IN THE
ARIZONA COURT OF APPEALS
DIVISION ONE

ROADSAFE TRAFFIC SYSTEMS INC., *Plaintiff/Appellant*,

v.

ARIZONA DEPARTMENT OF REVENUE, *Defendant/Appellee*.

No. 1 CA-TX 17-0005
FILED 10-23-2018

Appeal from the Maricopa County Superior Court
No. LC2015-000544-001
and Arizona Tax Court
No. TX2015-000439
(Consolidated)

The Honorable Christopher T. Whitten, Judge

AFFIRMED

COUNSEL

McFarlane Law, PLC, Phoenix
By Stephen J. McFarlane (argued)
Co-Counsel for Plaintiff/Appellant

Porter Law Firm, Phoenix
By Robert S. Porter
Co-Counsel for Plaintiff/Appellant

Arizona Attorney General's Office, Phoenix
By Benjamin H. Updike (argued)
Counsel for Defendant/Appellee

MEMORANDUM DECISION

Judge Paul J. McMurdie delivered the decision of the Court, in which Presiding Judge Jennifer B. Campbell and Judge Kent E. Cattani joined.

M c M U R D I E, Judge:

¶1 Roadsafe Traffic Systems, Inc. ("Roadsafe") appeals from the summary judgment entered in favor of the Arizona Department of Revenue (the "Department") determining that income derived from traffic control personnel and plans is subject to the transaction privilege tax. For the following reasons, we affirm.

FACTS AND PROCEDURAL BACKGROUND

¶2 During the relevant tax periods, Roadsafe was engaged in the business of renting traffic control equipment, such as barricades, cones, signage, sandbags, and flags, for use at construction sites and other locations requiring traffic control. At times, Roadsafe also provided traffic control personnel, both flaggers and police officers, and drafted traffic control plans. Roadsafe also operated a road-striping business, which is not the subject of this appeal.

¶3 The Department audited Roadsafe for the period from December 2007 through January 2011. The audit resulted in an additional tax assessment of $236,984.04, based on the Department's determination that revenues derived from flaggers, police officers, and traffic control plans were subject to the transaction privilege tax. After exhausting its administrative remedies, Roadsafe filed a complaint in the tax court.

¶4 Agreeing the case presented a legal issue, the parties filed cross-motions for summary judgment. The tax court granted the Department's motion and denied Roadsafe's motion. Roadsafe timely appealed, and we have jurisdiction pursuant to Arizona Revised Statutes ("A.R.S.") sections 12-120.04(G), -120.21(A)(1), and -170(C).

DISCUSSION

¶5 We review the tax court's grant of summary judgment *de novo*. *Wilderness World, Inc. v. Dep't of Revenue State of Ariz.*, 182 Ariz. 196, 198 (1995). We likewise review the court's interpretation and application of the

relevant statutes *de novo*. *Energy Squared, Inc. v. Ariz. Dep't of Revenue*, 203 Ariz. 507, 509, ¶ 15 (App. 2002).

A. Roadsafe's Revenues Derived from Flaggers, Police Officers, and Traffic Control Plans are Part of Its Personal Property Rental Tax Base.

¶6 Arizona imposes a transaction privilege tax on the "amount or volume of business transacted by persons on account of their business activities." A.R.S. § 42-5008(A). The transaction privilege tax is not a tax on the sale or rental transaction itself, but "on the privilege or right to engage in an occupation or business in the State of Arizona." *Ariz. Dep't of Revenue v. Mountain States Tel. & Tel. Co.*, 113 Ariz. 467, 468 (1976).

¶7 The transaction privilege tax applies to sixteen different business classifications. *See* A.R.S. §§ 42-5061 to -5076. This case involves the personal property rental classification, A.R.S. § 42-5071, which imposes a tax on "the business of leasing or renting tangible personal property for a consideration." A.R.S. § 42-5071(A). The tax base for a rental business is the "gross proceeds of sales or *gross income derived from the business*." A.R.S. § 42-5071(B) (emphasis added). The question raised by this appeal is whether the revenues Roadsafe generated from traffic control personnel and plans are taxable under § 42-5071.

¶8 Roadsafe does not contest that its rental revenue was generally subject to taxation under § 42-5071**.** It argues, however, that revenues derived from flaggers, police officers, and traffic control plans were "not derived from the rental of tangible personal property and are not part of the rental transaction." Pursuant to § 42-5071, however, the revenue need not arise directly from the rental transaction to be taxable. Section 42-5071(B) defines the tax base as gross income derived **"**from the business" not from specific rental transactions. Business is broadly defined as "all activities or acts . . . engaged in or caused to be engaged in with the object of gain, benefit or advantage, either directly or indirectly." A.R.S. § 42-5001(1).

¶9 The statutory definition of "gross income" is also instructive. Section 42-5001(4) defines gross income as "the *gross receipts* of a taxpayer derived from trade, business, commerce or sales and the value proceeding or accruing from the sale of tangible personal property or service, or both." The term "sale" includes a lease or rental. A.R.S. § 42-5001(14). Again, the statute references gross receipts of the business, not of specific rental transactions. The revenues from flaggers, police officers, and traffic control

plans form part of the "gross receipts" derived from Roadsafe's rental business.

¶10 The Arizona Administrative Code ("Code") explains what is included in a rental company's gross income:

> Gross income from the rental of tangible personal property includes charges for installation, *labor*, insurance, maintenance, repairs, pick-up, delivery, assembly, set-up, personal property taxes, and penalty fees even if these charges are billed as separate items, unless a specific statutory exemption, exclusion, or deduction applies.

A.A.C. R15-5-1502(D) (emphasis added). Roadsafe argues the term "labor" is limited to installation, maintenance, pick-up, delivery, assembly, set-up, and removal of equipment. We disagree. The Code lists "labor" separately, suggesting there may be additional types of labor that form part of a rental company's tax base beyond the specific activities listed.

¶11 When applying the statutory and Code definitions to Roadsafe's business, we keep in mind the important statutory presumption that applies to all transaction privilege taxes: "[I]t is presumed that all gross proceeds of sales and gross income derived by a person from business activity classified under a taxable business classification *comprise the tax base for the business until the contrary is established*." A.R.S. § 42-5023 (emphasis added). Considering this presumption when applying the relevant statutes, we conclude that the income derived from flaggers, police officers, and traffic plans is part of Roadsafe's personal property rental tax base.

B. Based on the *Holmes & Narver* Test, Roadsafe's Revenues Derived from Flaggers, Police Officers, and Traffic Control Plans Must Be Included in Its Tax Base.

¶12 Arizona courts have recognized cases in which nontaxable income should be excluded from the transaction privilege tax base. *See, e.g., Ebasco Servs. Inc. v. Ariz. State Tax Comm'n*, 105 Ariz. 94 (1969). *Ebasco* involved a taxpayer that built power-generating plants. *Id.* at 95. The taxpayer had separate and distinct divisions, which included construction, engineering, and purchasing. *Id.* at 96. Our supreme court held that Ebasco's revenues from engineering and purchasing were not taxable under the contracting classification. *Id.* at 98 ("We do not believe that this statute goes so far as to tax all activities of a corporation based on the fact that one of the activities engaged in is that of contracting.").

¶13 Later, in *State Tax Commission v. Holmes & Narver, Inc.*, our supreme court established a three-part test for determining when nontaxable income from a separate line of business can be excluded from the tax base. 113 Ariz. 165, 169 (1976). To exclude nontaxable income, the taxpayer must show: (1) the receipts from the separate business can be "readily ascertained"; (2) the income from the separate business is "not inconsequential" in relation to the taxpayer's total income; and (3) the separate business is not "incidental" to the main business. *Id.* In *Holmes & Narver*, the court concluded that design and engineering services should be excluded from the taxpayer's contracting tax base. *Id.* In so holding, the court specifically found that the taxpayer's design and engineering services (1) were separately itemized and billed; (2) comprised forty-three percent of the revenue; and (3) constituted the primary reason the company was retained. *Id.* at 168.

¶14 This court later applied this three-part test in *City of Phoenix v. Arizona Rent-A-Car Systems*, to conclude that refueling charges should be included in a car rental company's tax base. 182 Ariz. 75, 76, 78 (App. 1995). We determined that refueling charges (1) were easily calculated; (2) comprised only two percent of the company's total revenue; and (3) were integral to the taxpayer's business. *Id.* at 78–80.

¶15 Here, Roadsafe's revenues derived from traffic control personnel and plans fail the second and third parts of the *Holmes & Narver* test.[1] Roadsafe's revenues from flaggers, police officers, and traffic control plans comprise approximately 3.07%, 3.80%, and .67% respectively of Roadsafe's total gross revenue without deductions during the audit period. Like the gasoline charges in *Arizona Rent-A-Car Systems*, these revenues are inconsequential when compared to Roadsafe's total income. Moreover, the services are incidental to Roadsafe's traffic control equipment rental business. Black's Law Dictionary defines incidental as "[s]ubordinate to

---

[1] Referencing the first part of the test, the tax court found that Roadsafe "could not easily ascertain the revenue related to the services of planners, flaggers, and police officers without substantial difficulty." At the administrative level, however, the parties stipulated that at least "the flagging business can be readily ascertained without substantial difficulty." However, there was no stipulation regarding the ability to ascertain the business concerning the planners and police officers. Nevertheless, because we find that Roadsafe has failed under the second and third prongs of *Holmes & Narver*, we need not resolve the discrepancy related to the first prong.

something of greater importance; having a minor role." *Incidental*, Black's Law Dictionary (10th ed. 2014). Roadsafe's primary business is renting traffic control equipment. It provides flaggers, police officers, and traffic control plans as a supplement to that more important rental business.

¶16 While acknowledging *Holmes & Narver*, Roadsafe relies instead on *Arizona Department of Revenue v. Ormond Builders, Inc.*, a case in which this court held that payments made to a prime contractor for services provided by trade contractors were not taxable to the prime contractor because the prime contractor acted simply as a "conduit" between the customers and the trade contractors. 216 Ariz. 379, 387, ¶ 37 (App. 2007). Roadsafe does not explain how the holding from that case applies here as Roadsafe has specifically withdrawn its argument that it was a subcontractor.

¶17 Applying the *Holmes & Narver* test, we conclude that revenues derived from flaggers, police officers, and traffic control plans must be included in Roadsafe's personal property rental tax base. We award costs to the Department upon compliance with Arizona Rule of Civil Appellate Procedure 21.

CONCLUSION

¶18 For the foregoing reasons, we affirm the decision of the tax court.

COURT OF APPEALS
STATE OF ARIZONA

AMY M. WOOD • Clerk of the Court
FILED: AA