

May 31, 2012

***Taxpayer's Representative
Address of Representative***

MTHO #684, 685 & 686

Dear Taxpayer's Representative:

We have reviewed the evidence submitted for redetermination by (*Taxpayers collectively*) and the City of Tucson (Tax Collector or City). The review periods covered were January 2007 through August 2011 for *Taxpayer #1* (MTHO # 684), June 2008 through August 2011 for *Taxpayer #2* (MTHO # 685) and May 2007 through August 2011 for *Taxpayer #3* (MTHO # 686). Taxpayer's protest, Tax Collector's response, and our findings and ruling follow.

Taxpayer's Protest

The Tax Collector issued assessments against three licenses. The assessments are incorrect and overstated. Taxpayers will provide additional information that was not taken into account in the audit. There was only one business entity operating and making sales at any given time and not three separate entities.

Tax Collector's Response

Taxpayers obtained three licenses that are still active with the City. None of the licenses have been cancelled. Taxpayers did not provide any business records to the auditor and the auditor could not determine where one license stopped and the other began. Taxpayers were requested to provide records to determine gross income and allowable deductions. The Tax Collector made several requests but Taxpayers failed to provide any records. The Tax Collector therefore based the assessment on an estimate of income. Taxpayers have not presented records or other documents to show that only one entity operated at any given time or that the Tax Collector's estimate of gross receipts was not reasonable and correct. The City's assessment should be upheld as issued.

Discussion

Taxpayers obtained three City privilege tax licenses for activities conducted at ***12345 Numbers Road in Tucson***. All three licenses were active during the audit periods. Two of the Taxpayers had filed some, but not all of the required privilege tax returns. The Tax Collector conducted an audit of Taxpayers.

The Tax Collector made several requests to Taxpayers for records to determine gross income and allowable deductions for each license. Taxpayers did not provide any business records such as sales journals, income tax returns or invoices. The only records Taxpayers provided during the audit process were copies of some State of Arizona privilege tax returns for two of the licenses.

Because the requested records were not provided, the Tax Collector issued estimated assessments. The Tax Collector estimated the monthly income for *Taxpayer #1*, MTHO # 684 and *Taxpayer*

#2, MTHO # 685) at \$24,190.48 which was the amount reported under *Taxpayer #1* in its October 2007 City privilege tax return. That was the highest income reported by *Taxpayers #1 & #2*. The Tax Collector used the highest reported net income because so few returns were filed and no records were provided.

The Tax Collector estimated the monthly income *Taxpayer #3*, MTHO # 686) at \$10,164.32 which was the amount reported by Taxpayer in its March 2008 City privilege tax return. That was the highest income reported by *Taxpayer #3*.

The estimated amount was used for each month for which no City privilege tax return was filed by Taxpayers. The Tax Collector used the actual reported amounts for the months City returns were filed. While the Tax Collector looked at the state privilege tax returns that were submitted, he did not use that information in the assessments.

Taxpayers timely protested the assessments contending that the assessments were incorrect and overstated. Taxpayers also stated they would be submitting additional documentation. The Tax Collector stated in his response to the protest that the City would be willing to look at additional documentation. The Tax Collector specified that any documentation should verify ownership and responsibility for sales taxes for each business and should include sales and income records for each business showing the income for each business.

Taxpayers attached over six hundred pages of documents to their reply. The documents consisted of copies of bank account statements for two of the licenses under audit. Taxpayers also submitted a spreadsheet showing deposits for each account and transfers between the different accounts. Taxpayers contend that there was only one business entity operating and making sales at any given time. Only the initial deposits should be counted as income and not the transfers between the accounts.

Taxpayers did not submit any documentation verifying ownership and responsibility for sales taxes or sales and income records. The questions presented are whether Taxpayers have established that the Tax Collector's estimate was unreasonable and that only one business operated at any given time.

Was the City's estimate of gross receipts reasonable?

The privilege tax is measured by gross income from the business. Taxpayers were required to keep books and records showing Taxpayers' gross income attributable to their activities in the City. Regulation § 19-350.1(g) requires taxpayers' books and records to indicate both individual transaction amounts and totals for each reporting period for each category of taxable, exempt, and excluded income. Taxpayers did not provide the necessary records to permit the Tax Collector to ascertain Taxpayers' gross receipts and any applicable deductions or exemptions for the review periods.

Because Taxpayers did not have the required records, Tucson City Code (TCC) §§ 19-545(b) and 19-555(e) authorize the Tax Collector to estimate Taxpayers' income, on a reasonable basis, to determine the correct tax. Taxpayers filed City privilege tax returns for some months of the audit periods. For the unreported months, the Tax Collector based his estimate on the highest reported net income reported by Taxpayers to the City. It was reasonable for the Tax Collector to believe that months in the audit period for which no privilege returns were submitted could have higher income than the highest month for which returns were produced. Under the circumstances, the Tax Collector used a reasonable method to estimate Taxpayers' gross income where no income information was available.

It is Taxpayers' responsibility to prove that the Tax Collector's estimate is not reasonable and correct. Taxpayers argue that the assessment should have been based on the bank statements of two of the licensees and that the income of the third licensee was reported by one of the other two licensees. However, Taxpayers' bank statements did not show Taxpayers' individual transaction amounts for any month. None of the monthly amounts for initial deposits listed in the bank statements (summarized in Taxpayers' spreadsheet) matched the amounts listed in any of Taxpayers' monthly City or state privilege tax returns. Except for the months of August through October 2007, the monthly amounts listed in Taxpayers' spreadsheet were greater than the amounts that had been listed in Taxpayers' City and state privilege tax returns.

In addition, no bank statements were provided for *Taxpayer #3*, MTHO # 686). *Taxpayer #3* filed City privilege tax returns for the months of May 2007 through March 2008 and paid City privilege taxes for January 2008 through March 2008. The Tax Collector was unable to match the tax amounts paid by *Taxpayer #3* to any check amounts in the bank statements for the other two licensees. This could indicate to the Tax Collector that Taxpayers did not provide all bank statements for the three entities. Thus Taxpayers have not established that Taxpayers' bank statements reliably reflected Taxpayers' gross receipts during the audit period. Taxpayers did not prove that the Tax Collector's estimate was not reasonable.

The Tax Collector did have copies of state privilege tax returns available for some of the months of the audit period. We believe the gross receipt amounts reported by Taxpayers in state privilege tax returns are more reliable than the Tax Collector's estimates for those months. While we hold that the Tax Collector's estimates are reasonable for months where no City or state privilege tax returns were filed, the Tax Collector should utilize the gross receipt amounts listed by Taxpayers in their Arizona state privilege tax returns for the months such returns were submitted.

Was only one business operating at any given time?

Taxpayers contend that only one business was operating at any given time and it was therefore not proper to assess all three licensees for the same audit periods. However, the record in this case does not support Taxpayers' contention.

No information was provided by Taxpayers showing when activities under one license stopped and activities under a new license began. All three entities were separately licensed and all three licenses were active during the audit periods. Each license applications listed different principals. The license applications each listed a different SIC or NAICS code for its activity indicating that different activities may have been conducted by each licensee. Two of the licensees were limited liability companies that had different members. The bank statements for *Taxpayer #1* (MTHO # 684) and *Taxpayer #2* (MTHO # 685) overlapped from October 2008 to February 2009. No documentation was submitted showing the transfer of the business.

Based on the above, we cannot conclude that Taxpayers established that only one business was operating at any given time. The Tax Collector properly issued assessments against each licensee for the audit periods.

The Tax Collector's assessments are upheld except that the Tax Collector shall use the actual amount of gross receipts reported by Taxpayers in state privilege tax returns for the months copies of state privilege tax reports were submitted by Taxpayers.

Findings of Fact

1. This consolidated case involves three Taxpayers, ***Taxpayer #1***, MTHO # 684 and ***Taxpayer #2***, MTHO # 685) ***Taxpayer #3***, MTHO # 686).
2. The privilege tax license application for ***Taxpayer #1*** showed:
 - a. Business start date of November 1, 2006.
 - b. The application was signed by ***Taxpayer #1***.
 - c. Nature of the business as ***Restaurant***.
 - d. SIC Code of 5812 – Retail eating place
3. The privilege tax license application for ***Taxpayer #2*** showed:
 - a. Business start date of June 1, 2008.
 - b. The application was signed by ***Taxpayer #2***.
 - c. Nature of the business as Dance Hall/Admissions.
 - d. NAICS Code of 713990 – Amusement and recreation.
4. The privilege tax license application for ***Taxpayer #3*** showed:
 - a. Business start date of May 22, 2007.
 - b. The application was signed by ***Taxpayer #3***.
 - c. Nature of the business as ***Coffee & Lounge***.
 - d. SIC Code of 5399 – Misc general merchandise store
5. All three licenses were active with the City during the audit periods.
6. Each license application listed different owner or members.
7. The license applications each listed a different SIC or NAICS code and nature of business.
8. Two of the licensees were limited liability companies that had different members.
9. No documentation was submitted showing a transfer of the business.
10. The address listed for all three Taxpayers is ***12345 Numbers Road in Tucson***.
11. The Tax Collector audited the three Taxpayers.
12. The Tax Collector requested Taxpayers to provide information for the Tax Collector to conduct the audit. The Tax Collector requested business records, including sales journals, income tax returns, and invoices.
13. The only records Taxpayers provided during the audit process were copies of some of the State of Arizona privilege tax returns for two of the licenses.
14. ***Taxpayer #1*** (MTHO 684)
 - a. Filed city privilege tax returns for the months of January 2007 through March 2008.
 - b. Submitted copies of Arizona state privilege tax returns for the months of June 2008 through December 2008.

- c. Is registered as a limited liability company with the Arizona Corporation Commission. Members listed are *Person 1* and *Person 2*.
15. **Taxpayer #2** (MTHO 685)
 - a. Did not file city privilege tax returns.
 - b. Submitted copies of Arizona state privilege tax returns for the months of February 2009 through July 2010.
 - c. Is registered as a limited liability company with the Arizona Corporation Commission. Members listed are *Person 3*, *Person 2* and *Person 4*.
16. **Taxpayer #3** (MTHO 686)
 - a. Filed city privilege tax returns for the months of May 2007 through March 2008. The returns for the months of May 2007 through December 2007 were filed as zeros.
 - b. Did not file Arizona state privilege tax returns.
 - c. Is a sole proprietorship. *Person 1* is listed as the owner on the privilege tax license application.
17. Because requested records were not provided, the Tax Collector estimated Taxpayer's gross income for the assessments as follows:
 - a. For MTHO ## 684 and 685 the Tax Collector used the monthly amount of \$24,190.48 shown in the return filed for October 2007 for the months when no City returns were filed.
 - b. For MTHO # 686 the Tax Collector used the monthly amount of \$10,164.32 shown in the return filed for March 2008 for the months when no City returns were filed.
18. The amounts used for the estimates were the highest reported net income by Taxpayers.
19. The Tax Collector used the highest reported net income because so few returns were filed and no records were provided.
20. The Tax Collector assessed both **Taxpayer #1** (MTHO # 684) and **Taxpayer #2** (MTHO # 685) for the months of June 2008 through August 2011 because documentation was not provided by Taxpayers to show when activities under one license stopped and activities under a new license began.
21. Taxpayers protested the assessments stating that
 - a. Taxpayers will provide additional information that was not taken into account in the audit.
 - b. The average gross receipts used in the audit are artificially high.
 - c. The gross income for **Taxpayer #3** was included in the other licenses.
22. Taxpayers did not provide additional documentation with their protest.
23. The Tax Collector timely filed his response to the protest and indicated he would be willing to review and examine any documentation provided by Taxpayers.
24. Taxpayers filed their reply and submitted over 600 pages of bank statements for two of the licenses under audit.

25. Taxpayers contend that
 - a. There was only one business entity operating and making sales at any given time and not three entities.
 - b. Some of the deposits into the bank accounts were transfers from Taxpayers' other accounts.
 - c. Only the initial deposits into the accounts should be considered taxable income and not the transfers between the accounts.
26. The bank statements for ***Taxpayer #1*** (MTHO # 684) ***and Taxpayer #2*** (MTHO # 685) overlapped from October 2008 to February 2009.
27. Taxpayers also submitted a spreadsheet showing the deposits for each account and transfers between the different accounts. Taxpayer contends that only the initial deposits should be counted as income and not the transfers between the accounts.
28. The spreadsheet also listed the monthly total of all income for all sources deposited into the accounts.
29. None of the monthly amounts for initial deposits listed in Taxpayers' spreadsheet matched the amounts listed in any of Taxpayers' monthly City or state privilege tax returns.
30. Except for the months of August through October 2007, the monthly amounts listed in Taxpayers' spreadsheet were greater than the amounts that had been listed in Taxpayers' City and state privilege tax returns.
31. The bank statements were not previously provided to the Tax Collector and were not used in preparing the estimated audit.

Conclusions of Law

1. The City privilege tax is imposed on persons engaging in certain business activities. Tucson City Code, Chapter 19, Article II.
2. The privilege tax is measured by the person's gross income from the taxable business activity. TCC § 19-400(a)(1).
3. It is the taxpayer's responsibility to cause his return and payment to be timely received by the Tax Collector. TCC § 19-530(c).
4. The presumption is that an assessment of additional tax is correct. *See, Arizona State Tax Commission v. Kieckhefer*, 67 Ariz. 102, 191 P.2d 729 (1948).
5. Taxpayers are required to maintain records showing the gross income of the taxpayer attributable to any activity occurring in whole or in part in the City. Regulation 19-350.1(a).
6. The books and records of the taxpayer are required to indicate both individual transaction amounts and totals for each reporting period for each category of taxable, exempt, and excluded income. Regulation 19-350.1(g).
7. Taxpayers did not have the required records for the audit period showing Taxpayers' income attributable to their activities in the City.
8. Taxpayers' records made available to the Tax Collector were insufficient for the Tax Collector to correctly determine the amount of tax owed by Taxpayers.

9. The Tax Collector was authorized to estimate Taxpayers' income to determine the correct tax. TCC § 19-555(e).
10. The Tax Collector's estimate is required to be made on a reasonable basis. TCC § 19-545(b).
11. The Tax Collector's estimate based on the highest monthly amount reported by Taxpayers was reasonable.
12. It is the responsibility of the taxpayer to prove that the Tax Collector's estimate is not reasonable and correct. TCC § 19-545(b).
13. Taxpayers filed some City privilege tax returns and submitted copies of state privilege tax returns.
14. The City accepted the amount of income listed in the city privilege tax returns in the assessments but not the amounts listed in the state privilege tax returns.
15. The state privilege tax returns provided by Taxpayers are more reliable than the Tax Collector's estimates for the months that state privilege tax returns were submitted.
16. The Tax Collector shall modify the assessment to **Taxpayer #1** (MTHO # 684) to utilize the amounts of gross receipts listed by **Taxpayer #1** in its state privilege tax returns for the months of June 2008 through December 2008.
17. The Tax Collector shall modify the assessment to Taxpayer #2 (MTHO # 685, License No. 3001068) to utilize the amounts of gross receipts listed by **Taxpayer #1** in its state privilege tax returns for the months of February 2009 through July 2010.
18. Taxpayer did not prove that the Tax Collector's estimate of gross receipts was not reasonable and correct for the other months of the assessments.
19. A taxing agency may assert inconsistent positions in tax collection proceedings and assess deficiencies against more than one person for the same liability in order to protect the public fisc and to prevent the "whipsaw" effect of a decision in favor of one of the parties. *See, Kean v. Commissioner of Internal Revenue*, 407 F.3d 186, 189 (2005).
20. Taxpayers did not provide any documentation substantiating the assertion that only one business entity operated and made sales at any given time and not three entities.
21. Based on the record in this case, the Tax Collector had a reasonable basis to issue assessments to each of the licensees.
22. The Tax Collector's assessments to Taxpayers are upheld in part and denied in part. The Tax Collector shall modify the assessments as specified in Conclusions of Law Nos. 16 and 17.
23. The Tax Collector's Notices of Assessment are proper in all other respects.

Ruling

Taxpayer's protest of the assessment to **Taxpayer #1** for the period January 2007 through August 2011 by the City of Tucson is granted in part and denied in part.

The Tax Collector shall modify the assessment to **Taxpayer #1** (MTHO # 684) to utilize the amounts of gross receipts listed by Taxpayer in its state privilege tax returns for the months of June 2008 through December 2008.

Taxpayer's protest of the assessment to *Taxpayer #2* for the period June 2008 through August 2011 by the City of Tucson is granted in part and denied in part.

The Tax Collector shall modify the assessment to *Taxpayer #2* (MTHO # 685) to utilize the amounts of gross receipts listed by Taxpayer in its state privilege tax returns for the months of February 2009 through July 2010.

Taxpayer's protest of the assessment to *Taxpayer #3* for the period May 2007 through August 2011 by the City of Tucson is denied.

The Tax Collector's Notice of Assessment to *Taxpayer #3* (MTHO # 686) is upheld.

The parties have timely rights of appeal to the Arizona Tax Court pursuant to Model City Tax Code Section -575.

Sincerely,

Hearing Officer

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c: *Tax Audit Administrator*
Municipal Tax Hearing Office