

BEFORE THE ARIZONA DEPARTMENT OF REVENUE

In the Matter of)
) DECISION OF
[REDACTED]) HEARING OFFICER
)
License No. [REDACTED]) Case No. 200700120-S
)
)
_____)

A hearing was held on December 3, 2007 in the matter of the protest of [REDACTED] (Taxpayers) to an assessment of transaction privilege tax and interest by the Transaction Privilege and Use Tax Audit Section (Section) of the Arizona Department of Revenue (Department) for the period from [REDACTED] through [REDACTED]. The record in this matter was left open until February 21, 2008 to allow for post-hearing memoranda. Taxpayers' opening post-hearing memorandum was timely filed by postmark dated January 3, 2008. The Section timely filed its response post-hearing memorandum on February 1, 2008. Taxpayers did not file their reply post-hearing memorandum by February 21, 2008. A reasonable amount of time has passed to allow Taxpayers to file this memorandum. Therefore, this matter is ready for ruling.

FINDINGS OF FACT

The Section audited Taxpayers for the period from [REDACTED] through [REDACTED] (Audit Period). During the Audit Period, Taxpayers owned/operated a number of Schedule C businesses, including: [REDACTED], [REDACTED], [REDACTED], and [REDACTED]. Taxpayers had a single transaction privilege license during the Audit Period, which was issued to [REDACTED].

However, Taxpayers appeared to have used that license for all of their businesses.

Due to a lack of documentation received from Taxpayers, the Section based its audit primarily upon Schedule Cs from Taxpayers' federal income tax returns during the Audit Period. However, the Section also used federal Form 1099s issued by [REDACTED], and U.S. Department of Housing and Urban Development (HUD) settlement sheets issued by [REDACTED] to verify amounts.

The largest portion of the assessment is derived from construction activities pertaining to three (3) homes that were built upon land that Taxpayers owned. Taxpayers appear to have built these homes for their noncapital contribution for the joint venture of [REDACTED], of which [REDACTED] was a member. The three (3) homes were sold in 2003. On Schedule C of Taxpayers' 2003 federal income tax return, Taxpayers list gross receipts or sales of \$[REDACTED] for [REDACTED].

In 2003, [REDACTED] issued three (3) 1099s to Taxpayers showing that Taxpayers had received income from the sale of the homes. One of the 1099s showed that a home was sold on October [X], 2003 for \$[REDACTED]. A second 1099 showed that another home was sold on October [XX], 2003 for \$[REDACTED], and a third 1099 showed that another home was sold on December [X], 2003 for \$[REDACTED]. The HUD settlement sheets prepared by [REDACTED] confirm these figures. When added up, the total amount of sales for these homes comes to \$[REDACTED], the same amount reported on Schedule C of Taxpayers' federal income tax return.

The Section also assessed additional gross income based upon income from Taxpayers' backhoe business. Using Schedule C from Taxpayers' 2000 and 2001 federal income tax returns, the Section determined that Taxpayers received \$[REDACTED] in 2000 and \$[REDACTED] in 2001 for backhoe services which Taxpayers had performed. The annual amounts reported on the tax returns were divided by 12 (months) and then used to calculate the assessment of income during the Audit Period. There was no backhoe income reported on Schedule C for Taxpayers' 2002 or 2003 federal tax returns. Consequently, the Section assessed \$[REDACTED] of gross income for the backhoe business during the Audit Period.

As a result of the audit, the Section issued an assessment of transaction privilege tax in the amount of \$[REDACTED] on August 23, 2004. Interest was also included in the assessment at the statutory rate, but no penalties were assessed. To determine the amount of tax, the Section used 65 percent of Taxpayers' gross receipts as the taxable base. The Section also allowed a deduction for the fair market value of the land pertaining to the home sales, as well as a deduction for factored tax.

Taxpayers timely protested the audit stating that they did not actually receive the proceeds of the sale of the houses and that they wished to assess the tax on the party who received the proceeds. At the hearing, [REDACTED] stated that he does not dispute that he was engaged in contracting activity nor the amount of tax owed; only that he did not receive the proceeds and therefore should not be liable for the tax. The issue to be

determined is the propriety of the Section's August 23, 2004 proposed assessment.

CONCLUSIONS OF LAW

The Arizona transaction privilege tax is imposed on several categories of business activities, including prime contracting. See A.R.S. § 42-5075. Current A.R.S. § 42-5075.N.7 provides that "prime contracting" means engaging in business as a prime contractor. A.R.S. § 42-5075.N.8 defines "prime contractor" in part as follows:

. . . a contractor who supervises, performs or coordinates the modification of any building, highway, road, railroad, excavation, manufactured building or other structure, project, development or improvement including the contracting, if any, with any subcontractors or specialty contractors and who is responsible for the completion of the contract.

The evidence indicates that, pursuant to a joint venture agreement, Taxpayers were responsible for building homes as part of their noncapital contribution to the joint venture.

Taxpayers indeed constructed three (3) homes during the Audit Period which were then sold. This evidence indicates that Taxpayers were prime contractors on the jobs at issue.

Taxpayers did not refute that they were engaged in contracting activities. Rather, they disputed receiving the proceeds from the sales.

With respect to calculating the tax base of the transaction privilege tax, A.R.S. § 42-5023 provides:

For the purpose of proper administration of this article and to prevent evasion of the

tax imposed by this article it 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.

Taxpayers were engaged in contracting activities. Thus, pursuant to A.R.S. § 42-5023, it is presumed that all of Taxpayers' gross income from its business activity is subject to tax under the prime contracting classification until the contrary is established.

"Gross Income" is broadly defined 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, and without any deduction on account of losses." A.R.S. § 42-5001.4 (emphasis added).

The term "Gross Receipts" is defined as follows:

. . . the total amount of the sale, lease or rental price, as the case may be, of the retail sales of retailers, including any services that are a part of the sales, valued in money, whether received in money or otherwise, including all receipts, cash, credits and property of every kind or nature, and any amount for which credit is allowed by the seller to the purchaser without any deduction from the amount on account of the cost of the property sold, materials used, labor or service performed, interest paid, losses or any other expense. Gross receipts do not include cash discounts allowed and taken nor the sale price of property returned by customers if the full sale price is refunded either in cash or by credit.

A.R.S. § 42-5001.7.

Based upon the broad language of these statutes, the Hearing Office concludes that the Taxpayers are subject to

transaction privilege tax for the proceeds from the sale of the homes. Regardless of where Taxpayers' directed the funds to be paid, they had dominion over the funds as the contractors and sellers of the homes, and thus they are deemed to have received gross receipts from the sale of the homes. Taxpayers' 2003 federal tax return supports this. Taxpayers reported the \$[REDACTED] of income as gross receipts or sales on Schedule C of their 2003 federal income tax return. The HUD settlement sheets and 1099s issued to Taxpayers also substantiate that Taxpayers received gross income.

The assignment of the income to [REDACTED] does not exclude the sales proceeds of the homes from being subject to the transaction privilege tax under the prime contracting classification. The actual receipt or division of the funds is a different issue. The Hearing Office is not unsympathetic toward Taxpayers' predicament. However, in the event that Taxpayers' partner in the joint venture agreement kept more than his share of the proceeds, other remedies at law are available to Taxpayers.¹

As for the income received by Taxpayers' backhoe business, the Arizona Administrative Code provides that backhoe services and operations are also taxable contracting activities. See A.A.C. R15-5-612. During the Audit Period, Taxpayers received gross income for operating and providing backhoe services. The

¹Indeed, at the hearing, Taxpayers testified that they are currently pursuing other legal remedies in an attempt to recuperate those funds.

Section used an appropriate method to calculate the amount of the income, and such amount is taxable under the prime contracting classification.

As to the interest portion of the assessment, A.R.S. § 42-1123.C provides that if the tax "or any portion of the tax is not paid" when due "the department shall collect, as a part of the tax, interest on the unpaid amount" until the tax has been paid. Thus, interest is a part of the tax and generally may not be abated unless the tax to which it relates is found not to be due for whatever reason. The tax was due in this case and the associated interest cannot be abated.

Based on the foregoing, the Section's proposed assessment dated August 23, 2004 is affirmed.

DATED this 14th day of March, 2008.

ARIZONA DEPARTMENT OF REVENUE
APPEALS SECTION

[REDACTED]
Hearing Officer

Original of the foregoing sent by certified mail to:

[REDACTED]

Copies of the foregoing delivered to:

Arizona Department of Revenue
Transaction Privilege and Use Tax Audit Section and
Transaction Privilege Tax Appeals