

IN THE COURT OF APPEALS
STATE OF ARIZONA
DIVISION ONE

HOME DEPOT USA, INC., a foreign) 1 CA-TX 02-0007
corporation,) 1 CA-TX 02-0008
) (Consolidated)
Plaintiff-Appellant,)
Cross Appellee,) DEPARTMENT T
)
v.)
) **MEMORANDUM DECISION**
PIMA COUNTY, a body politic and) (Not for Publication -
corporate; RICK LYONS, in his capacity) Rule 28, Arizona Rules
as Pima County Assessor; JAMES LEE) of Civil Appellate
KIRK, in his capacity as PIMA COUNTY) Procedure)
TREASURER; MIKE BOYD, DAN ECKSTROM,)
SHARON BRONSON, RAY CARROLL, RAUL)
GRIJALVA, as members of the Pima County)
Board of Supervisors; MARICOPA COUNTY,)
a political subdivision of the state of)
Arizona,)
)
Defendants-Appellees,)
Cross Appellants.)
) **FILED 5-1-03**

Appeal from the Arizona Tax Court

Cause Nos. TX 1999-000591 and TX 2000-000014

The Honorable Jeffrey S. Cates, Judge

AFFIRMED

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Tucson

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W E I S B E R G, Judge

¶1 At a few of its retail stores in Arizona, taxpayer Home Depot USA, Inc. ("Home Depot") installed and used certain items of property, including Sensormatic anti-shoplifting security systems, pneumatic tube systems for transporting cash from cash registers to the accounting office, exterior signs, and interior displays of kitchen and bath fixtures (hereinafter collectively the "disputed items"). Maricopa County and Pima County ("the counties") assessed business personal property taxes on these items for tax year 1999. The tax court's judgment sustained assessments of delinquent business personal property taxes against the exterior signs and interior kitchen and bath fixture displays, but held that the taxpayer's pneumatic tube systems and Sensormatic security systems were real property and should not have been assessed as personal property.

¶2 Home Depot appeals and the counties each cross-appeal. The appeal and cross-appeals present these issues:

1. Whether the tax court erred in classifying Home Depot's pneumatic tube

systems and Sensormatic security systems as real rather than personal property;

2. Whether the tax court erred in classifying Home Depot's exterior signs and kitchen and bath displays as personal rather than real property;

3. Whether the tax court erred in failing to refund to Home Depot the full amount of taxes imposed on its pneumatic tube systems and Sensormatic security systems after holding that these items constituted real rather than personal property;

4. Whether the tax court erred in failing to refund 1999 taxes assessed against Home Depot's Pima County personal property because the county had failed to apply accelerated depreciation in assessing it; and

5. Whether the tax court erred in failing to require the imposition of additional real property taxes due to the recharacterization of Home Depot's pneumatic tube systems and Sensormatic security systems as real property.

We have jurisdiction in the appeal and cross-appeals under Arizona Revised Statutes ("A.R.S.") section 12-2101(B) (1994).

FACTS AND PROCEDURAL HISTORY

¶3 This appeal concerns the ad valorem taxation of business property in use at three Home Depot stores in Tucson and ten in Phoenix. Home Depot owns one of the Tucson stores and seven of those in Phoenix. It leases the remaining two in Tucson and three in Phoenix.

¶4 For tax year 1999, Home Depot's Arizona Business Personal Property Tax Statements (Form 520s) reported all the disputed items as personal property. In June 1999, Home Depot engaged property

tax and appraisal consultant John Fox to value Home Depot's business personal property in Arizona and Colorado for tax appeal purposes. Fox physically inspected each of Home Depot's stores in Arizona, inventoried all property at each location, and characterized various categories of property as real or personal.

¶5 Four of the categories of property that Fox determined were real rather than personal property were the anti-shoplifting Sensormatic security systems, the pneumatic tube systems, the exterior signs, and the in-store kitchen and bath displays. Home Depot paid the counties' 1999 assessment on these items and brought two separate actions against the counties seeking refunds.

¶6 Counsel in Home Depot's Maricopa County action agreed in advance of trial to be bound by the tax court's findings and rulings of law in the separate Pima County action. Home Depot's action against Pima County was tried to the tax court on May 15 and 16, 2001. After taking the matter under advisement and considering post-trial memoranda, the tax court held that Home Depot's exterior signs and kitchen and bath fixture displays constituted personal property, but that Home Depot's pneumatic tube systems and Sensormatic security systems constituted real property. Citing *Scottsdale Princess Partnership v. Maricopa County*, 185 Ariz. 368, 372, 916 P.2d 1084, 1088 (App. 1995), the court further held that Home Depot was entitled to recover any excess in taxes that it had paid for the pneumatic tube and Sensormatic systems as personal

property over what it would have paid if they had been correctly treated as real property.

¶7 The tax court acknowledged and applied the following principles in distinguishing between real and personal property:

To determine whether personal property has become a fixture, there must be 1) an annexation of the personal property to the realty; 2) adaptability or application of the personal property to the use and purpose for which the realty is used; and 3) intent of the owner to permanently annex the personal property to the realty [sic]. See Fish v. Valley Nat. Bank of Phoenix, 64 Ariz. 164, 170, 167 P.2d 107, 111 [(1946)].

The court must examine objective manifestations of the taxpayer's intent to determine whether there was intent to affix the personal property indefinitely to the real property. See Murray v. Zerbel, 159 Ariz. 99, 101, 764 P.2d 1158, 1160 (App. 1988). One such manifestation is the substantial physical attachment of the personal property to the land. See Price v. Sunmaster, 27 Ariz. App. 771, 775, 558 P.2d 966, 970 (App. 1976). In addition, it must be determined whether "items can be removed from the building or structure itself without affecting materially the use of the building for other and different purposes." Voight v. Ott, 86 Ariz. 128, 134, 341 P.2d 923, 927 (1959).

¶8 The tax court entered virtually identical judgments in the Maricopa and Pima County actions. In each case Home Depot timely appealed and the counties timely cross-appealed, generating this court's case nos. 1 CA-TX 02-0007 and 1 CA-TX 02-0008. We consolidated the two under case no. 1 CA-TX 02-0007.

ANALYSIS

Realty vs. Personality

Trial Court Rulings

¶9 In its ruling on the merits, the tax court noted it was undisputed that the items in question were all physically annexed to the real estate, but that the parties disputed whether the items had been annexed with the intent that they remain so indefinitely. Concerning the exterior signs and kitchen and bath fixture displays, the tax court ruled:

The merchandise displays, exterior signs, service desk and lumber are attached to the building by brackets and bolts. The bolts are easily removed without much damage to either the building or the items themselves. The method of attachment does not suggest intent to attach the items permanently to the land. The items are removable and interchangeable with other similar items and unnecessary for the building's use as a commercial building. Therefore the merchandise displays, exterior signs, service desk and lumber were properly classified as personal property in 1999.

¶10 Regarding the pneumatic tube systems and Sensormatic security systems, the tax court ruled:

As to Home Depot's appeal of the classification of its pneumatic tube system as personal property, the pneumatic tube system is attached to the building by a series of brackets which could be removed without causing damage to either the building or the pneumatic tube system. However, the pneumatic tube system passes through a wall in the rear of the store and is attached more permanently in other areas. The removal of the tubing would damage both the building and the tubing. In addition, the motor and safe would be

difficult to remove from the property without damage to the building or the items themselves. The means of attachment suggest the pneumatic tube system was affixed with the intent to remain affixed permanently. Therefore, the pneumatic tube system was incorrectly classified as personal property in 1999.

The final dispute involves the classification of a [S]ensormatic security system as personal property. This system was designed to detect theft of inventory. Its wiring and control devices are embedded in concrete, and could not be removed without damaging the concrete or the items. Furthermore, the security arches are embedded into the concrete floor and could not be removed without damage to the security arches or the building. The system was installed with the intent to remain attached indefinitely. Therefore, it was incorrectly classified as personal property in 1999.

Controlling Principles

¶11 The tax court issued its decision in this matter in October 2001. At that time, the test for distinguishing between real and personal property in tax cases was set forth in *Brink Electric Construction Co. v. Arizona Department of Revenue*, 184 Ariz. 354, 361-62, 909 P.2d 421, 428-29 (App. 1995). Under that test, in determining whether a given article of personal property has become real property, a court considers (1) whether the item has been actually or constructively annexed to real property, (2) whether it is adaptable to the use and purpose for which the realty is used, and (3) whether the party who accomplished the annexation intended that the personal property constitute a permanent accession to the real property. These criteria are for all

practical purposes the same as those on which the tax court relied below, citing *Fish v. Valley National Bank of Phoenix*, 64 Ariz. 164, 170, 167 P.2d 107, 111 (1946).

¶12 This court has since adopted a broader and more expansive test for characterizing property as real or personal for tax purposes. *Arizona Dep't of Revenue v. Ariz. Outdoor Advertisers, Inc.*, 202 Ariz. 93, 41 P.3d 631 (App. 2002) (nature of outdoor advertising billboard as real or personal property). In *Outdoor Advertisers*, this court traced the origin of the test applied in *Brink Electric to Teaff v. Hewitt*, 1 Ohio St. 511 (1853), rejected on other grounds by *Kings Entm't Co. v. Limbach*, 63 Ohio St. 3d 369, 370, 588 N.E.2d 777, 778 (1992).

¶13 *Outdoor Advertisers* criticized the *Teaff* test on numerous grounds. This court found the test's focus on the annexor's intent as of the time of affixation of personalty to realty to be arbitrarily narrow. This court stated, "Only if the events giving rise to a dispute logically relate to the time of annexation should the resolution focus on original annexor intent." 202 Ariz. at 98, ¶ 23, 41 P.3d at 636. This court likewise criticized the *Teaff* test on the ground that it unduly confined the inquiry to its three express factors. This court stated:

Common sense teaches that in an investigation into the proper characterization of personalty, there are many factors that could point the way to the correct answer. *Teaff*, however, limits the inquiry by selecting three of these factors and elevating them to the

status of test elements, thereby implying that these factors are the only ones relevant to the issue. If applied strictly, the test would preclude consideration of factors as pertinent as a written agreement between the parties, a long-standing custom in an industry, or even whether the item in question adds to or subtracts from the value of the realty.

Not surprisingly, courts have tended to avoid the restrictions implicit in the test in order to consider other relevant factors.

Id. at 98, ¶ 27, 41 P.3d at 636.

¶14 This court in *Outdoor Advertisers* further disagreed that only the annexor's objective intent, rather than his subjective intent, was relevant to resolving the question at which the *Teaff* test was aimed. This court stated:

What is needed is a test that is intellectually honest, that invites consideration of all circumstances that might bear on the fixtures inquiry, and that permits consideration without the kind of language-skewing exercise necessitated by *Teaff*. This test should bar evidence only because it fails the probative value criterion of Rule 401, Arizona Rules 11 of Evidence, and it should direct the inquiry to the relevant time frame, either the time of the original annexation or a later time.

Id. at 99, ¶ 33, 41 P.3d at 637.

¶15 This court ultimately chose to adopt a new, "reasonable person" test to supplant the *Teaff* test "in the context of characterizing property as real or personal for tax purposes." *Id.* at 100, ¶ 38, 41 P.3d at 638. This court phrased the new test as follows: "Would a reasonable person, after considering all the

relevant circumstances, assume that the item in question belongs to and is a part of the real estate on which it is located?" *Id.* at 99-100, ¶ 35, 41 P.3d at 637-38. This court stated that, once the trial court had resolved all disputed issues of fact, "the trial court acting as the reasonable person will make the initial fixtures determination . . . , and it is that determination which will be subject to our independent review." *Id.* at 101, ¶ 42, 41 P.3d at 639. This court remarked:

We also note that notwithstanding this rejection of the *Teaff* methodology by adopting a different approach, *Teaff* jurisprudence is not being entirely discarded. While *Teaff's* three factors will no longer limit the inquiry, they will continue to play a major role. In fact, annexation will probably continue as the triggering event for most fixtures inquiries. In addition, the century and a half of *Teaff* case applications remain available as source material on which to draw for specific relevant circumstances that can easily be integrated into a reasonable person inquiry.

Id. at 100, ¶ 37, 41 P.3d at 638.

¶16 The tax court resolved this litigation after a bench trial. No disputed issues of fact remain undetermined. Pursuant to *Outdoor Advertisers*, we review de novo the tax court's determinations concerning the disputed items. 202 Ariz. at 101, ¶ 42, 41 P.3d at 639.

¶17 Home Depot contends that the tax court erred in determining that its exterior signs and kitchen and bath fixture displays had properly been taxed as business personal property.

Although it reached its result without the benefit of *Outdoor Advertisers*, we hold that the tax court was correct.

¶18 Under *Outdoor Advertisers*, the approach for determining whether personalty has become realty no longer relies exclusively on the three-factor test described and applied in *Brink Electric*. The ultimate question under *Outdoor Advertisers* is whether a reasonable person, after considering all the relevant circumstances, would assume that the item in question belongs to and is a part of the real estate on which it is located. 202 Ariz. at 99-100, ¶ 35, 41 P.3d at 637-38. The intent of the annexor at the time of initial annexation is no longer the "controlling criterion," *cf. Brink Electric*, 184 Ariz. at 361, 909 P.2d at 428, and any circumstance that may rationally be deemed relevant to the ultimate inquiry in the particular case may be weighed in the balance.

¶19 Nothing about the way in which Home Depot attached its exterior signs to its home improvement centers supports a clear inference on the question whether it originally "intended" the signs to remain attached indefinitely. To be sure, each sign was bolted and wired to the front of the store, but the evidence does not suggest that the signs were anchored so that the annexor could only have intended that they become permanent accessions to the realty. More compelling is Home Depot's continuing "intent" to the contrary, evidenced by its having consistently listed its signs with the counties as personal property for tax purposes before this

litigation arose. Moreover, while exterior signs that display "Home Depot" are certainly adapted to the operation of Home Depot's particular business, they could not be regarded as a permanent accession to the real property if the building were acquired by a different user. The tax court did not err in determining that Home Depot's exterior signs were personalty.

¶20 We reach the same conclusion concerning Home Depot's kitchen and bath fixture displays. These displays are used to display certain residential fixtures that Home Depot offers for sale. Although they are fastened to the floors and permanent partition walls in each home improvement center by bolts or nails, as styles change or Home Depot switches vendors, it removes and replaces the displays with new ones "to reflect the newer product lines that they are carrying." The displays are secured to the floors as well as the walls to protect them from being loosened by customers. Finally, we note that the displays are sometimes moved, and that at one of Home Depot's Tucson stores, a display of a kitchen fixture line that Home Depot was no longer going to carry was removed from the store floor, placed in front of the store, and offered for sale. For these reasons, the tax court did not err in characterizing the kitchen and bath fixture displays as personalty.

¶21 We likewise agree with the tax court that Home Depot's pneumatic tube systems and Sensormatic security systems constituted real and not personal property. Both systems are fully integrated into the permanent configuration of the building itself and cannot

be removed without causing substantial damage to it. While it is true that both systems were used in connection with Home Depot's particular business, that neither performed any function that was essential to the use of the building, and that Home Depot consistently listed these items as personal property before this litigation arose, we conclude that the physical nature of these items and the extent of their integration into the structure of the building itself is of the greatest significance. We therefore hold that a reasonable person who was aware of all the circumstances would conclude that the pneumatic tube systems and Sensormatic security systems constituted real property. The tax court did not err in so holding.¹

Amounts to be Refunded

¶22 While the tax court determined that the pneumatic tube systems and Sensormatic security systems should have properly been classified as real property, it declined to award Home Depot a refund of all taxes that had been imposed on them for 1999. Instead, following *Scottsdale Princess*, 185 Ariz. at 372, 916 P.2d

¹ In reaching our conclusions, we reject the counties' argument that all the disputed items were "trade fixtures" and therefore necessarily personal property. In support of this contention they cite only a definition of "trade fixture" in *Webster's Third International Dictionary* 861 (1976) and a statement from 35A Am. Jur. 2d *Fixtures* § 34, that trade fixtures installed by a lessee are presumed to remain the lessee's personal property. But the counties cite no Arizona decision that has applied the concept of "trade fixture" outside the commercial landlord-tenant context. We hold that the analysis adopted in *Outdoor Advertisers*, not the trade fixture doctrine, is Arizona's accepted method for distinguishing real from personal property for tax purposes.

at 1088, the tax court held that a full refund of all taxes was unwarranted, and that the property should instead be taxed as if it had been correctly listed as real property. The court held that Home Depot was entitled only to "excess taxes paid on the assessment on the incorrect tax roll as compared to the assessment on the correct tax roll."

¶23 Home Depot now contends this was error. It argues that by assessing personal property taxes against items of real property, the counties imposed illegal taxes under A.R.S. § 42-11005(A) (1999). It reasons that this is so because, under Arizona's "unitary plan" for real estate taxation, the pneumatic tube and Sensormatic security systems were necessarily valued and fully taxed when the home improvement center buildings were valued and taxed. See *Westward Look Dev. Corp. v. Dep't of Revenue*, 138 Ariz. 88, 89, 673 P.2d 26, 27 (App. 1983). Home Depot urges that the tax court therefore erred in failing to refund all personal property taxes that it paid for 1999 on its pneumatic tube systems and Sensormatic security systems. We disagree.

¶24 We rejected a similar argument in *Scottsdale Princess*, 185 Ariz. at 368, 916 P.2d at 1084. In that case, Maricopa County had mistakenly listed and taxed the taxpayer's hotel complex, tennis casitas, and tennis center on the unsecured roll as personal property rather than on the secured roll as real property. *Id.* at 370-71, 916 P.2d at 1086-87. The taxpayer urged that it was entitled to a refund of the full amount of the personal property

taxes that it had paid as a result. *Id.* at 372, 916 P.2d at 1088. We determined that the statutory requirement that real property be taxed on the secured roll was directory and not mandatory, and that the legislature had not "intended to prevent ADOR from collecting any taxes from property assessed on the wrong roll when the harm can be remedied merely by taxing the property as if it had been correctly listed." *Id.* at 372-73, 916 P.2d at 1088-89.

¶25 The taxpayer in *Scottsdale Princess* contended that *Westward Look* precluded assessors from re-valuing property that had been erroneously undervalued on the unsecured roll due to a computer malfunction. Noting that the taxing authorities in *Westward Look* had sought increased taxes for prior years, which would pose a risk to any intervening bona fide purchaser of the property without notice of the undervaluation, *Scottsdale Princess* distinguished *Westward Look* as follows:

Here the correction pertained to the same tax year on which taxes had been billed erroneously. Further, in *Westward Look*, back taxes were sought because the property had "escaped" taxation within the meaning of A.R.S. section 42-236(D). In contrast, the "property" here was assessed, but at less than the correct value, and the error was corrected under A.R.S. section 42-405(A).

185 Ariz. at 374, 916 P.2d at 1090.

¶26 Here the error to be corrected likewise pertained to the same year for which the erroneous billing was made. Further, the property in question did not altogether "escape" taxation. All the

property here was assessed, but at incorrect values due to a listing error. Accordingly, any harm to Home Depot due to the incorrect listing of the pneumatic tube and Sensormatic security systems as personal property may be remedied by taxing those items as if they had been correctly listed as real property.

¶27 Furthermore, we disagree with Home Depot's argument that the refundable "excess" taxes will necessarily be the full amounts imposed on the pneumatic tube and Sensormatic security systems as personal property. Two of the three Home Depot home improvement centers in Pima County were valued by the comparable sales (market) method. The remaining Pima County home improvement center, and all of those in Maricopa County, were valued by the construction cost method.

¶28 To value a commercial building under the construction cost method, the assessor records detailed information about the building such as construction type, square footage, number of stories, and age. The cost of the various elements of the building, such as plumbing, air conditioning, and interior finishes are then recorded. These data are then entered into a computerized cost system developed for and modified by the Department of Revenue. The computerized cost system excludes all items that the Department of Revenue considers to be personal property, including

security systems and pneumatic tube systems. Based on the data entered, the system yields a final full cash value for the building.

¶29 Under the market method, commercial buildings are valued by reference to sales of comparable buildings. For each comparable sale, the assessor inspects the affidavit of value and the sale documents for personal property items, and adjusts the sale price downward to exclude the sums attributable to those items. The excluded personal property items include security systems and pneumatic tube systems. The resulting adjusted sales prices are used to derive a per-square-foot value that is then applied to the square footage of the building to be valued, yielding its full cash value.

¶30 This evidence fully supports the tax court's determination that "[t]he disputed items were taxed as personal property and were deliberately excluded in the assessment of Plaintiff's real property." We conclude that there was no double taxation, and that Home Depot is not as a matter of law entitled to a full refund of all personal property taxes paid on the Sensormatic security systems and the pneumatic tube systems in its home improvement centers for 1999.

**Tax Court's Failure to Refund Accelerated Depreciation
Omitted by Pima County**

¶31 Home Depot next contends that the tax court erred in failing to award it a refund of sums representing the accelerated

depreciation by which Pima County omitted to reduce Home Depot's personal property tax bill for 1999. We disagree.

¶32 In its post-trial closing memorandum, Home Depot told the tax court that it was "entitled to a refund for the overvaluation at the Irvington store for the County's failure to grant Home Depot accelerated depreciation for the tax year 1999." The tax court's minute entry ruling did not mention this point or award relief on it.

¶33 Home Depot nevertheless failed to ask the tax court to include such a refund in its final judgment. Instead, it lodged a form of judgment that tracked the tax court's minute entry ruling, including its omission of any mention of Home Depot's alleged entitlement to a refund for omitted accelerated depreciation. Under these circumstances, the tax court cannot be said to have erred in failing to include in its final judgment a refund pertaining to the Irvington store.

**Tax Court's Failure to Award Additional Taxes
on Real Property Items to Recapture Accelerated Depreciation**

¶34 Next, the counties argue that recharacterizing the Sensormatic security systems and pneumatic tube systems as real property automatically disqualified them for any accelerated depreciation that Home Depot may have claimed for them as personal property. The counties reason that the tax court should therefore have ordered an increase in the taxes assessed on the real property

at all of Home Depot's Tucson and Phoenix locations to account for Home Depot's loss of the accelerated depreciation benefit. We disagree.

¶35 In *Scottsdale Princess*, 185 Ariz. at 377, 916 P.2d at 1093, Maricopa County contended that the tax court had erred in declining to direct the taxpayer to pay any difference in taxes that might result from the transfer of the taxpayer's hotel complex and tennis center from the unsecured roll to the secured roll. We disagreed, holding that former A.R.S. § 42-204, now A.R.S. § 42-11005 (1999) (illegal taxation), did not authorize awards of additional taxes against an unsuccessful taxpayer. *Id.* We further held that a claim for a refund of taxes paid as a result of assessing property on the wrong tax roll was neither a "valuation" nor a "classification" claim as to which former A.R.S. § 42-178(D) and (E), now A.R.S. § 42-16213(B) and (C) (1999), permitted recovery of a tax deficiency against the taxpayer. *Id.* at 378, 916 P.2d at 1094.

¶36 The same principles apply in this case. The tax court did not err in declining to award increased 1999 taxes against Home Depot.

CONCLUSION

¶37 For the foregoing reasons, we affirm the judgments of the tax court. Home Depot requests an award of attorney's fees on appeal under A.R.S. § 12-348(B) (Supp. 2002). We grant the

request, limited to fees charged for representing Home Depot in connection with the counties' cross-appeal.

SHELDON H. WEISBERG, Judge

CONCURRING:

SUSAN A. EHRLICH, Presiding Judge

ROGER W. KAUFMAN, Judge *Pro Tempore**

*NOTE: The Honorable Roger W. Kaufman, Judge *Pro Tempore*, was authorized by the Chief Justice of the Arizona Supreme Court to participate in the disposition of this appeal pursuant to Ariz. Const. art. VI, § 3 and A.R.S. §§ 12-145 through 147.