

DECISION OF MUNICIPAL TAX HEARING OFFICER

Decision Date: October 30, 2007

Decision: MTHO #353

Taxpayer: *Taxpayer ABC*

Tax Collector: City of Tucson

Hearing Date: June 18, 2007

DISCUSSION

Introduction

On March 15, 2007, *Taxpayer ABC* (“Taxpayer”) filed a protest of a tax assessment made by the City of Tucson (“City”). After review, the City concluded on March 19, 2007 that the protest was timely and in the proper form. On March 26, 2007, the Municipal Tax Hearing Officer (“Hearing Officer”) ordered the City to file any response to the protest on or before May 10, 2007. On May 7, 2007, the City filed a response to the protest. On May 11, 2007, the Hearing Officer ordered Taxpayer to file any reply on or before June 1, 2007. On May 21, 2007, a Notice of Tax Hearing (“Notice”) scheduled the matter for hearing commencing on June 18, 2007. Both parties appeared and presented evidence at the June 18, 2007 hearing. On June 19, 2007, the Hearing Officer indicated Taxpayer would be filing additional documentation on or before July 2, 2007 for the City to review, the City would review the additional documentation and file any recommendations on or before July 30, 2007, and Taxpayer would file any reply on or before August 27, 2007. On July 25, 2007, the City filed recommendations. On August 30, 2007, Taxpayer sent an email requesting an extension for its reply. On September 1, 2007, the Hearing Officer granted Taxpayer an extension until September 17, 2007. On September 17, 2007, Taxpayer filed additional documentation with the City to support claimed deductions. On September 17, 2007, the Hearing Officer granted the City until October 9, 2007 to review the additional documentation and provide their recommendation(s). On September 27, 2007, the City filed additional recommendations. On October 2, 2007, the Hearing Officer granted Taxpayer until October 16, 2007 in which to file a reply. Taxpayer failed to file a reply.

City Position

The City conducted an audit of Taxpayer for the period of December 2002 through August 2006. The City assessed Taxpayer for additional taxes due in the amount of \$30,568.47, interest up through December 2006 in the amount of \$6,372.78, and penalties totaling \$6,137.45. Subsequently, the City waived \$4,538.78 of the penalties.

The City acknowledged that a new auditor had to be assigned to complete Taxpayer’s audit because the original auditor left the City in 2005. The City asserted Taxpayer had

not been informed that the audit had been completed. The new auditor determined the available records did not correspond to the amounts reported to either the City or the State of Arizona ("State"). According to the City, Taxpayer was informed that additional documentation was needed to verify the subcontracting and out-of-City deductions. The auditor indicated an attempt was made several times in June and July 2006 to contact Taxpayer and either Taxpayer was not there and messages were left or Taxpayer did not have time to look at the income worksheets provided by the City. According to the City, there was never any mention by Taxpayer that the business was going to be closed and/or the owners were going to file for personal bankruptcy.

The City auditor was the lead jurisdiction for the City and for the State. The auditor compared the reported gross income for each month that had been reported to the City and the State. The City determined Taxpayer had both contracting and retail income. The City indicated that for most months, Taxpayer reported the same gross income to both City and State. In the months they differed, the City utilized the higher gross income in the audit assessment. For contracting taxable income, Taxpayer had deducted subcontracting and out-of-City contracting. The City disallowed both because Taxpayer failed to provide sufficient documentation. Under the rental classification, Taxpayer deducted labor, out-of-City sales, motor fuel expenses, exempt hospital sales, bad debts, and discounts. The City disallowed the motor fuel deduction as it was an expense item and they disallowed out-of-City sales because Taxpayer did not have an out-of-City location to make a retail sale. The City opined the remaining deductions were disallowed because of the lack of sufficient documentation.

The City reviewed additional documentation provided by Taxpayer after the hearing. Taxpayer was to provide income records and documentation to verify deductions for sales-for-resale and for subcontracting jobs. As a result of the additional documentation provided by Taxpayer, the City did a redetermination of the original audit assessment. The tax assessment was reduced from \$30,568.47 to \$13,691.88, interest was reduced from \$6,372.78 to \$3,063.12, and penalties were reduced from \$1,598.67 to \$931.41.

The City reviewed the information provided by Taxpayer on September 17, 2007. Taxpayer had provided the City with fifteen State of Arizona Form 5005 exemption certificates ("Form 5000") based on the list of disallowed subcontracting jobs from the audit. After review, the City accepted eleven of them. Based on the City's review of all the documents, the City recommended the tax assessment be reduced to \$12,020.52, interest of \$2,862.52, and penalties of \$931.41.

Taxpayer Position

Taxpayer argued the City's assessment was too high. Taxpayer opined that its original tax returns were accurate and only about \$4000.00 of taxes were owed for returns sent in without payment. Taxpayer indicated the business closed in August of 2006. Shortly before the business was closed, the City contacted Taxpayer requesting clarification of some information in the records. According to Taxpayer, their records were all turned over to the Bankruptcy Trustee as a result of a personal bankruptcy filed by Taxpayer's

owners. Taxpayer asserted the landlord threw out all of the company's records. As a result, Taxpayer opined it was unable to provide records to the City to verify deductions. According to Taxpayer, the City's original auditor indicated there was nothing wrong with Taxpayer's returns. Subsequently, a new auditor was assigned to audit Taxpayer and had questions about Taxpayer's invoices. Taxpayer asserted that if the City had completed the audit in a timely manner Taxpayer would have had the needed documents. Subsequent to the hearing, Taxpayer provided additional documentation on July 2, 2007 and again on September 17, 2007. Taxpayer provided documentation to support income amounts and documentation to verify deductions for resale and for subcontracting jobs.

ANALYSIS

There was no dispute that Taxpayer had contracting and retail income during the audit period. It was also clear that Taxpayer claimed exemptions/deductions from its taxable gross income. City Code Section 19-360 ("Section 360") requires taxpayers to maintain books and records to support claimed deductions/exemptions. During the audit process, the City on several occasions requested documentation from Taxpayer. Since Taxpayer failed to provide any documentation to support claimed deductions/exemptions, it was proper for the City to disallow the claimed deductions/exemptions. Subsequent to the hearing, Taxpayer provided documentation to support some of the claimed deductions/exemptions. As a result, after review of the additional documentation, it was proper for the City to recommend adjustments to the assessment. We hereby approved the City's recommended adjustments set forth in the City's July 25, 2007 and September 27, 2007 letters. Based on the above, Taxpayer's protest should be partly granted and partly denied.

FINDINGS OF FACT

1. On March 15, 2007, Taxpayer filed a protest of a tax assessment made by the City.
2. After review, the City concluded on March 19, 2007 that the protest was timely and in the proper form.
3. On March 26, 2007, the Hearing Officer ordered the City to file any response to the protest on or before May 10, 2007.
4. On May 7, 2007, the City filed a response to the protest.
5. On May 11, 2007, the Hearing Officer ordered Taxpayer to file any reply on or before June 1, 2007.
6. On May 21, 2007, a Notice schedule the matter for hearing commencing on June 18, 2007.

7. Both parties appeared and presented evidence at the June 18, 2007 hearing.
8. On June 19, 2007, the Hearing Officer indicated Taxpayer would be filing additional documentation on or before July 2, 2007 for the City to review, the City would review the additional document and file any recommendations on or before July 30, 2007, and Taxpayer would file any reply on or before August 27, 2007.
9. On July 25, 2007, the City filed recommendations.
10. On August 30, 2007, Taxpayer sent an email requesting an extension for its reply.
11. On September 1, 2007, the Hearing Officer granted Taxpayer an extension until September 17, 2007.
12. On September 17, 2007, Taxpayer filed additional documentation with the City to support claimed deductions.
13. On September 17, 2007, the Hearing Officer granted the City until October 9, 2007 to review the additional documentation and provide recommendation(s).
14. The City conducted an audit of Taxpayer for the period of December 2002 through August 2006.
15. The City assessed Taxpayer for additional taxes due in the amount of \$30,368.47, interest up through December 2006 in the amount of \$6,372.78, and penalties totaling \$6,137.45.
16. The City waived \$4,538.78 of the penalties.
17. The auditor that started Taxpayer's audit left the City before completing the audit.
18. Another auditor was assigned to complete the audit and determined the available records from Taxpayer did not correspond to the amounts reported by the Taxpayer to either the City or the State.
19. Taxpayer was informed by the City that additional documentation was needed to verify the subcontracting and out-of-City deductions.
20. Taxpayer failed to provide additional documentation requested by the City.
21. Taxpayer closed the business in August of 2006 and the owners filed for personal bankruptcy.
22. Taxpayer did not inform the City that it was going to close the business and that the owners were going to file for personal bankruptcy.

23. The City auditor was the lead auditor for both the City and the State.
24. The City compared the reported gross income for each month that had been reported to the City and the State.
25. For most of the months in the audit, Taxpayer reported the same amounts to the City and the State.
26. In the months in which the City and State reports differed, the City utilized the higher gross income in the audit assessment.
27. The City disallowed deductions claimed by Taxpayer because of the lack of sufficient documentation.
28. In conjunction with the personal bankruptcy filed by Taxpayer's owners, Taxpayer's landlord threw out many of the company's records.
29. The City reviewed additional documentation provided by Taxpayer after the hearing.
30. As a result of the additional documentation provided by Taxpayer, the City did a July 25, 2007 redetermination of the original audit assessment.
31. The tax assessment was reduced from \$30,568.47 to \$13,691.88, interest was reduced from \$6,372.78 to \$3,063.12, and penalties were reduced from \$1,598.67 to \$931.41.
32. On September 17, 2007, Taxpayer provided documentation including fifteen Form 5000's based on the list of disallowed subcontracting jobs from the City audit.
33. After review of Taxpayer's September 17, 2007 documentation, the City recommended on September 27, 2007 to reduce the tax assessment to \$12,020.52, interest up through September 30, 2007 reduced to \$2,862.52, and penalties of \$931.41.
34. On October 2, 2007, the Hearing Officer granted Taxpayer until October 16, 2007 in which to file a reply.
35. Taxpayer failed to file a reply.

CONCLUSIONS OF LAW

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. During the audit period, Taxpayer had contracting income pursuant to Section 415.
3. During the audit period, Taxpayer had retail income pursuant to Section 460.
4. During the audit period, Taxpayer claimed deductions/exemptions from its taxable contracting income and from its taxable retail income.
5. Pursuant to Section 360, the burden of proof is on Taxpayer to provide documentation to support deductions/exemption.
6. As part of the audit process, Taxpayer failed to meet its burden of proof pursuant to Section 360.
7. Subsequent to the hearing, Taxpayer provided documentation to support some deduction/exemptions.
8. It was proper to revise Taxpayer's assessment as a result of the post-hearing documentation that was provided by Taxpayer.
9. Taxpayer's protest should be partly granted and partly denied, consistent with the Discussion, Findings, and Conclusions, herein.

ORDER

It is therefore ordered that the March 15, 2007 protest of *Taxpayer ABC* of a tax assessment made by the City of Tucson is hereby partly granted and partly denied, consistent with the Discussion, Findings, and Conclusions, herein.

It is further ordered that the City of Tucson shall revise *Taxpayer ABC* assessment consistent with the City's July 25, 2007 and September 27, 2007 letters.

It is further ordered that this Decision is effective immediately.

Jerry Rudibaugh
Municipal Tax Hearing Officer