

STATE OF ARIZONA

Department of Revenue
Office of the Director
(602) 716-6090



Janet Napolitano
Governor

Gale Garrriott
Director

CERTIFIED MAIL [Redacted]

**The Director's Review of the Decision
of the Hearing Officer Regarding:**

[Redacted]

Id No. [Redacted]

O R D E R

Case No. 200600005-S

On March 29, 2006 the Administrative Law Judge issued a decision regarding the protest of [Redacted] ("Taxpayer"). Taxpayer appealed this decision on April 21, 2006. The appeal being timely, the Director of the Department of Revenue ("Director") issued a notice of intent to review the decision.

In accordance with the notice given the parties, the Director has reviewed the Administrative Law Judge's decision and now issues this order.

Statement of Case

The Transaction Privilege and Use Tax Audit Section of the Audit Division of the Department ("Section") audited Taxpayer for the period of [Redacted] and issued a deficiency assessment to Taxpayer for the periods [Redacted]. Taxpayer protested the penalties and interest only and paid the tax assessed. After a hearing the Administrative Law Judge denied the protest. On appeal, Taxpayer requests forgiveness of penalties because they were doing business in Arizona for the first time. The Section argues that taxpayers have the duty to know and comply with the law, which Taxpayer did not do, and there is no reasonable cause to abate penalties.

Findings of Fact

The Director adopts from the findings of fact of the Administrative Law Judge and makes additional findings as follows:

1. Taxpayer is a construction company based in [Redacted] doing business in multiple states.
2. Taxpayer had [Redacted] projects in Arizona and received income from these activities in [Redacted].
3. Taxpayer did not perform any of the actual construction work, but had the construction completed through subcontractors.
4. The contracts Taxpayer had with the subcontractors stated that the subcontractors were responsible for any taxes to local jurisdictions and the requisite materials for the projects.
5. Taxpayer did not file any transaction privilege tax returns for the above periods.
6. In June 2005 the Section issued a proposed assessment reflecting tax, interest and penalties in the amount of \$[Redacted].
7. Taxpayer did not dispute that it owed the transaction privilege tax and paid the tax subsequent to the assessment.
8. While Taxpayer protested the interest, Taxpayer did not appeal the Administrative Law Judge's conclusion that the interest could not be abated.

Conclusions of Law

The Director adopts from the following conclusions of law of the Administrative Law Judge and makes additional conclusions as follows:

1. A.R.S. § 42-1125 requires assessment of penalties for late filing and late payment and allows abatement only if the failure to timely comply is due to reasonable cause and not due to willful neglect.
2. A.R.S. §§ 42-1125(S) and 42-2062(C) provide that for purposes of the transaction privilege tax “reasonable cause” means a reasonable basis for the taxpayer to believe that the tax did not apply to the business activity.
3. Taxpayer did not state it believed its business activity was not subject to transaction privilege tax and established no reasonable basis for a belief that it’s business activity was not subject to transaction privilege tax
4. Reasonable cause to abate also is established if the taxpayer demonstrates that he exercised ordinary business care and prudence but nevertheless was unable to file the return or pay the tax within the prescribed time. *See, Sarto v. United States*, 563 F. Supp. 476 (N.D. Cal. 1983), *Daley v. United States*, 480 F. Supp. 808 (D.N.D. 1979).
5. Reliance on subcontractors to tell Taxpayer of a tax obligation is not the exercise of ordinary business care. *See, United States v. Boyle*, 105 S.Ct. 687 (1985).
6. Taxpayer had the obligation to determine its filing and payment obligations and comply. *Newman v. Fidelity Savings and Loan Association*, 14 Ariz. 354, 128 P. 53 (1912); *Heller v. Commissioner*, 40 T.C.M. 1338 (1980).
7. Every person is presumed to know the law and its requirements and a mistake as to such requirements is no excuse for failure to meet them. *Newman v. Fidelity Savings and Loan Association*, 14 Ariz. 354, 128 P. 53 (1912).
8. There was no reasonable cause for the late filings and payments; therefore, penalties cannot be abated.
9. The Section’s assessment of penalties is proper.

Discussion

Taxpayer had an obligation to file transaction privilege tax returns and pay its transaction privilege tax obligations monthly. A.R.S. § 42-5014. Taxpayer did not understand its tax obligations because it had not done business in Arizona before. Taxpayer failed to file and pay. Furthermore, in the hearing process, Taxpayer argued it relied upon the subcontractors to say there were tax obligations. A.R.S. § 42-1125(A) provides that if a taxpayer fails to file a return on or before the due date, a penalty "shall be added to the tax" unless the failure is due to reasonable cause and not due to willful neglect. Similarly, A.R.S. § 42-1125(D) provides that if a person fails to pay the tax within the time prescribed, a penalty "shall be added to the amount shown as tax" unless the failure is due to reasonable cause and not due to willful neglect.

As provided by statute, penalties for failure to timely file and pay tax may not be avoided unless Taxpayer demonstrates that failure to file and pay was due to reasonable cause. *People of Faith, Inc. v. Arizona Dept. of Revenue*, 171 Ariz. 140, 154, 829 P.2d 330, 344, (App. 1992). "Reasonable cause" is defined by A.R.S. §§ 42-1125(S) and 42-2062(C) to mean "a reasonable basis for the taxpayer to believe that the tax did not apply to the business activity..." While Taxpayer did not understand that it was liable for transaction privilege tax at the time it received income from its projects, it has subsequently accepted this obligation and has paid the tax. Taxpayer has not produced any evidence showing a reasonable basis to believe that the tax did not apply to its prime contracting business activity. Therefore, A.R.S. §§ 42-1125(S) and 42-2062(C) do not aid Taxpayer in establishing reasonable cause to abate.

Reasonable cause also can be established by demonstrating that, despite the taxpayer's exercise of ordinary business care and prudence, the taxpayer was unable to meet a deadline or requirement. *See, Sarto v. United States*, 563 F. Supp. 476 (N.D. Cal. 1983), *Daley v. United States*, 480 F. Supp. 808 (D.N.D. 1979). Taxpayer did not attempt to determine its tax obligations when it came into a new state to do business. Instead, Taxpayer counted on subcontractors to inform it of Arizona's tax obligations and attempted to make the subcontractors liable for taxes by a provision in the contract.

Every person is presumed to know the law and its requirements and a mistake as to such requirements is no excuse for failure to meet them. *Newman v. Fidelity Savings and Loan Association*, 14 Ariz. 354, 128 P. 53 (1912). Taxpayer had the obligation to determine its filing and payment obligations and comply. *Id.*; *Heller v. Commissioner*, 40 T.C.M. 1338 (1980). Reliance on someone who is an agent or employee does not constitute reasonable cause. See, *Pioneer Automobile Service Co. v. Commissioner of Internal Revenue*, 36 B.T.A. 213 (1937); *Janice Leather Imports Ltd. v. United States*, 391 F. Supp. 1235 (1974); *United States v. Boyle*, 105 S. Ct. 687 (1985). There is even less reason to rely on subcontractors than agents or employees. Taxpayer did not exercise ordinary business care and prudence in relying on subcontractors.

There is no reasonable cause to abate the penalties.

ORDER

The Administrative Law Judge's decision is affirmed.

This decision is the final order of the Department of Revenue. Taxpayer may contest the final order of the Department in one of two manners. Within 60 days of the receipt of the final order, Taxpayer may file an appeal to the State Board of Tax Appeal, 100 North 15th Avenue, Suite 140 Phoenix, AZ 85007 Phoenix, AZ 85003) or Taxpayer may bring an action in Tax Court (125 West Washington, Phoenix, Arizona 85003). For appeal forms and other information from the Board of Tax Appeals, call (602) 364-1102. For information from the Tax Court, call (602) 506-3763.

Dated this 3rd day of October, 2006.

ARIZONA DEPARTMENT OF REVENUE

Gale Garriott
Director

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Certified original of the foregoing
mailed to:

[Redacted]

Copy of the foregoing mailed to:

[Redacted]

GG:st

cc: Audit Division
Transaction Privilege and Use Tax Audit Section
Transaction Privilege Tax Appeals Section