

DECISION OF MUNICIPAL TAX HEARING OFFICER

Decision Date: October 27, 2008

Decision: MTHO #'s 413/418

Taxpayer A/Taxpayer B

Tax Collector: City of Glendale

Hearing Date: May 20, 2008

DISCUSSION

Introduction

On January 11, 2008, "***Taxpayer A***" filed a protest of a tax assessment made by the City of Glendale ("City"). On January 31, 2008, "***Taxpayer B***" filed a protest of a tax assessment made by the City. Taxpayer A and Taxpayer B will be hereafter collectively referred to as Taxpayers. On February 11, 2008, the Municipal Tax Hearing Officer ("Hearing Officer") concluded the protest by Taxpayer A was timely and in the proper form and ordered the City to file a response to the protest on or before March 27, 2008. After review, the City concluded on February 26, 2008 that Taxpayer B's protest was timely and in the proper form. On March 4, 2008, the Hearing Officer ordered the City to file a response to Taxpayer B's protest on or before April 18, 2008. On March 25, 2008, the City filed a response to the protest of Taxpayer A. On March 31, 2008, the Hearing Officer ordered Taxpayer A to file any reply on or before April 21, 2008. On April 17, 2008, the City filed a response to the protest of Taxpayer B. On April 18, 2008, a Notice of Tax Hearing ("Notice") scheduled a consolidated hearing for Taxpayers. On April 21, 2008, the Hearing Officer ordered Taxpayer B to file any reply on or before May 12, 2008. The City and Taxpayers appeared and presented evidence at the May 20, 2008 hearing. On May 22, 2008, the Hearing Officer indicated the parties had agreed to the following post hearing schedule: Taxpayers would provide company comparables for the City to review on or before June 3, 2008; the City would review the comparables and provide any comments/recommendations on or before June 17, 2008; and, Taxpayers would file any reply on or before June 24, 2008. On May 22, 2008, Taxpayers filed a request for a two week extension. On May 27, 2008, the Hearing Officer granted Taxpayers an extension until June 17, 2008 in which to file comparables; an extension for the City to file any comments/recommendations until July 1, 2008; and, an extension until July 8, 2008 for Taxpayers to file a reply. On June 3, 2008, Taxpayers filed a Motion to Compel. On June 11, 2008, the Hearing Officer denied the Motion to Compel. On June 13, 2008, Taxpayers requested another two week extension. On June 19, 2008, the Hearing Officer granted Taxpayers an extension until July 1, 2008 to file comparables; the City an extension until July 15, 2008 to file any comments/recommendations; and, Taxpayers an extension for a reply until July 22, 2008. On July 10, 2008, Taxpayers filed a response as well as another request for an extension. On July 14, 2008, the Hearing Officer extended the City's deadline for

comments/recommendations until August 11, 2008 and Taxpayers reply deadline was extended to August 18, 2008. On August 10, 2008, the City filed comments/recommendations. On August 22, 2008, the Hearing Officer indicated no reply had been filed by Taxpayers and as a result the record was closed and a written decision would be issued on or before October 6, 2008. On September 11, 2008, Taxpayers filed a Motion to Reopen. On September 12, 2008, the Hearing Officer granted the City until September 22, 2008 to file a response to the Motion to Reopen and Taxpayers until September 29, 2008 to file a reply. On September 16, 2008, the City filed a response to the Motion to Reopen. On October 6, 2008, the Hearing Officer indicated no reply had been filed by Taxpayers and as a result the Motion to Reopen was denied and the deadline for a written decision was extended until October 27, 2008.

City Position-Taxpayer A

The City performed an audit of Taxpayer A for the period October 2001 through August 2007. The City assessed Taxpayer A for additional taxes in the amount of \$9,742.20, penalties for failure to file reports and failure to timely pay taxes in the amount of \$1,441.20, and interest up through October 2007 in the amount of \$2,714.10.

The City determined Taxpayer A owned and operated a self service carwash in the City during the audit period. The City requested documentation from Taxpayer A to determine the gross receipts for the audit period. Taxpayer A was unable to provide any documentation. As a result, the City utilized comparable companies to estimate Taxpayer A's gross receipts for the audit period. The City informed Taxpayer A that if additional relevant documentation was provided, the City would review and consider such documentation. The City asserted that no such documentation was provided. The City did receive information from Taxpayer A that its cash deposits are consolidated with other cash deposits for fifteen other companies with approximately thirty different properties all owned by "*Managing Company*". The City asserted a reasonable and prudent business person would not combine income from separate legal business entities. According to the City, Taxpayer A did provide a schedule which was to represent the income for the business. In reviewing the schedule, the City noted there was no reasonable correlation between the water usage and the income listed. For example; July 2007 showed water usage of 110 units and income of \$4,137.00 while October 2007 showed water usage of 51 units and income of \$4,226.00. The City asserted there was no supporting documentation provided with Taxpayer A's schedules to explain these inconsistencies.

The City noted that the City Code Section 21.1-555(e) ("Section 555(e)") provides that the fact a taxpayer fails to maintain or provide necessary books and records do not preclude the City from making an assessment. Section 555(e) authorizes the City to use estimates to determine the amount of tax. City Code Section 21.1-545(b) ("Section 545(b)") states that any estimate made by the City must be made on a reasonable basis. Section 545(b) further provides that it is the responsibility of the taxpayer to prove the City's estimate is not reasonable.

The City indicated it visited Taxpayer A's business location and the locations of three similar businesses located in the City. According to the City, Taxpayer A had five manual bays, one automatic bay and seven vacuums; the first comparable company had six manual bays and nine vacuums; the second comparable company had five manual bays and four vacuums; and, the third comparable had five manual bays and six vacuums. The City determined the average monthly income for the three comparables for the year 2006. The average monthly income was determined to be \$8,327.46. The City compared the average water usage of 856 units to Taxpayer A's average water usage of 708 units to conclude the water usage was reasonably close. The City then utilized the Consumer Price Index ("CPI") to estimate the income for the remainder of the audit period.

The City noted that City Code Section 21.1-350(a) ("Section 350") states that: "It shall be the duty of every person subject to the tax imposed by this Chapter to keep and preserve suitable records and such other books and accounts as may be necessary to determine the amount of tax for which he is liable under this Chapter...." The City indicated City Code Regulation 21.1-350.1 ("Regulation 350") states that: "The minimum records required for persons having gross income subject to, or exempt or excluded from, tax by this Chapter must show (a) the gross income of the taxpayer attributable to any activity occurring in whole or in part in the City...."

The City argued that every opportunity was given to Taxpayer A to provide reasonable and reliable records. According to the City, no such records were ever provided. Further, the City asserted Taxpayer A has failed to show the City estimates were not conducted on a reasonable basis. Based on all the above, the City requested the assessment be upheld.

City Position- Taxpayer B

The City performed an audit of Taxpayer B for the period January 2002 through December 2007. The City assessed Taxpayer B for additional taxes in the amount of \$5,114.57, interest up through January 2008 in the amount of \$1,416.78, and penalties for failure to file reports and failure to timely pay taxes in the amount of \$743.40.

The City determined that Taxpayer B owned and operated a self service carwash in the City during the audit period. Taxpayer B had three manual bays and three vacuums. According to the City, the average usage for Taxpayer B was 493 units. For the same reasons set forth for Taxpayer A, the City estimated Taxpayer B's gross receipts for the audit period. The City utilized the same comparable companies that were used to estimate Taxpayer A's gross receipts. Because Taxpayer B had only about fifty percent of the machines that Taxpayer A had and Taxpayer B's average water usage was only about fifty percent of the 856 average usage of the comparable companies, the City utilized fifty percent of the comparables average monthly income to estimate Taxpayer B's gross receipts. All the City arguments set forth herein for Taxpayer A would also apply to Taxpayer B.

Taxpayers Position

Taxpayers protested the amount of tax, penalty and interest. Taxpayers asserted that the City arrived at an arbitrary amount by utilizing comparable companies. Taxpayer argued that the City has violated Taxpayers' due process rights by refusing to provide the identity of the comparable companies. According to Taxpayers, the City refused to review evidence of vandalism that would show the income was low because of the vandalism impact.

Taxpayers acknowledged that the Managing Company had all of its companies/properties deposit monies into the same bank account. As a result, Taxpayers were unable to show their individual incomes separately. Taxpayers opined that if credit card sales were utilized to estimate the gross income, the estimate would be substantially less than the City's estimate.

Taxpayer indicated no tax reports were filed with the City or taxes paid because Taxpayers were unaware of the tax. According to Taxpayers, the City of Phoenix does not assess such a tax for car washes located in Phoenix. As a result, Taxpayers requested any penalties be waived.

ANALYSIS

Taxpayers clearly were in the self-service car wash business in the City during their respective audit periods. Since the City has adopted Model Option No. 7, Taxpayers gross receipts from the car wash business are taxable. The Code makes it clear that it is the responsibility of the Taxpayers to maintain proper books and records to determine the amount of the gross income pursuant to Section 350 and Regulation 350.

The City requested Taxpayer provide documentation to determine the proper amount of tax but no documentation was provided. Because the deposits for Taxpayers were commingled with deposits from fifteen companies owned by the Managing Company, the City was unable to determine the gross income of the Taxpayers. As a result, the City was authorized pursuant to Section 545 to make an estimate of the amount of taxes due. Section 545 provides that the estimate must be made on a reasonable basis. Section 545 places the burden of proof on Taxpayers to prove the City's estimate is not reasonable and correct. In this case, the City utilized information from comparable companies located in the City to estimate the gross income of Taxpayers for the year of 2006. The City determined that the average water usage for the three companies to be 856 units while Taxpayer A had an average rate usage of 708 units. The City concluded that the water usage was reasonably close and used the average gross income from the comparables to estimate Taxpayer A's gross income for the year 2006. The City then utilized the CPI index to estimate the gross usage of the other years of the audit. The City utilized the exact same methodology for Taxpayer B with the exception that the gross income amounts were reduced to reflect the water usage for Taxpayer B was 493 units or approximately fifty percent of the water usage of the comparables.

The primary issue is whether or not the City's estimation methodology was reasonable.

We conclude that the City's method of utilizing comparable companies within the City to be a reasonable basis for an estimation. We do have a concern on whether or not the City's use of three comparables unfairly skewed the results. The average water usage for the three comparables was 574 units, 923 units and 1022 units, respectively. The average for these comparables was 856 units or approximately twenty-one percent higher than the average 708 units of Taxpayer A.

At the same time, the City utilized fifty percent of the comparables on an average of 428 units for Taxpayer B whose water usage was 493 units or approximately fifteen percent higher. As a result, we conclude that the City's overall estimate for Taxpayers was reasonable and will approve the City's estimation methodology and results.

Taxpayers complained because the City would not divulge the names of their comparable companies. First, we want to make it clear that the City's use of comparables resulted from the fact that Taxpayers did not provide records and documentation as required by the Code to demonstrate the appropriate amount of tax. Secondly, the City is prohibited by Section 510 of divulging the names of the comparables. Thirdly, Taxpayer were given several opportunities to come up with their own comparables but failed to do so. Lastly, Section 545 makes it absolutely clear that Taxpayers had the burden of proving the City's estimate was not reasonable by providing sufficient documentation of the type and form required by the Code. Taxpayers have failed to meet their burden of proof.

Since Taxpayers failed to timely file tax reports and failed to timely pay taxes, the City was authorized to assess penalties. These penalties may be waived if Taxpayers could demonstrate reasonable cause. Taxpayers indicated there were unaware they had to file returns and pay City taxes as they did not have to do so for the City of Phoenix. We conclude Taxpayers have demonstrated reasonable cause for failing to file returns and failing to pay taxes. Section 450 permits some cities to adopt Model Option #7 which permits them to tax coin-operated car washing machines. As a result, some cities tax the car washes and some do not. Based on the above, we shall waive all penalties assessed in this matter.

FINDINGS OF FACT

1. On January 11, 2008, Taxpayer A filed a protest of a tax assessment made by the City.
2. On January 31, 2008, Taxpayer B filed a protest of a tax assessment made by the City.
3. On February 11, 2008, the Hearing Officer concluded that the protest by Taxpayer A was timely and in the proper form and ordered the City to file a response to the protest on or before March 27, 2008.

4. After review, the City concluded on February 26, 2008 that Taxpayer B's protest was timely and in the proper form.
5. On March 4, 2008, the Hearing Officer ordered the City to file a response to Taxpayer B's protest on or before April 18, 2008.
6. On March 25, 2008, the City filed a response to the protest to Taxpayer A.
7. On March 31, 2008, the Hearing Officer ordered Taxpayer A to file any reply on or before April 21, 2008.
8. On April 17, 2008, the City filed a response to the protest of Taxpayer B.
9. On April 18, 2008, a Notice scheduled a consolidated hearing for Taxpayers.
10. On April 21, 2008, the Hearing Officer ordered Taxpayer B to file any reply on or before May 12, 2008.
11. The City and Taxpayers appeared and presented evidence at the May 20, 2008 hearing.
12. On May 22, 2008, the Hearing Officer indicated that the parties had agreed to the following post-hearing schedule: Taxpayers would provide company comparables for the City to review on or before June 3, 2008; the City would review the comparables and provide any comments/recommendations on or before June 17, 2008; and, Taxpayers would file any reply on or before June 24, 2008.
13. On May 22, 2008, Taxpayers filed a request for a two week extension.
14. On May 27, 2008, the Hearing Officer granted Taxpayers an extension until June 17, 2008 to file comparables; an extension for the City to file any comments/recommendations until July 1, 2008; and, an extension until July 8, 2008 for Taxpayers to file a reply.
15. On June 3, 2008, Taxpayers filed a Motion to Compel.
16. On June 11, 2008, the Hearing Officer denied the Motion to Compel.
17. On June 13, 2008, Taxpayers requested another two week extension.
18. On June 19, 2008, the Hearing Officer granted Taxpayers an extension until July 1, 2008 to file comparables; the City an extension until July 15, 2008 to file any comments/recommendations; and, Taxpayers an extension for a reply until July 22, 2008.
19. On July 10, 2008, Taxpayers filed a response as well as another request for an

extension.

20. On July 14, 2008, the Hearing Officer extended the City's deadline for comments/recommendations until August 11, 2008 and extended Taxpayers reply deadline until August 18, 2008.
21. On August 10, 2008, the City filed comments/recommendation.
22. On August 22, 2008, the Hearing Officer indicated no reply had been filed by Taxpayers and as a result the record was closed and a written decision would be issued on or before October 6, 2008.
23. On September 11, 2008, Taxpayers filed a Motion to Reopen.
24. On September 12, 2008, the Hearing Officer granted the City until September 22, 2008 to file a response to the Motion to Reopen and Taxpayer until September 29, 2008 to file a reply.
25. On September 16, 2008, the City filed a response to the Motion to Reopen.
26. On October 6, 2008, the Hearing Officer indicated no reply had been filed by Taxpayer and as a result the Motion to Reopen was denied and the deadline for a written decision was extended to October 27, 2008.
27. The City performed an audit of Taxpayer A for the period October 2001 through August 2007.
28. The City assessed Taxpayer A for additional taxes in the amount of \$9,742.20, penalties for failure to file reports and failure to timely pay taxes in the amount of \$1,441.20, and interest up through October 2007 in the amount of \$2,714.10.
29. The City determined Taxpayer A owned and operated a self-service carwash in the City during the audit period.
30. The City requested documentation from Taxpayers to determine the gross receipts for the audit period.
31. Taxpayers never provided documentation requested by the City.
32. Taxpayers deposited monies into a consolidated account shared with fifteen other companies with approximately thirty different properties all owned by the Managing Company.
33. Taxpayer A provided a schedule which was to represent the income for the business.

34. The schedule provided by Taxpayer A showed water usage of 110 units for July 2007 and income of \$4,137.00; and water usage of 51 units and income of \$4,226.00 for October 2007.
35. Because of the lack of documentation, the City estimated the income and taxes due for Taxpayers.
36. Taxpayer A had five manual bays, one automatic bay, and seven vacuums with an average water usage of 708 units.
37. Taxpayer B had three manual bays and three vacuums and an average water use of 493 units.
38. The City utilized three comparable companies located in the City to estimate the incomes for Taxpayers.
39. The first comparable company had six manual bays and nine vacuums; the second comparable company had five manual bays and four vacuums; and, the third comparable company had five manual bays and four vacuums.
40. The comparable companies had average water usage of 574 units, 923 units and 1074 units, respectively.
41. The City determined the average monthly income for the three comparable companies for the year 2006 was \$8,327.46.
42. The City utilized the average monthly income for the three comparables to estimate the 2006 income for Taxpayer A and utilized fifty percent of that amount to estimate the 2006 income for Taxpayer B.
43. The City performed an audit of Taxpayer B for the period January 2002 through December 2007.
44. The City assessed Taxpayer B for additional taxes in the amount of \$5,114.57, interest up through January 2008 in the amount of \$1,416.78, and penalties for failure to timely file returns and for failure to timely pay taxes in the amount of \$743.40.
45. The City determined Taxpayer B owned and operated a self-service carwash in the City during the audit period.
46. Taxpayers had some vandalism during the audit period.
47. Taxpayers failed to file reports or timely pay taxes because they were unaware of the tax.

48. The City of Phoenix does not tax self-service carwashes located in Phoenix pursuant to Section 450.

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. Taxpayers were in the self-service carwash business in the City during their respective audit periods and their gross receipts were taxable pursuant to Section 450, Model Option No. 7.
3. Pursuant to Section 350 and Regulation 350, Taxpayers were required to maintain proper books and records to determine the amount of gross income.
4. Taxpayers failed to provide books and records requested by the City to determine the gross income of Taxpayers.
5. The City was authorized pursuant to Section 545 to make an estimate of the amount of taxes due.
6. The City's method of utilizing these comparable companies within the City was a reasonable basis for estimation.
7. The City's overall estimate for Taxpayers was reasonable and we shall approve the City's estimation methodology and results.
8. The City is prohibited by Section 510 of divulging the names of the comparables.
9. Taxpayers failed to meet their burden of proof pursuant to Section 545 of proving the City's estimate was not reasonable.
10. Since Taxpayers failed to timely report and failed to timely pay taxes, the City was authorized pursuant to Section 540 to assess penalties.
11. Taxpayers have demonstrated reasonable cause for failing to file returns and failing to pay taxes.
12. All penalties assessed should be waived.
13. The protests of Taxpayers should be partly denied and partly granted consistent with the Discussion, Findings and Conclusions, herein.

ORDER

It is therefore ordered that the January 11, 2008 protest of *Taxpayer A* and the January 31, 2008 protest of *Taxpayer B* of tax assessments made by the City of Glendale are hereby partly denied, and partly granted, consistent with the Discussion, Findings, and Conclusions, herein.

It is further ordered that the City of Glendale shall waive all penalties assessed against *Taxpayer A* and *Taxpayer B* in this matter.

It is further ordered that this Decision is effective immediately.

Municipal Tax Hearing Officer