

## DECISION OF MUNICIPAL TAX HEARING OFFICER

May 20, 2015

*Taxpayer's Representative*  
*Address for Representative*

*Taxpayer*  
MTHO #865

*Dear Representative:*

We have reviewed the evidence presented by *Taxpayer* and the City of Tempe (Tax Collector or City) at the hearing on April 20, 2015. The review period covered was July 2008 through May 2014. Taxpayer's protest, Tax Collector's response, and our findings and ruling follow.

### Taxpayer's Protest

Taxpayer was assessed City of Tempe privilege tax under the retail classification for the sale of flour to the (*MCSO*) used to prepare food for prisoners. The sales are exempt from state privilege tax and are also exempt from the City's privilege tax. Taxpayer also obtained an exemption certificate from *MCSO* stating that the sales were exempt from privilege tax. If the sales were not exempt, the City should collect the tax from *MCSO*.

### Tax Collector's Response

Taxpayer sold flour to *MCSO* at retail. While the sale of food to *MCSO* is excluded from state and certain city privilege taxes as the sale of food for home consumption, the City of Tempe has always taxed the sale of food for home consumption. Taxpayer's sales to *MCSO* were therefore subject to the City privilege tax. Taxpayer obtained the exemption certificate from *MCSO* after the review period. The assessment should be upheld.

### Discussion

Taxpayer sold flour to *MCSO* at retail. The flour was used by *MCSO* for food to feed inmates. The flour was processed at a mill in Tolleson Arizona and shipped to a location in Phoenix Arizona. The flour did not enter the City. Taxpayer received the order for the flour at its Tempe office.

Taxpayer did not pay City privilege tax on its sale of the flour. The City audited Taxpayer and issued an assessment for the sale of the flour to *MCSO*. Taxpayer timely protested the assessment. Taxpayer has contended that it was not subject to the City privilege tax because:

1. The sale of food for home consumption is exempt from state privilege tax and therefore should also be exempt from City privilege tax,
2. *MCSO* provided an exemption certificate to Taxpayer and *MCSO* should therefore be liable for the tax, and
3. The sale was an exempt out-of-city sale.

**Taxpayer's sale of flour to MCSO was subject to City privilege tax.**

The state and certain cities exempt the sale of food for home consumption from privilege tax. Food for home consumption includes sale of food to *MCSO* for consumption within the premises of any prison, jail or other institution under the jurisdiction of *MCSO*. Therefore the state and cities that do not tax the sale of food for home consumption would not have taxed the sale of flour to *MCSO*. The City of Tempe however has always taxed the sale of food for home consumption. Because the City taxes the sale of food for home consumption, Taxpayer's sales to *MCSO* were subject to the City privilege tax.

**The City tax on food for home consumption is not preempted by state law.**

Taxpayer argued at the hearing that the City was required to follow state law in exempting the sale of food for home consumption, including sales to *MCSO*. The City of Tempe is a charter city. The Tempe City Charter authorizes the city council to levy excise taxes, including a transaction privilege tax. The city council levied a transaction privilege tax by adopting the Model City Tax Code. The Code allows for various Options, including the option to tax food for home consumption. The City adopted that Option.

For state legislation to preempt local legislation, the subject must be of statewide concern, and state legislation must have appropriated the field. A.R.S. § 42-6004 only precludes cities from taxing certain specified activities. There is no indication that the state has appropriated the entire field of city privilege taxes. The City therefore had the authority to determine whether to tax the sale of food for home consumption.

**Taxpayer's sales were not out-of-city sales.**

Out-of-city sales are exempt from the City privilege tax. The code defines out-of-city sales as including sales where title transfers outside the city, the property is taken from stock outside the city and the order is received at a permanent business location of the seller located outside the City. All three conditions must be met. Here, Taxpayer received the order at its location within the City. Taxpayer's sales to *MCSO* were therefore not exempt out-of-city sales.

**Exemption Certificate**

Taxpayer obtained an exemption certificate from *MCSO* after the review period. During the review period, Tempe City Code (TCC) § 16-360(a) provided in part that all deductions, exclusions, exemptions, and credits provided in the tax code are conditional upon adequate proof. Tempe Reg. § 360.2 provided that for the purpose of proof of exemption, the minimum acceptable proof and documentation for each transaction was the completion of a certificate at the time of the transaction. There is no evidence that Taxpayer obtained an exemption certificate at the time of the transaction.

In addition, the certificate may be used to document or prove an exemption provided in the tax code. In other words, the exemption certificate is used to establish entitlement to an exemption, it cannot be used to create an exemption if one does not exist in the code. Here, the Tempe City Code did not contain an exemption for the sale of food for home consumption.

**Any possible liability of MCSO is not before the Hearing Office in this case**

Taxpayer also argued that because *MCSO* provided an exemption certificate to Taxpayer, *MCSO* became liable for the tax. During the review period TCC § 16-360(b) provided that any person who claims and receives an exemption to which he is not entitled under the code is subject to the tax as if the vendor subject to the tax had passed the burden of the payment of the tax to the

person wrongfully claiming the exemption. Subsection (b) also provides however that if the tax is collected from the vendor it shall not again be collected from the person claiming the exemption, or if collected from the person claiming the exemption it shall not also be collected from the vendor.

In other words, the City cannot collect the tax on a single transaction twice. Because of the prohibition of collecting the tax twice, it is clear subsection (b) does not preclude the City from collecting the tax from either the vendor or the customer. Subsection (b) does not require the City to exhaust its collection efforts against either party before it can collect from the other.

The question presented is whether Taxpayer was subject to tax on its sale of flour to *MCSO*. Whether *MCSO* may be liable for tax under TCC § 16-360(b) is not before the Hearing Office. Based on the record in this case we hold that the City's assessment of transaction privilege tax on Taxpayer's sale of flour to *MCSO* was proper.

#### Findings of Fact

1. Taxpayer is a distributor of food and bakery supplies.
2. Taxpayer typically sells its products in bulk to bakeries and other retailers.
3. Taxpayer also sells bulk flour to *MCSO*.
4. The flour is processed at a mill in Tolleson Arizona and shipped to a location in Phoenix Arizona.
5. The flour is processed by *MCSO* into food for inmates under the care of *MCSO*.
6. The flour does not enter or pass through the City.
7. The order from the *MCSO* for the flour is received by Taxpayer at its office in the City.
8. Taxpayer did not pay City privilege tax on its sale of the flour to *MCSO*. Taxpayer believed the sale of the flour was not subject to either the City or the state privilege tax.
9. The City conducted an audit of Taxpayer for the period July 2008 through May 2014 and issued an assessment dated October 9, 2014 taxing the sale of flour to *MCSO*.
10. Taxpayer timely protested the assessment.
11. Taxpayer obtained a state exemption certificate (Form 5000) signed by a representative of the *MCSO* on June 5, 2014.
12. During the review period the City's adoption of Model Option 2 was in effect.
13. TCC § 16-120 was repealed by Ord. No. O2014.01, 1-9-14. TCC § 16-462 was enacted by the same ordinance.

#### Conclusions of Law

1. TCC § 16-400 levies a privilege tax on persons on account of their business activities specified in Article IV of the Code measured by the gross income of persons, whether derived from residents of the City or not, or whether derived from within the City or from without.

2. TCC § 16-460 imposes the City privilege tax on every person engaging or continuing in the business of selling tangible personal property at retail.
3. Before January 2014, Model City Tax Code Section -465(q) exempted from the retail classification sales of food for home consumption unless a City adopted Model Option 2.
4. Before January 2014 "food for home consumption" was defined by Model City Tax Code Section -120.
5. Cities that enacted Model Option 2 taxed food for home consumption and Model City Tax Code section -120, otherwise defining food for home consumption, would be reserved.
6. During the review period the City had adopted Model Option 2 taxing the sale of food for home consumption.
7. In January 2014 the City enacted TCC § 16-462 that specifically imposed the City privilege tax on the sale of food for home consumption at a specified tax rate. City Ord. No. O2014.01, 1-9-14
8. For periods before January 2014 Taxpayer's sales of flour to *MCSO* were retail sales subject to the City privilege tax under TCC § 16-460.
9. For periods beginning January 2014, Taxpayer's sales of flour to *MCSO* were sales of food for home consumption subject to the City privilege tax under TCC § 16-462.
10. Sec. 5.02 of the Tempe City Charter authorizes the city council shall to levy excise taxes, including a transaction privilege tax, to be paid by any person, firm, corporation or association for carrying on any business, profession, game or amusement, calling or occupation.
11. Out-of-city sales are exempt under TCC §§ 16-462(c)(2) and 16-465(b).
12. Out-of-city sale means the sale of tangible personal property and job printing if all of the following occur:
  - (1) Transference of title and possession occur without the City; and
  - (2) The stock from which such personal property was taken was not within the corporate limits of the City; and
  - (3) The order is received at a permanent business location of the seller located outside the City; which location is used for the substantial and regular conduct of such business sales activity. In no event shall the place of business of the buyer be determinative of the situs of the receipt of the order. TCC § 16-100.
13. Because Taxpayer received the order within the City, the sales were not exempt out-of-city sales.
14. During the review period TCC § 16-360(a) provided that all deductions, exclusions, exemptions, and credits provided in the tax code are conditional upon adequate proof and documentation of such as may be required either by the code or regulation.
15. During the review period TCC § 16-360(b) provided that any person who claims and receives an exemption, deduction, exclusion, or credit to which he is not entitled under the code shall be subject to, liable for, and pay the tax on the transaction as if the vendor subject to the tax had passed the burden of the payment of the tax to the person

wrongfully claiming the exemption. A person who wrongfully claimed such exemption shall be treated as if he is delinquent in the payment of the tax and shall be subject to interest and penalties upon such delinquency. However, if the tax is collected from the vendor on such transaction it shall not again be collected from the person claiming the exemption, or if collected from the person claiming the exemption it shall not also be collected from the vendor.<sup>1</sup>

16. While a person who receives an exemption to which he is not entitled may be liable for the tax, TCC § 16-360(b) does not preclude the City from collecting the tax from the Taxpayer. The City is only precluded from collecting the tax more than once.
17. During the review period Tempe Reg. § 360.2 provided that for the purpose of proof of exemption, the minimum acceptable proof and documentation for each transaction shall be the completion, at the time of the transaction, in all material respects, of a certificate containing the information set forth in the regulation.
18. For state legislation to preempt local legislation two conditions must concur: the subject must be of statewide concern, and state legislation must have appropriated the field. *See, State v. Jacobson*, 121 Ariz. 65, 588 P.2d 358 (App. 1978).
19. While A.R.S. § 42-6004 precludes cities from taxing certain specified activities, the state has not appropriated the field of city privilege taxes. *See, City of Prescott v. Town of Chino Valley*, 163 Ariz. 608, 790 P.2d 263 (App. 1989).
20. The City is not precluded by state law from taxing sales of food for home consumption.
21. Tax statutes are construed strictly against a party who claims an exemption or a credit. *Davis v. Arizona Department of Revenue*, 197 Ariz. 527, 529-30, 4 P.3d 1070, 1072-73 (App. 2000).
22. The burden is on the taxpayer to show he is entitled to a deduction or exemption from tax. *See Ebasco Servs., Inc. v. Ariz. State Tax Comm'n*, 105 Ariz. 94, 99, 459 P.2d 719, 724 (1969).
23. There is a presumption that all gross income is subject to the tax until the contrary is established by the taxpayer. TCC § 16-400(c).
24. Taxpayer has not established entitlement to an exemption from tax on its sales of flour to **MCSO**.
25. The City's assessment against Taxpayer dated October 9, 2014 for the period July 2008 through May 2014 was proper.

### Ruling

Taxpayer's protest of an assessment of privilege tax and interest made by the City of Tempe for the period July 2008 through May 2014 is denied.

The Tax Collector's Notice of Assessment to Taxpayer dated October 9, 2014 for the period July 2008 through May 2014 is upheld.

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<sup>1</sup> The provisions of TCC § 16-360 are now codified at TCC § 16-370.

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

Sincerely,

*Hearing Officer*

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c: *Tax Audit Supervisor*  
Municipal Tax Hearing Office