DECISION OF MUNICIPAL TAX HEARING OFFICER

October 12, 2016

Taxpayer's Representative

Taxpayer
MTHO # 900

Dear ***Taxpayer's Representative***:

We have reviewed the evidence and arguments presented by ***Taxpayer*** for redetermination and the City of Phoenix (Tax Collector or City). The review period covered was January 2010 through December 2014. Taxpayer's protest, Tax Collector's response, and our findings and ruling follow.

Taxpayer's Protest

Taxpayer is in the business of organizing and managing gift shows. The gift shows are held at locations not owned by Taxpayer. Approximately 10% of Taxpayer's expenses relate to Taxpayer renting the facility for the gift show. The remainder of the expenses include the cost of setting up and tearing down the booths and other show related administrative expenses such as computers, advertising, and printing. Taxpayer was assessed City privilege tax under the renting, leasing or licensing for use real property classification. Taxpayer does not rent or license the use of real property but conducts gift shows. The 10% cost of leasing the facility is inconsequential. In addition, the Tax Collector failed to provide Taxpayer an informal conference and therefore the assessment is void. Finally, Taxpayer requests that penalties included in the assessment be abated.

Tax Collector's Response

The City assessed privilege taxes against Taxpayer for licensing the use of booth space at gift shows to its participating vendors. A license is an agreement for the use of real property. The participating vendors use their booth space to conduct their activity of writing orders and selling their product. Therefore Taxpayer's activity is taxable as a license of real property for use under Phoenix City Code (PCC) § 14-445. The tax base is Taxpayer's income from the activity, which includes the entire booth fee received by Taxpayer. Because Taxpayer did not file returns or pay privilege tax, penalties were properly imposed. Finally, Taxpayer did not request an informal conference.

Discussion

Taxpayer was established to provide its members, who are wholesale sellers of various products, a forum where they could easily meet customers for the benefit of all. Taxpayer organizes and operates gift shows where participating vendors can obtain the use of booth space, write orders and sell their products. Taxpayer obtains the use of space from the owner of a facility, such as a convention center, designs a floor plan for the show and is responsible for assigning sales booth locations to the participating vendors. Taxpayer hires independent contractors to set up the booths before the gift show and to tear down the booths after the conclusion of the gift show.

Taxpayer charges participating vendors a booth fee. Taxpayer's cost of obtaining the use of the space constitutes about 10% of Taxpayers total costs of operating the gift show. The amounts paid to the subcontractors to set up and then tear down the booths constitutes close to 65% of the total costs. The remainder of the expenses included other show related administrative expenses.

The questions presented are whether:

- Taxpayer's activity is subject to privilege tax under the commercial lease/license classification.
- The penalties included in the assessment should be abated.
- The assessment is void because Taxpayer was not provided an informal conference.

Is Taxpayer's activity subject to the City's privilege tax?

A "license for use" is defined by the City code as any agreement between the user and the owner of the land for the use of the owner's property whereby the licensor receives consideration, where such agreement does not qualify as a "sale" or "lease" or "rental" agreement. The agreement between Taxpayer and the participating vendors provides that Taxpayer grants a revocable license to the participant vendor to use the space assigned subject to certain conditions. Though this clause is not controlling, it is persuasive and is consistent with the conduct of the parties. The participating vendors have access to their assigned booths to conduct their business. Providing the booth space to its participating vendors so the vendors have a location to write orders for and sell their merchandise is the focus of the agreement and is consistent with the reason Taxpayer was established. Taxpayer is therefore subject to the City privilege tax under the lease/license of commercial real property classification.

The Tax Collector imposed the privilege tax on the total amount of booth fees received by Taxpayer. Taxpayer objects to the tax being based on total receipts when only 10% of Taxpayer's expenses relate to it obtaining the use of the facility. However, the privilege tax is measured by a taxpayer's gross income from its taxable business activity. The space provided by Taxpayer is a built-out booth with back and side curtains, chairs and a table. Taxpayer's costs of providing built-out booths for use by the vendors include not only the cost of leasing the facility but also the cost of setting up the booth, tearing it down at the end of the show and the other show related administrative expenses. Therefore, the booth fee is income from Taxpayer's licensing of real property activity and is subject to the tax. *See e.g., Walden Books Co. v. Department of Revenue,* 198 Ariz. 584, 12 P.3d 809 (Ariz. App., 2000); *ADVO System, Inc. v. City of Phoenix,* 942 P.2d 1187, 189 Ariz. 355 (Ariz. App. Div. 1, 1997).

Were penalties properly assessed?

The assessment included a 25% late filing penalty. Taxpayer argues that it had a reasonable basis to believe that the tax did not apply because it had been informed by the Arizona Department of Revenue that it did not need a state privilege tax license or pay a state privilege tax on its activity.

The Tax Collector is authorized to assess penalties pursuant to PCC § 14-540. PCC § 14-540(f) sets out specific circumstances for penalty abatement and further provides that a taxpayer may request a waiver for a reason thought to be equally substantive to those listed.

Penalties may be abated for reasonable cause if:

- a taxpayer was not previously audited by a city for the tax or on the issue in question and relied, in good faith, on a state exemption or interpretation. PCC § 14-540(f)(3)(I).
- the taxpayer had a reasonable basis for believing that the tax did not apply to taxpayer's business activity in the city. PCC § 14-540(h).

Here Taxpayer relied on statements from a representative of the Arizona Department of Revenue that no state tax was due in concluding that no City tax was due. It may be argued that Taxpayer's reliance on the Department of Revenue was not reasonable because licensing of real property is not subject to the state tax. A.R.S. § 42-5069 only imposes the state transaction privilege tax on the business of leasing the use or occupancy of real property. Unlike the City code, the state tax does not include the activity of licensing the use of real property. *See, Wenner v. Dayton-Hudson Corp.* 123 Ariz. 203, 208, 598 P.2d 1022, 1027 (App. 1979). We do not believe, however, that it is reasonable to expect a lay person to recognize such legal distinction. Taxpayer therefore had reasonable cause for failing to file a tax return. The failure to file penalty should be abated.

Did failure to provide an informal conference void the assessment?

Taxpayer contends it was not given an informal conference to discuss the proposed assessment with the auditor and the assessment is therefore void. PCC § 14-570(a) provides that a taxpayer has the right to discuss any proposed assessment with the auditor prior to the issuance of any assessment, but a conference is not required for the taxpayer to file a petition for administrative review. PCC § 14-570 does not state what result will follow if an informal conference is not conducted.

The record does not disclose any request by Taxpayer for an informal conference or any action by the Tax Collector that prevented Taxpayer from requesting an informal conference. The record does indicate the auditor contacted Taxpayer's bookkeeper with a question the day before the first letter was issued. The bookkeeper answered the question and then told the auditor she was not to talk to the auditor on her attorney's advice.

The question presented is whether scheduling an informal conference is mandatory, whether or not a taxpayer requested a conference, so that the assessment must be vacated, or directory so that the Municipal Tax Hearing Office may still consider 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 § 14-570(a) serves as a procedural directive intended to give method and dispatch to the processing of protests. It does not state the consequences of not scheduling an informal conference. While an informal conference allows the parties an opportunity to resolve some or all issues early, it is not a prerequisite to filing a petition or pursuing an administrative review. The lack of an informal conference 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 provision allowing an opportunity for an informal conference is directory and the absence of an informal conference does not void an assessment.

Based on the foregoing, the Tax Collector's determination of an amount due is upheld except for the failure to file penalty.

Findings of Fact

1. Taxpayer was established to provide its members, who are wholesale sellers of various products, a forum where they could easily meet customers for the benefit of all.
2. Taxpayer organizes and manages gift shows where participant vendors may sell their products to customers attending the gift shows.
3. Taxpayer is responsible for setting up the shows.
4. The shows are held at locations not owned by Taxpayer, such as a city convention center.
5. Taxpayer obtains the use of space from the owner, designs a floor plan for the show and is responsible for assigning sales booth locations at the event to the participating vendors.
6. Taxpayer hires independent contractors to set up the vendor booths. The items used in setting up the booths are owned by the contractor.
7. Taxpayer requires that booths be designed and operated in good taste and that the booth is not left unattended at any time.
8. Most of the income that taxpayer receives from a show is based on a price per booth, assigned location basis.
9. Taxpayer's Exhibitor Contract/Agreement provides that:
    a. Booth assignments are made by Taxpayer based on the "best space available".
    b. Booth space is assigned in seniority point order and the time when the Space Agreement and deposit are received.
    c. Taxpayer grants a revocable license to the participant vendor to use the space assigned subject to the terms and conditions set forth in the Agreement.
    d. Booths generally include company ID sign, back and side drapes, chairs, a table and wastebasket. Some of the booths are located in carpeted rooms.
    e. Participating vendors may write orders in their booths for their customers and may sell products in certain booth locations.
10. Taxpayer's profit and loss statements characterizes its payment for use of the facility as "Hall Rental" and payments to its subcontractor to set up and take down the booths as "Decorator Expense" and "Contract Labor".
11. Over 70% of Taxpayer's expenses each year related to obtaining the space for the shows and setting up and taking down the booths.
12. Taxpayer did not file City privilege tax returns or pay City privilege taxes for the period January 2010 through December 2014.
13. Based on information provided by Taxpayer, the Tax Collector issued a "Calculation of Tax Due" dated September 30, 2015.

14. Taxpayer submitted a Petition for Review of the Calculation. The matter was submitted to the Hearing Officer by letter dated December 4, 2015 as a protest of a proposed assessment.

15. Based on additional information provided by Taxpayer, the Tax Collector issued a revised "Self Reported Tax Calculation" dated February 19, 2016 reflecting privilege tax due of $81,362.08 for leasing/licensing commercial real property, $273.69 for advertising, $839.35 for licensing tangible personal property, interest of $9,141.66 calculated through January 2016 and penalties of $20,618.78.

16. The record does not contain a request by Taxpayer for an informal conference.

Conclusions of Law

1. PCC § 14-445 imposes the city privilege tax on the business activity of renting, leasing or licensing for use real property located in the city to the final licensee.

2. "Licensing (for Use)" is defined as any agreement between the user ("licensee") and the owner or the owner's agent ("licensor") for the use of the licensor's property whereby the licensor receives consideration, where such agreement does not qualify as a "sale" or "lease" or "rental" agreement. PCC § 14-100.

3. The agreement between Taxpayer and the participating vendors grants the vendors a license to use the exhibit space assigned.

4. Taxpayer's activity of providing exhibit space to the participating vendors constitutes licensing real property for use under PCC § 14-445 and is therefore subject to the City privilege tax.

5. PCC § 14-400(c) provides that it shall be presumed that all gross income is subject to the tax until the contrary is established by the taxpayer.

6. The privilege tax is measured by a Taxpayer's gross income from its business activity. PCC §§ 14-400(a) and 14-445.

7. Gross income includes the total amount of the sale, lease, license for use, or rental price at the time of such sale, rental, lease, or license. PCC § 14-200(a)(2).

8. No deduction or exclusion is allowed from gross income on account of the cost of the property sold, the time value of money, expense of any kind or nature, losses, materials used, labor or service performed, interest paid, or credits granted. PCC § 14-200(c).

9. The booth fees received by Taxpayer are subject to the City privilege tax.

10. Taxpayer was assessed a penalty for failure to file privilege tax returns. The penalty for failure to file a tax return may be waived if the taxpayer can demonstrate reasonable cause for its failure to file. PCC § 14-540.

11. Reasonable cause may exist if:

    a. a taxpayer was not previously audited by a city for the tax or on the issue in question and relied, in good faith, on a state exemption or interpretation. PCC § 14-540(f)(3)(I).

    b. the taxpayer had a reasonable basis for believing that the tax did not apply to taxpayer's business activity in the city. PCC § 14-540(h).

12. Taxpayer's reliance on information from a representative of the Arizona Department of Revenue that no state privilege tax was due was reasonable.

13. Taxpayer has demonstrated reasonable cause for its failure to file City privilege tax returns for its licensing activity.

14. PCC § 14-570(a) provides that a taxpayer has the right to discuss any proposed assessment with the auditor prior to the issuance of any assessment, but an informal conference is not required for the taxpayer to file a petition for administrative review.

15. Taxpayer did not request an informal conference.

16. In a tax dispute between a governmental entity and a private party, due process is generally satisfied as long as the taxpayer receives notice and an opportunity to be heard before the tax obligation becomes irrevocably fixed. *State ex rel. Arizona Dept. of Revenue v. Care Const. Corp.,* 166 Ariz. 294, 802 P.2d 445 (App. 1990).

17. Taxpayer received notice of the Tax Calculation and has exercised the opportunity to be heard in this redetermination process.

18. PCC § 14-570 does not state what result will follow if an informal conference is not conducted.

19. 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.

20. PCC § 14-570(a) serves as a procedural directive intended to give method, system, uniformity and dispatch to the processing of assessments and is therefore directory, not mandatory.

21. The lack of an informal conference did not interfere with Taxpayer's protest rights.

22. The Tax Collector's determination of an amount due is not void because an informal conference was not held with Taxpayer.

23. Based on the foregoing, the Tax Collector's determination of an amount due is upheld except for the failure to file penalty.

24. The failure to file penalty included in the determination is abated.

Ruling

Taxpayer's protest of a determination of privilege tax and interest due made by the City of Phoenix for the period January 2010 through December 2014 is denied. Taxpayer's protest of the failure to file penalty included in the determination is granted.

The Tax Collector shall abate the failure to file penalty included in the determination for the period January 2010 through December 2014. The determination is otherwise upheld.

The parties have 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: ***Asst. City Attorney***
Municipal Tax Hearing Office