

**Jerry Rudibaugh**  
**Municipal Tax Hearing Officer**

**DECISION OF MUNICIPAL TAX HEARING OFFICER**

Decision Date: October 25, 2002

Decision: MTHO #12

Tax Collector: City of Phoenix

Hearing Date: April 11, 2002

**DISCUSSION**

**Introduction**

On September 14, 2001, Taxpayer Restaurant ("Taxpayer") filed a protest petition of the City of Phoenix ("City") tax assessment. After review the City concluded on September 21, 2001 that the protest was timely but not in proper form. On October 1, 2001, the Municipal Tax Hearing Officer ("Hearing Officer") granted the Taxpayer an extension until November 15, 2001 to correct the form of its protest. On November 15, 2001 the Taxpayer amended the form of its protest letter. On November 26, 2001, the Hearing Officer issued a letter ordering the Taxpayer to file a copy of any purchase agreement on or before December 26, 2001 and the City to file a response to the Taxpayer's protest on or before January 10, 2002. On January 21, 2002, the Hearing Officer granted the City an extension until February 4, 2002 to file its response since the Taxpayer had failed to provide any purchase agreement. On January 29, 2002, the City filed its response to the protest. On February 11, 2002, the matter was set for hearing commencing on April 11, 2002. Both the Taxpayer and the City appeared and presented evidence at the April 11, 2002 hearing. The Taxpayer filed a hearing memorandum on April 11, 2002. The Taxpayer filed a supplemental hearing memorandum on June 10, 2002. The City filed a response memorandum on August 22, 2002. The Taxpayer filed a reply memorandum on September 6, 2002. On September 26, 2002, the Hearing Officer issued a letter indicating the record was closed and a written decision would be issued on or before October 25, 2002.

The Taxpayer applied for a Transaction Privilege Tax. License ("PLT License") with the City on XXX YY, 1994 for the location on N. \_\_\_\_ Avenue ("\_\_\_\_ Avenue Location"). The owner on the application was identified as Mr. A as the "sole owner". The business start date on the application was November 1993. The City reviewed the Taxpayer's records and compared the monthly amounts reported to the City to the amounts reported by the Taxpayer on its federal tax returns.

Based on their review, the City concluded the amounts reported on the federal tax returns were substantially higher than the amounts reported to the City. Since the difference was in excess of 25 percent, the City extended the audit review period an additional two years to March 1995. On August 17, 2001, the City assessed the Taxpayer for the period March 1995 through December 2000 for taxes in the amount of \$26,459.26, a penalty for failing to file taxes in a timely manner in the amount of \$2,651.62, and interest through July 2001 in the amount of \$16,137.24.

**City Position**

In February of 1994, Mr. A applied for a PLT License with the City and identified himself as the sole owner of the business. In addition, all of the federal income tax returns filed by Mr. A during the period in question indicated that

Mr. A was the "proprietor" of Taxpayer. The City argued those facts were sufficient to uphold the assessment. In addition, the City argued that there is no requirement under the City Code that Mr. A be the owner of the restaurants in order to assess him for the underpayment of the taxes. The City asserted there was no dispute that the Taxpayer was running the restaurant during the applicable period. As a result of the Taxpayer being engaged in the restaurant business, the City argued that was enough to support the City's assessment whether or not Mr. A was the "real owner" of the restaurant.

According to the City, Section 14-300 ("Section 300") of the City Code requires every person desiring to engage or continue in business activities within the City to apply for a privilege license. Further, the City indicated that Section 14-400 (a) ("Section 400a") of the City Code imposes a privilege tax upon persons on account of their business activities, to the extent provided elsewhere in the code. Lastly, the City argued that Section 14-455 ("Section 455") of the City Code imposes a tax on the gross income from the business activity "upon every person engaging or continuing in the business of ... restaurant". As a result, the City argued that the tax is imposed on one engaged in the business of operating a restaurant and there is no provision that it is only the "owner" of the restaurant that is responsible for paying the tax to the City.

### **Taxpayer Position**

The Taxpayer asserted that he was not the owner of the restaurant but only the manager of the business. According to the Taxpayer, the Taxpayer Restaurants were started by the T-Q brothers ("T Brothers") in the early 1990's and were defacto partnerships or sole proprietorships. Mr. A worked for the T Brothers in California. On October 15, 1993 two of the T Brothers entered into a commercial lease for \_\_\_\_ Avenue Location. One of the T's signed as personal guarantor of the lease. At about the same time, Mr. A was offered the job of managing the restaurant at the \_\_\_\_ Avenue Location and he accepted the job. The T Brothers hired a CPA to do their tax work. The CPA filled out the PLT License application and had Mr. A sign the document. Mr. A did not understand what he was signing as he did not speak, nor understand English at that time. According to the Taxpayer, he never owned nor controlled the restaurant business at the \_\_\_\_ Avenue Location. During the audit time period, the T Brothers employed many Mexican workers who did not speak, nor understand much English. In addition, the T Brothers were under-reporting their income to various tax agencies. In January of 2000, the T Brothers pleaded guilty in federal district court to one count of Conspiracy to Engage in a Pattern and Practice of Hiring Unauthorized Aliens ("Conspiracy") and one count of Conspiracy to Commit Tax Fraud ("Tax Fraud").

The Taxpayer argued that the tax liabilities involved herein accrued during the ownership of the business by the T Brothers. According to the Taxpayer, Mr. A did not begin to run the business until the T Brothers were incarcerated. On June 10, 1998, Mr. A entered into a licensing agreement ("Agreement") with L, Inc. ("L"). L was the successor in interest to the T Brothers with regards to the Taxpayer Restaurants. Mr. A was identified in the Agreement as the sole proprietor of the \_\_\_\_ Avenue Location.

The Taxpayer argued that Arizona law does not support the City's argument that Mr. A need not be the owner in order for the City to assess him taxes. The City Code defines a person to be a distinct and separate person from any partnership or joint venture or other association. According to the Taxpayer, Mr. A is distinct and separate from the partnership of the T Brothers, who were the owners of the restaurant at the \_\_\_\_ Avenue Location. According to the Taxpayer, Mr. A was running the restaurant as a manager and cannot be responsible for the acts of the T Brothers partnerships. The Taxpayer asserted that if the City position were to be accepted, every manager of every business would be liable for the transaction privilege tax. While Mr. A had filed federal income tax, which evidenced his interest in the restaurant, he was permitted through his pleas agreement to amend all personal income tax returns. The liability for those taxes was attributed to the T Brothers. The Taxpayer concluded that the income tax obligation belonged to the T Brothers, as does the transaction privilege obligation.

### **ANALYSIS**

Based on the evidence, it is clear that the income for the restaurant at the \_\_\_\_ Avenue Location was under-reported for the audit period. It is also clear that Mr. A managed and operated the restaurant business during the audit period.

We also conclude that the owner of the \_\_\_\_ Avenue Location during the period of under-reporting was the T Brothers. The sole issue is whether or not Mr. A can be assessed by the City for the taxes, penalty, and interest for the under-reporting for the \_\_\_\_ Avenue Location. The City has argued that the fact that Mr. A was running the restaurant during the applicable period is sufficient enough to assess Mr. A even though he was not the "real owner". We concur with the Taxpayer that the City's argument would not pass a common sense test, since the end result of the City's argument would result in every manager of a taxable business being potentially liable for paying the taxes for their respective business. Accordingly, we reject the City's primary argument. However, we also reject the Taxpayer's primary argument that only the actual owner of a business can be assessed for the tax liability herein. In this case, Mr. A went beyond the normal managerial responsibilities and held himself out to the City to be the actual owner of the \_\_\_\_ Avenue Location. Mr. A signed the PLT License application as the owner and signed federal tax returns as the owner. In addition, Mr. A signed the monthly sales tax returns filed with the City as being accurate even though he knew the numbers were too low. Mr. A did this for approximately three years to the detriment of the City. We recognize that Mr. A was afraid of losing his job if he did not continue to file false sales tax returns. However, there was no evidence to demonstrate that Mr. A made any effort to search for other employment in order to get out of a situation that he knew was wrong and illegal. Instead, Mr. A continued to knowingly file false sales tax returns to the detriment of the City. Based on the overall evidence, we must conclude that while Mr. A was not the actual owner of the \_\_\_\_ Avenue Location, he held himself out to the City as the defacto owner and knowingly filed false tax returns for approximately three years. Accordingly, the protest of the Taxpayer is denied.

#### **FINDINGS OF FACT**

1. On September 14, 2001, Taxpayer filed a protest petition of a City tax assessment.
2. After review, the City concluded on September 21, 2001 that the protest was timely but not in proper form.
3. On October 1, 2001, the Hearing Officer granted the Taxpayer an extension until November 15, 2001 to correct the form of its protest.
4. On November 15, 2001, the Taxpayer amended the form of its protest letter.
5. On November 26, 2001, the Hearing Officer issued a letter ordering the Taxpayer to file a copy of any purchase agreement on or before December 26, 2001, and the City to file a response to the Taxpayer's protest on or before January 10, 2002.
6. On January 21, 2002, the Hearing Officer granted the City an extension until February 4, 2002 to file its response since the Taxpayer had failed to provide any purchase agreement.
7. On January 29, 2002, the City filed its response to the protest.
8. On February 11, 2002, the matter was set for hearing commencing on April 11, 2002.
9. Both the Taxpayer and City appeared and presented evidence at the April 11, 2002 hearing.
10. The Taxpayer filed a hearing memorandum on April 11, 2002.
11. The Taxpayer filed a supplemental hearing memorandum on June 10, 2002.
12. The City filed a response memorandum on August 22, 2002.
13. The Taxpayer filed a reply memorandum on September 6, 2002.

14. The Hearing Officer issued a letter on September 26, 2002 indicating a written decision would be issued on or before October 25, 2002.
15. The Taxpayer applied for a PLT License with the City on February 8, 1994 for \_\_\_\_ Avenue Location.
16. The owner on the PLT application was identified as Mr. A.
17. The City compared the monthly amounts reported to the City with the monthly amounts reported by the Taxpayer on its federal tax returns.
18. Based on their review, the City concluded the amounts reported on the federal tax returns were substantially higher than the amounts reported to the City.
19. Since the difference was in excess of 25 percent, the City extended the audit review period an additional two years to March 1995.
20. On August 17, 2001, the City assessed the Taxpayer for taxes in the amount of \$26,459.26, a penalty for failing to file taxes in the amount of \$2,651.62, and interest through July 2001 in the amount of \$16,137.24.
21. The Taxpayer Restaurant was started by the T Brothers in the early 1990s, and was defacto partnerships or sole proprietorships.
22. On October 15, 1993, two of the T Brothers entered into a commercial lease for the \_\_\_\_ Avenue Location.
23. The T Brothers hired a CPA who had Mr. A sign the PLT License application.
24. Mr. A did not understand what he was signing as he did not speak, nor understand English at that time.
25. The T Brothers under-reported their income to various tax agencies.
26. In January of 2000, the T Brothers pleaded guilty in federal district court to one count of Conspiracy and one count of Tax Fraud.
27. On June 10, 1998, Mr. A entered into an Agreement with L for the \_\_\_\_ Avenue Location in which Mr. A was identified as the sole proprietor.
28. During the period the T Brothers owned the \_\_\_\_ Avenue Location, Mr. A filed federal income tax returns that evidenced his interest in the restaurant.
29. Mr. A was permitted to enter into a plea agreement to amend all personal income tax returns and the taxes were attributed to the T Brothers.
30. Mr. A was running the restaurant business at the \_\_\_\_ Avenue Location during the audit period.
31. Mr. A signed the PLT reports, as being accurate even though he knew the income was being under-reported.
32. There was no evidence that Mr. A made any effort to search for other employment in order to get out of a situation that he knew was wrong and illegal.

**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. The Taxpayer is in the restaurant business pursuant to Section 14-455 of the City Code.
3. The City is authorized to assess a penalty pursuant to Section 14-540 (c) of the city Code.
4. The City is authorized to assess interest pursuant to Section 14-540 (a) of the City Code.
5. Mr. A held himself out to the City to be the owner of the \_\_\_\_ Avenue Location.
6. Mr. A knowingly filed PLT reports on a monthly basis for approximately three years that substantially under-reported income to the detriment of the City.
7. Based on his overall actions, Mr. A was the defacto owner of the \_\_\_\_ Avenue Location for the purpose of the City privilege license tax.
8. It was proper for the City to assess Mr. A for the privilege license tax for \_\_\_\_ Avenue Location.
9. The protest of the Taxpayer should be denied.

**ORDER**

It is therefore ordered that the September 14, 2001 protest by Taxpayer Restaurant of the City of Phoenix tax assessment is hereby denied.

It is further ordered that this decision is effective immediately.

Jerry Rudibaugh

Municipal Tax Hearing Officer