, the City concluded on September 16, 2002, that the protest was timely and in proper form. On September 23, 2002, the Municipal Tax Hearing Officer ("Hearing Officer") ordered the City to file a response to the protest on or before November 7, 2002. The City filed a response on November 6, 2002. On November 8, 2002, the Hearing Officer ordered the Taxpayer to file any reply on or before November 29, 2002. The Taxpayer did not file any reply. On December 4, 2002, a Notice of Hearing was issued setting the matter for hearing commencing on January 15, 2003. On December 26, 2002, the Taxpayer filed a request for a continuance of the hearing. On December 30, 2002, the Hearing Officer granted the continuance. On January 6, 2003, another Notice of Hearing was issued rescheduling the hearing for February 26, 2003. The City and Taxpayer both appeared and presented evidence at the February 26, 2003 hearing. On March 3, 2003, the Hearing Officer issued a letter indicating a written decision would be issued on or before April 14, 2003.

The Taxpayer is in the business of installing and servicing electric signs. The City conducted an audit for the period June 1998 through May 2002. The audit assessment was for $3,925.81 plus interest through June 30, 2002 of $734.42. The assessment resulted primarily from maintenance contract income.

City Position

The City utilized four sample months from the audit period and determined the Taxpayer was not reporting the income from Maintenance Agreements. The City calculated the monthly average not reported for the sample months to determine the amount not reported over the audit period. As part of its audit, the City concluded that the greatest part of the work done pursuant to the Maintenance Agreements was not for cleaning and night patrol but was for maintenance that involved rewiring, ballast replacement, and general sign repair. According to the City, they have historically treated such activity as construction contracting and not retail repair labor. As to the Court case cited by the Taxpayer, the City argued that the taxable status of the Taxpayer differs because of the ownership of the signs.

Taxpayer Protest

The Taxpayer argued that the City's classification of the Maintenance Agreements, as construction contracting, was not supported by the law. A construction contract is defined in City Code Section 19-100 ("Section 100") as an activity that must involve an improvement to real property. The Taxpayer argued that the Maintenance Agreements do not deal with real property as previously decided under Arizona law. According to the Taxpayer, the Maintenance Agreements are solely for

signs mounted on buildings and poles. The Taxpayer relied upon an Arizona Court of Appeals ("Court") case that held that billboards erected on real property were personal property rather than fixtures for transaction privilege tax purposes. In the case cited by the Taxpayer, the Court employed the reasonable person test as the analytical framework for characterizing the billboards. The reasonable person test asks, "Would the ordinary reasonable person validly assume that the article in question belongs to and is part of the real estate on which it is located." The owner of the billboards in question leased the real property where they were erected and the owner of the billboards retained the right to remove the billboards at the end of the lease. The evidence demonstrated that the owner did regularly remove the billboards and erect them elsewhere when the lease expired.

In this case, the Taxpayer asserts the on-premise signs that are subject to the Maintenance Agreements are for business signs that are the property of the sign owner, often a tenant, who has the right to remove the sign at the termination of their lease. According to the Taxpayer, the signs are designed to be easily removed. In light of the reasoning in the Court case cited, the Taxpayer concluded there was no meaningful distinction to be made between billboards erected upon real property and signs, which are simply attached to realty. For that reason, the Taxpayer concluded the Maintenance Agreements are not subject to the transaction privilege tax.

Even if one concluded the signs constituted real property, the Taxpayer argued the nature of the services performed pursuant to the Maintenance Agreements couldn't be characterized as construction contracting. The Taxpayer cited an Arizona Department of Revenue ("ADOR") ruling that concluded that:

> The gross proceeds of sales or gross income derived from the sale of contracts that provide for the performance of non-taxable services is not subject to transaction privilege tax under the prime contracting classification.

The Taxpayer asserted the Maintenance Agreements provide for a broad range of optional services some of which such as "cleaning" and "night patrol" are clearly non-taxable services. As a result, the Taxpayer argued that the City cannot establish a blanket tax upon the gross income of the Maintenance Agreements that include both taxable and non-taxable services. The Taxpayer further argued that the City must audit the Maintenance Agreements to determine if it was a potentially taxable class of activity. According to the Taxpayer, the City should then audit the actual services provided in order to make an appropriate determination whether a taxable service had been provided by the Taxpayer. At the hearing, the Taxpayer also questioned the City's sample methodology in performing the audit. According to the Taxpayer, the City has included some out-of-City activity as part of their sample.

ANALYSIS

The primary issue is whether or not the Taxpayer is repairing or maintaining real property. The Taxpayer has relied upon a Court case holding that billboards erected on real property were personal property rather than fixtures. As the Taxpayer noted the Court utilized a reasonable person test in reaching its conclusion. We shall also utilize a reasonable person test in this case. The reasonable person test asks," Would the ordinary reasonable person validly assume that the article in question belongs to and is a part of the real estate on which it is located."

Unlike the billboards which generally have no relationship to the real estate other than being located on such property, we find the signs in this case are directly associated with the land on which they are located. The signage would not be useable at another location unless the business moved to another location. The Hearing Officer concludes the ordinary reasonable person would assume the signage belongs to and is part of the facility on which it is located. As such, the Hearing Officer

concludes the Taxpayer is repairing or maintaining real property.

It is also clear from the evidence that the Taxpayer performed both contracting services and non-taxable services pursuant to its Maintenance Agreements. While the Maintenance Agreements -don't reflect how much, if any, of the services are for contracting and how much are for non-taxable services, we do find it is appropriate to make that determination if the Taxpayer has sufficient documentation to support a breakdown between contracting services and non-taxable services. The Taxpayer did provide job reports in order to support their testimony that 60 to 70 percent of the activities are for non-taxable services. Even if that testimony is accurate, we don't find that the activity level necessarily reflects the monetary breakdown between contracting services and non-taxable services. As a result, we find that the Taxpayer has failed to meet its burden of proof of how much of its income is associated with non-taxable services. Without such breakdown, the Hearing Officer concludes the City's designation of all the income from the Maintenance Agreements as contracting income was appropriate. Lastly, the Taxpayer raised the issue at the hearing that the City had included some non-City Maintenance Agreements as part of its sample. Clearly, non-City Maintenance Agreements are not taxable by the City. If there were such Agreements included by the City, this assessment must be revised by removing such Agreements.

FINDINGS OF FACT

1. On September 6, 2002, the Taxpayer filed a protest of a City tax assessment.

2. After review, the City concluded on September 16, 2002 that the protest was timely and in the proper form.

3. On September 23, 2002, the Hearing Officer ordered the City to file a response to the protest on or before November 7, 2002.

4. The City filed its response on November 6, 2002.

5. On November 8, 2002, the Hearing Officer ordered the Taxpayer to file any reply on or before November 29, 2002.

6. The Taxpayer did not file any reply.

7. On December 4, 2002, a Notice of Hearing was issued setting the matter for hearing commencing on January 15, 2003.

8. On December 26, 2002, the Taxpayer filed a request for a continuance of the hearing.

9. On December 30, 2002, the Hearing Officer granted the continuance.

10. On January 6, 2003, another Notice of Hearing was issued rescheduling the hearing for February 26, 2003.

11. On March 3, 2002, the Hearing Officer issued a letter indicating a written decision would be issued on or before April 14, 2003.

12. The Taxpayer is in the business of installing and servicing electronic signs.

13. The City conducted an audit for the period June 1998 through May 2002.

14. The audit assessment was for $3,925.81 plus interest through June 30, 2002 of $734.42.

15. The assessment resulted primarily from maintenance contract income.

16. The Maintenance Agreements provide for a broad range of optional services to be performed for the Taxpayer's customers.

17. The signs mounted on buildings and poles by the Taxpayer for its customers are directly associated with the location of the business.

18. The Taxpayer provided both contracting services and non-taxable services pursuant to its Maintenance Agreements.

19. Based on the evidence presented, it is unclear how much of the Taxpayer's income was for non-taxable services.

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. Use of random selected sample months is a proper auditing technique.

3. Contracting income is taxable pursuant to Section 19-415 of the City Code.

4. Out-of-City contracting is not taxable by the City.

5. The ordinary reasonable person would assume the signs installed by the Taxpayer belonged to and are part of the facility in which they are installed.

6. The Taxpayer is repairing or maintaining real property.

7. The Taxpayer has failed to demonstrate how much of its Maintenance Agreement income is for non-taxable services.

8. With the exception of its arguments regarding out-of-City contracting, the Taxpayer's protest should be denied.

ORDER

It is therefore ordered that the September 6, 2002 protest of ***Taxpayer*** of a tax assessment by the City of Tucson should be denied with the exception of its arguments regarding out-of-City contracting.

It is further ordered that the City of Tucson shall revise its assessment to remove any out-of-City contracting income that had been included as part of the assessment.

It is further ordered that this decision shall be effective immediately.

Jerry Rudibaugh
Municipal Tax Hearing Officer