DECISION OF MUNICIPAL TAX HEARING OFFICER

Decision Date: January 17, 2006
Decision: MTHO #155 & 187
Tax Collector: City of Mesa
Hearing Date: August 18, 2005

DISCUSSION

Introduction

On October 21, 2003, ***Taxpayer*** ("Taxpayer") filed a protest of a tax assessment (MTHO #155) made by the City of Mesa ("City"). After review, the City concluded on November 7, 2003, that the protest was timely and in the proper form. On November 17, 2003, the Municipal Tax Hearing Officer ("Hearing Officer") ordered the City to file a response on or before January 2, 2004. On December 26, 2003, the City requested an extension until February 10, 2004, to file a response. On January 12, 2004, the Hearing Officer granted the City an extension to file a response until February 10, 2004. On February 23, 2004, the Hearing Officer indicated no response had been received from the City and the City was granted an extension until March 8, 2004, to file a response. On February 12, 2004, the Taxpayer filed a refund request with the City (MTHO #187). On February 20, 2004, the City filed a response to the protest. On March 3, 2004, the Hearing Officer ordered the Taxpayer to file any reply on or before March 24, 2004. On March 18, 2004, a Notice of Tax Hearing ("Notice") scheduled MTHO# 155 for hearing commencing on May 11, 2004. On April 26, 2004, the City denied the Taxpayer's refund claim. On April 30, 2004, the Taxpayer filed a protest of the refund denial. After review, the City concluded on May 4, 2004, that the refund protest was timely and in the proper form. On May 3, 2004, the City sent an email indicating both parties wanted a postponement of the May 11, 2004, hearing date. On May 5, 2004, the Hearing Officer stayed the hearing and ordered the parties to file an update on or before August 5, 2004. On May 12, 2004, the Hearing Officer ordered the City to file a response on MTHO #187 on or before June 28, 2004. On June 21, 2004, the City filed a response on the refund claim. On June 25, 2004, the Hearing Officer ordered the Taxpayer to file any reply on MTHO #187 on or before July 16, 2004. On July 12, 2004, the Taxpayer filed a reply on MTHO #187. On July 12, 2004, a Notice scheduled MTHO #187 for hearing commencing on August 17, 2004. On July 12, 2004, the Taxpayer filed a request to consolidate MTHO #187 with MTHO #155. On August 2, 2004, the Hearing Officer consolidated MTHO #'s 155 and 187. On August 4, 2004, both parties filed letters indicating no Court decision had been issued. On August 12, 2004, the Hearing Officer continued the stay and ordered the parties to provide an updated status on or before December 6, 2004. On December 3, 2004, the City filed a letter indicating there had been no Court decision. On December 6, 2004, the Taxpayer filed a similar letter. On December 6, 2004, the Hearing Officer continued to stay the matter and ordered the parties to file an updated status on or before March 17, 2005. On March 7, 2005, the Taxpayer filed an update indicating no Court decision had been issued. On March 9, 2005, the City sent an email indicating no Court decision had been issued. On March 14, 2005, the Hearing Officer continued the stay and ordered the parties to provide an update by May 16, 2005. On April 19, 2005, the Taxpayer indicated the Court had issued a decision and as a result the matter should be scheduled for hearing. On May 2, 2005, the Hearing Officer lifted the stay and indicated the matter would be scheduled for a hearing. On May 10, 2005, a Notice

scheduled the matter for hearing commencing on July 14, 2005. Subsequently, the hearing was rescheduled to commence on August 18, 2005. Both parties appeared and presented evidence at the August 18, 2005, hearing. On August 18, 2005, the Hearing Officer indicated the City would file any post hearing brief on or before September 15, 2005, and the Taxpayer would file any post hearing reply brief on or before October 13, 2005. Subsequently, the parties agreed to extend the City's deadline. The City filed a post hearing brief on September 23, 2005. On September 28, 2005, the Taxpayer requested an extension to file its reply brief. On October 3, 2005, the Hearing Officer granted the Taxpayer an extension until October 31, 2005 to file its reply brief. The Taxpayer filed a reply brief on October 31, 2005. On December 2, 2005, the Hearing Officer indicated the record was closed and a written decision would be issued on or before January 17, 2006.

City Position

According to the City, the Taxpayer is an Arizona corporation based in the City that is engaged in the advertising business of direct mail solicitation. The City indicated the Taxpayer has sales representatives who solicit local, state, and national advertising business. The City asserted that the Taxpayer prepares and develops coupons containing the local information for businesses that retain the Taxpayer's services. The City indicated the coupons used in the Taxpayer's direct mail solicitation business are printed in the State of Florida and mailed to Arizona addresses at the direction of the Taxpayer. During the audit period of June 1996 through July 2002, the City assessed the Taxpayer for use tax in the amount of $51,746.38 pursuant to City Code Section 5-10-610 ("Section 610").

The City acknowledged that the parties had agreed to stay the proceedings in this case pending the outcome of the Qwest Dex, Inc. v. ADOR, 210 Ariz. 223, 109 P.3d. 118 (Ct App. 2005). On April 5, 2005, the Arizona Court of Appeals ("Court") issued an opinion that favored the Taxpayer in this case. In the Qwest Dex decision, the Court held that the Arizona Use Tax could not be assessed against Qwest Dex under the job printing classification. The City argued the facts in this case were different than the Qwest Dex case. The City asserted that Qwest Dex contracted with an out of state printing company to print the White Pages and Yellow Pages telephone directories. The City also noted that Qwest Dex separately contracted with an out of state mill for the paper to be used for the directories. In this case, pursuant to the terms of its Franchise Agreement ("Agreement") with ***Franchisor*** ("Franchisor"), the Taxpayer was not required to separately contract for the paper as this was left to the Franchisor. The City also noted that the Franchisor had final approval over the form and content of each item to be included in the envelopes for the Taxpayer. Based on the above, the City concluded that the Taxpayer was purchasing the creation, printing and distribution of direct mail inserts from the Franchisor. As a result, the city argued the Taxpayer was purchasing a completed product from the Franchisor. According to the City, the Court in Qwest Dex relied on the fact that service, rather than tangible personal property was being purchased by Qwest Dex. The City noted that City Code Section 5-10-600 ("Section 600") provides as follows:

> For the purposes of this Article only, the following definitions shall apply, in addition to the definitions provided in Article I:

> <u>"Acquire (for Storage or Use)"</u> means purchase, rent, lease, or license for storage or use.
>
> <u>"Retailer"</u> also means any person selling, renting, licensing for sue, or leasing tangible personal property under circumstances which would render such transaction subject to the taxes imposed in Article IV, if such transaction had occurred within this City.
>
> <u>"Use (of Tangible Personal Property)"</u> means consumption or exercise of any other right or power over tangible personal property incident to the ownership thereof except the holding for the sale, rental, lease, or license for use of such property in the regular course of business.

Further, the City indicated that City Code Section 5-10-610 ("Section 610") sets forth the requirements for imposition of the use tax. Lastly, the City indicated that City Code Section 5-10-620 (Section 620") sets forth those persons liable for the City use tax. "Any person who acquires tangible personal property from a retailer,..." . In this case, the City asserts the Taxpayer acquired tangible personal property (the advertising mailing inserts) from the Franchisor, which were then prepared and distributed by the Franchisor to locations within the City. The City argued the advertising mailing inserts were personal property. As a result, the City concluded that the Franchisor would qualify as a retailer under the City Code. The City asserted that it could not impose a transaction privilege tax against the Florida job printers pursuant to City Code Section 5-10-425 ("Section 425") (Job Printing) because the Franchisor would have little or no nexus with the City. As a result, the City had to look to the Taxpayer in order to have the required nexus with the City to impose a use tax. The City also argued that the City Code provides for an assessment of use tax under the job printing classification. The City asserted that the City Code allows for a use tax if the retailer's activities would have been rendered directly taxable under Article IV, if the activities had occurred within the City. The City indicated that job printing within the City is taxable pursuant to Section 425. The City argued that the Florida printer falls within the use tax definition of "retailer". As a result, the City concluded the Taxpayer purchased tangible personal property from a retailer and thus liable for a use tax. Based on all the above, the City requested the assessment be upheld.

<u>**Taxpayer Position**</u>

The Taxpayer indicated they were engaged in the advertising business of direct mail solicitation. The Taxpayer asserted they were a franchisee in the advertising business who develops coupons for customers that are used for advertising the customers' businesses. According to the Taxpayer, the coupons were developed in response to the purchase of Taxpayer's advertising. The Taxpayer indicated that the Franchisor was the job printer. The Taxpayer asserted that they directed the Franchisor on the type of paper that was needed for the mailings. The Franchisor would then purchase the type of paper needed. According to the Taxpayer, the Franchisor would create, print, compile, and stuff the coupons into envelopes and mailed them to the Taxpayer's customers. The Taxpayer indicated that the paper costs represented nine percent of the total invoice from the Franchisor.

The Taxpayer asserted that the City agreed to stay this matter pending the outcome of Qwest Dex knowing all the facts and circumstances of that case. The City knew the relationship between the Taxpayer and the Franchisor and that the paper was not purchased directly by the Taxpayer. The Taxpayer asserted that the City's argument that the facts are dissimilar is a disingenuous argument. The Taxpayer argued that the Qwest Dex case stated that whether or not the printing service is performed on the Taxpayer's paper or paper authorized by the Taxpayer that was purchased by the Franchisor is inconsequential. According to the Taxpayer, printing represented the preponderance, ninety one per cent, of the costs of the advertising coupons. The Taxpayer asserted that pursuant to AACR15-5-104(C) (1) ("Regulation 104"), sales of tangible personal property shall be considered an inconsequential element of service if the "purchase price of the tangible personal property to the person rendering the services represents less than 15 percent of the charge, billing, or statement rendered to the purchaser in connection with the transaction." The Taxpayer argued that the Court in Qwest Dex stated that Section 42-5155(A) ("Section 5155") provides that use tax applies to tangible personal property only – not to the total sales price. According to the Taxpayer, the Court in Qwest Dex rejected the Arizona Department of Revenue's ("DOR") argument to broaden the definition of "retailer" for the imposition of the use tax beyond the definition of "retailer" for transaction privilege tax purposes.

The Taxpayer indicated that in Service Merch. Co. v. ADOR 188 Ariz. at 414, 937 P.2d at 336, the Court stated there was no indication that paper was purchased separately from the finished product. The Taxpayer argued however that Service Merchandise was purchasing catalogs the company received and were used by the company to solicit business for the company through mailing the catalogs to their prospective customers. The Taxpayer asserted that they sell advertising. According to the Taxpayer, the coupons are not purchased for use as advertising by the Taxpayer but instead the coupons are the advertising that was purchased by the Taxpayer's customers. The Taxpayer argued that there is no relationship between a retailer and a job printer simply because both would be taxable if located in the City. The Taxpayer asserted that the use tax statutes specifically state "retailer" because they meant to define and say "retailer".

The Taxpayer argued that the City is trying to tax job printing services in Florida under the guise that everything is taxable under retail and therefore subject to use tax. The Taxpayer indicated that the nature of the job printer in Florida did not change simply because of its physical location. The Taxpayer argued that by claiming the job printer in Florida is a "retailer", the City must also accept that "retailer services and service labor" are legitimately not taxable as recognized for any other "retailer". Based on all the above, the Taxpayer requested the entire assessment be disallowed.

ANALYSIS

In this case, we find that the "dominant purpose" of the transactions between the Taxpayer and the Franchisor was the purchase of printing services from the Franchisor. It is clear from the record that if the Franchisor had been located in the City, the City would have assessed a tax on the Franchisor under the job printing category pursuant to Section 425. The City acknowledged that because the Franchisor was located in the State of Florida, the City did not have sufficient nexus to tax the Franchisor. As a result, the City has argued that the Franchisor is also a retailer that was selling tangible personal property to the Taxpayer. If we accept the City's argument, the

tax category for job printing would seem to be redundant since the revenues would also be taxable as retail sales. As stated in Qwest Dex and numerous other cases, tax statutes are interpreted strictly against the taxing authority and any ambiguities are resolved in favor of the Taxpayer. Consequently, we must conclude that the printing revenues of the Franchisor are not subject to the City's use tax.

As pointed out by the City, the facts in Qwest Dex were different as to the purchase of paper to be used for the job printing. In Qwest Dex, the paper was purchased by the taxpayer and provided to the job printer for use in preparing the telephone directories. In this case, the Taxpayer purchased the paper from the Franchisor that was used to prepare the advertising mailings. While we have concluded the job printing revenues were not subject to use tax, we also find there was a sale of tangible personal property (the paper). If the paper was purchased by the Taxpayer from an independent entity from the Franchisor, we would have found that to be a purchase of tangible personal property subject to the use tax pursuant to Section 610. The fact that it was purchased from a job printer does not change the fact that it was a sale of tangible personal property. As noted in Qwest Dex, the use tax applies to tangible personal property only and not to the total sales price. Based on the evidenced presented, we find that the taxable costs of the paper would be nine percent of the total invoice between the Taxpayer and the Franchisor.

We note that because this matter was stayed for a period of time, the City's assessment was much higher than the original assessment. We also note that at the hearing, the Taxpayer withdrew its protest of the denial of its refund claim. The Taxpayer indicated the refund claim would be refiled sometime after October 1, 2005. As a result, no decision will be issued at this time regarding the refund claim.

FINDINGS OF FACT

1. On October 21, 2003, the Taxpayer filed a protest of a tax assessment made by the City (MTHO #155).

2. After review, the City concluded on November 7, 2003 that the protest was timely and in proper form.

3. On November 17, 2003, the Hearing Officer ordered the City to file a response on or before January 2, 2004.

4. On December 26, 2003, the City requested an extension until February 10, 2004.

5. On January 12, 2004, the Hearing Officer granted the City an extension to file a response until February 10, 2004.

6. On February 23, 2004, the Hearing Officer indicated no response had been received from the City and the City was granted an extension until March 8, 2004, to file a response.

7. On February 20, 2004, the City filed a response.

8. On February 12, 2004, the Taxpayer filed a refund request with the City (MTHO #187).

9. On March 18, 2004, a Notice scheduled MTHO #155 for hearing commencing on May 11, 2004.

10. On April 26, 2004, the City denied the Taxpayer's refund claim.

11. On April 30, 2004, the Taxpayer filed a protest of the refund denial.

12. After review, the City concluded on May 4, 2004, that the refund protest was timely and in the proper form.

13. On May 3, 2004, the City sent an email indicating both parties wanted a postponement of the May 11, 2004 hearing date.

14. On May 5, 2004, the Hearing Officer stayed the hearing and ordered the parties to file an update on or before August 5, 2004.

15. On May 12, 2004, the Hearing Officer ordered the City to file a response on MTHO #187 on or before June 28, 2004.

16. On June 21, 2004, the City filed a response on the refund claim.

17. On June 25, 2004, the Hearing Officer ordered the Taxpayer to file any reply on MTHO #187 on or before July 16, 2004.

18. On July 12, 2004, the Taxpayer filed a reply on MTHO #187.

19. On July 12, 2004, a Notice scheduled MTHO #187 for hearing commencing on August 17, 2004.

20. On July 12, 2004, the Taxpayer filed a request to consolidate MTHO #187 with MTHO #155.

21. On August 2, 2004, the Hearing Officer consolidated MTHO #'s 155 and 187.

22. On August 4, 2004, both parties filed letters indicating no Court decision had been issued.

23. On August 12, 2004, the Hearing Officer continued the stay and ordered the parties to provide an updated status on or before December 6, 2004.

24. On December 3, 2004, the City filed a letter indicating there had been no Court decision.

25. On December 6, 2004, the Taxpayer filed a similar letter.

26. On December 6, 2004, the Hearing Officer continued the stay and ordered the parties to file an updated status on or before March 17, 2005.

27. On March 7, 2005, the Taxpayer filed an update indicating no Court decision had been issued.

28. On March 9, 2005, the City sent an email indicating no Court decision had been issued..

29. On March 14, 2005, the Hearing Officer continued the stay and ordered the parties to provide an update on or before May 16, 2005.

30. On April 19, 2005, the Taxpayer indicated the Court had issued a decision and as a result the matter should be scheduled for a hearing.

31. On May 2, 2005, the Hearing Officer lifted the stay and indicated the matter would be set for a hearing.

32. On May 10, 2005, a Notice scheduled the matter for hearing commencing on July 14, 2005.

33. Subsequently, the hearing was rescheduled to commence on August 18, 2005.

34. Both parties appeared and presented evidence at the August 18, 2005, hearing.

35. On August 18, 2005, the Hearing Officer indicated the City would file any post hearing brief on or before September 15, 2005, and the Taxpayer would file any post hearing reply brief on or before October 13, 2005.

36. Subsequently, the parties agreed to extend the City's deadline.

37. The City filed a post hearing brief on September 23, 2005.

38. On September 28, 2005, the Taxpayer requested an extension to file its reply brief.

39. On October 3, 2005, the Hearing Officer granted the Taxpayer an extension until October 31, 2005, to file its reply brief.

40. The Taxpayer filed a reply brief on October 31, 2005.

41. On December 2, 2005, the Hearing Officer indicated the record was closed and a written decision would be issued on or before January 17, 2005.

42. The Taxpayer is an Arizona corporation, based in the City that is engaged in the advertising business of direct mail solicitation.

43. The Taxpayer prepares and develops coupons containing the local information for business that retain the Taxpayer's services.

44. The coupons used in the Taxpayer's direct mail solicitation business are printed in the State of Florida and mailed to the Arizona addresses at the direction of the Taxpayer.

45. During the audit period of June 1996 through July 2002, the City assessed the Taxpayer for use tax in the amount of $51,746.38 pursuant to Section 610.

46. The parties had agreed to stay the proceedings in this case pending the outcome of the <u>Qwest Dex</u> case.

47. The court in <u>Qwest Dex</u> held that the Arizona Use Tax could not be assessed against Qwest Dex under the job printing classification.

48. Qwest Dex contracted with an out of state printing company to print the White Pages and Yellow Pages telephone directories.

49. Qwest Dex separately contracted with an out of state mill for the paper to be used for the directories.

50. Pursuant to the terms of its Agreement with the Franchisor, the Taxpayer was not required to separately contract for the paper as this was left to the Franchisor.

51. The Franchisor had final approval over the form and content of each item to be included in the envelopes for the Taxpayer.

52. The Taxpayer directed the Franchisor on the type of paper that was needed for the mailings.

53. The Franchisor would create, print, compile, and stuff the coupons into envelopes and mail them to the Taxpayer's customers.

54. The paper costs represented nine percent of the total invoice from the Franchisor.

<u>CONCLUSIONS OF LAW</u>

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. Section 425 imposes a transaction privilege tax on job printing revenues from business activity in the City.

3. Sections 610 and 620 impose a use tax on any person who acquires tangible personal property from a retailer, whether or not such retailer is located in the City, when such person stores or uses said property within the City.

4. If the Franchisor had been located in the City, they would have been assessed a tax under the job printing category pursuant to Section 425.

5. Tax statutes are to be interpreted strictly against the taxing authority and any ambiguities are to be resolved in favor of the Taxpayer.

6. The printing revenues of the Franchisor are not subject to the City's use tax.

7. The "dominant purpose" of the transactions between the Taxpayer and the Franchisor was the purchase of printing services from the Franchisor.

8. In conjunction with the printing services, the Taxpayer also purchased paper from the Franchisor to be used to prepare the advertising mailings.

9. The cost of the paper was nine percent of the total invoice between the Taxpayer and the Franchisor.

10. Nine percent of the invoice between the Taxpayer and the Franchisor would be a purchase of tangible personal property that would be subject to the use tax pursuant to Sections 610 and 620.

11. At the hearing, the Taxpayer withdrew its request for a refund.

12. The taxpayer's protest should be partly denied and partly granted consistent with the Discussion, Findings, and Conclusions, herein.

ORDER

It is therefore ordered that the October 21, 2003 protest of ***Taxpayer*** of a tax assessment made by the City of Mesa 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 Mesa shall revise the assessment consistent with the Discussion, Findings, and Conclusions, herein.

It is further ordered that the request for a refund filed by ***Taxpayer*** has been withdrawn.

It is further ordered that this Decision is effective immediately.

Jerry Rudibaugh
Municipal Tax Hearing Officer