

DECISION OF MUNICIPAL TAX HEARING OFFICER

Decision Date: January 18, 2005

Decision: MTHO #195

Tax Collector: City of Scottsdale

Hearing Date: December 20, 2004

DISCUSSION

Introduction

On June 25, 2004, *Taxpayer* ("Taxpayer") filed a protest of a tax assessment made by the City of Scottsdale ("City"). After review, the City concluded on July 21, 2004 that the protest was timely but not in the proper form. On July 24, 2004, the Municipal Tax Hearing Officer ("Hearing Officer") granted the Taxpayer an extension until September 6, 2004 to correct the form of the protest. On August 13, 2004, the Taxpayer filed a clarification to the form. On August 18, 2004, the Hearing Officer concluded the form of the protest was proper and ordered the City to file any response to the protest on or before October 18, 2004. The City filed a response to the protest on October 13, 2004. On October 18, the Hearing Officer ordered the Taxpayer to file any reply on or before November 8, 2004. A Notice of Tax Hearing ("Notice") was issued on October 27, 2004 setting the matter for hearing commencing on December 20, 2004. Both parties appeared and presented evidence at the December 20, 2004 hearing. On December 21, 2004, the Hearing Officer closed the record and indicated that a written Decision would be issued on or before February 4, 2005.

City Position

The City conducted an audit of the Taxpayer for the period January 2000 through September 2003. During the audit period, the Taxpayer was in the business of selling tangible personal property, such as hats and boots, at retail. The City concluded the Taxpayer had underreported gross income and overstated deductions during the audit period. The City concluded that the Taxpayer owed additional taxes for the audit period in the amount of \$10,711.93. In addition, the City assessed interest, up through May 2004, in the amount of \$3,608.67 plus penalties in the amount of \$7,498.48.

The City concluded the Taxpayer had underreported gross income of \$199,944.18 during the audit period. The City utilized the Taxpayer's weekly recap sheets to determine the amount of underreported income. In addition, the City adjusted the income amount to include two invoices for conventions that did not appear on the weekly recap sheets.

While the Taxpayer had claimed deductions totaling \$575,923.98, the City disallowed all

the deductions except for \$10,745.82. The majority (\$548,963.92) of the disallowed deductions were for disallowed out-of-State sales. The City asserted that out-of-State sales are exempt from the tax on retail sales pursuant to City Code Section 465(b) (“Section 465(b”). Out-of-State sales are defined in City Code Section 100 (“Section 100”) as exempt sales if all the following occur: (1) The order is placed from without the State of Arizona; and (2) The order is placed by other than a resident of the State; and (3) The property is delivered to the buyer at a location outside the State; and (4) The property is purchased for use outside the State. In addition, City Regulation 350.3(b) (“Regulation 350.3”) provides that persons claiming out-of-State sales shall maintain the following documentation: (1) Documentation of location of the buyer at the time of order, and (2) Documentation of residency of the buyer, determined in the manner one determines if a person “resides within the City”, and (3) Shipping, delivery or freight documents showing where the buyer took delivery; and (4) Documentation of intended location of use or storage of the property sold to such buyer.

In addition to the out-of-State sales, the Taxpayer also claimed exempt government sales and some sales for resale. The City asserted that City Code Section 465(n) (“Section 465(n)”) exempts sales made directly to the Federal Government to the extent of fifty percent of the gross income derived from retail sales made by other than a manufacturer, modifier, assembler, or repairer. City Code Section 360(a) (“Section 360(a)”) provides that all deductions and exemptions are conditional upon adequate proof and documentation being provided by a taxpayer. The City argued that the Taxpayer failed to maintain adequate documentation to support the Federal Government exemption.

The Taxpayer claimed sales for resale totaling \$1,900.00 during the audit period. The City asserted that Regulation 350.1(d) (“Regulation 350.1(d)”) provides documentation and evidence needed by the Taxpayer to support exempt sales for resale. According to the City, the Taxpayer failed to maintain adequate documentation to support claimed sales for resale.

City Code Section 540(b)(2) (“Section 540(b)(2)”) provides for a penalty of ten percent on taxes not paid in a timely manner unless the failure to pay is due to reasonable cause and not due to willful neglect. Section 540(b)(4) provides for a penalty of ten percent when the cause of a tax deficiency is due to negligence, but without regard for intent to defraud. Section 540(i) defines “negligence” as characterized chiefly by inadvertence, thoughtlessness, inattention, rather than an honest mistake”. Section 540(b)(5) requires a penalty of fifty percent when the tax deficiency is determined by the City to be due to civil fraud or evasion of the tax. The City assessed penalties for failure to pay, negligence and evasion because the Taxpayer has undergone four previous audits and was assessed for tax due in the same areas every audit. According to the City, the Taxpayer had been provided with Sections of the Tax Code and requirements that explained how to collect and pay the tax correctly. In spite of the City’s efforts to educate the Taxpayer, the City asserts the Taxpayer has continued to claim out-of-State and resale deductions that are not valid and/or cannot be substantiated by the Taxpayer’s recordkeeping. Accordingly, the City requested the tax, interest, and penalties should be upheld.

Taxpayer Position

The Taxpayer protested the entire assessment including penalties and interest. According to the Taxpayer, the original audit was one amount and after the Taxpayer provided additional documentation the City increased the amount of gross income. The Taxpayer asserted that penalties of 70 percent were assessed but the Taxpayer was given no credit for sales that had no taxes collected. The Taxpayer argued that they cannot continue to pay other people's taxes that were not collected at time of sale.

ANALYSIS

The City utilized the Taxpayer's weekly recap sheets to determine the amount of underreported income. The Taxpayer testified at the hearing that the weekly recap sheets were accurate and acknowledged the gross amounts from the recap sheets was higher than the gross amounts reported on the sales tax reports. In addition, the Taxpayer did not provide any explanation of why the two invoices for the conventions did not appear on the weekly recap sheets. Based on the above, we must conclude that the City's determination of underreported gross income was correct.

As to the claimed out-of-State deductions, the Taxpayer did provide evidence that they had maintained some documentation to support the claimed deductions. However, when the Taxpayer was questioned at the hearing about an invoice the Taxpayer could not say for certain whether the sale occurred within the State or out-of-the-State. As a result, we conclude that the Taxpayer did not provide sufficient documentation to support the claimed out-of-State sales. Further, the Taxpayer did not provide documentation to support any Federal Government exemptions or any sale-for-resale. As a result, we conclude that the City's disallowance of deductions and exemptions was proper.

While the Taxpayer has protested the interest assessed, City Code Section 540(a) provides that interest may not be waived unless the underlying tax is determined not to be valid. In this case, we have concluded the underlying tax was proper and as a result the interest may not be waived. The City was authorized pursuant to Section 540(b)(2) to assess a penalty when taxes were not paid in a timely manner. Since the Taxpayer was previously assessed for the same disallowances in previous audits, we do not find the Taxpayer has demonstrated reasonable cause and the Section 540(b)(2) penalty is upheld. The Section 540(b)(4) penalty requires negligence but without intent to defraud. In this case, since the Taxpayer was assessed for similar disallowances in four other audits and the City provided the Taxpayer guidance on documentation to maintain, we conclude the Taxpayer's actions were characterized by inattention. Accordingly, the negligence penalty pursuant to Section 540(b)(4) is upheld. Lastly, Section 540(b)(5) requires a penalty when the tax deficiency is determined by the City to be due to civil fraud or evasion of the tax. We do find that the City would need to demonstrate an intent by the Taxpayer to deliberately not pay the tax. While we did conclude the Taxpayer was negligent in this case, we do not find any intent by the Taxpayer to evade the tax. As a result, we will waive the Section 540(b)(5) penalty.

FINDINGS OF FACT

1. On June 25, 2004, the Taxpayer filed a protest of a tax assessment made by the City.
2. After review, the City concluded on July 21, 2004 that the protest was timely but not in the proper form.
3. On July 24, 2004, the Hearing Officer granted the Taxpayer an extension until September 6, 2004 to correct the form of the protest.
4. On August 13, 2004, the Taxpayer filed a clarification to the form.
5. On August 18, 2004, the Hearing Officer concluded the form of the protest was proper and ordered the City to file any response to the protest on or before October 18, 2004.
6. The City filed a response to the protest on October 13, 2004.
7. On October 18, 2004, the Hearing Officer ordered the Taxpayer to file any reply on or before November 8, 2004.
8. A Notice was issued on October 27, 2004 setting the matter for hearing commencing on December 20, 2004.
9. Both parties appeared and presented evidence at the December 20, 2004 hearing.
10. On December 24, 2004, the Hearing Officer closed the record and indicated that a written Decision would be issued on or before February 4, 2005.
11. The City conducted an audit of the Taxpayer for the period January 2000 through September 2003.
12. During the audit period, the Taxpayer was in the business of selling tangible personal property, such as hats and boots, at retail.
13. The City concluded the Taxpayer had underreported gross income and overstated deductions during the audit period.
14. The City concluded that the Taxpayer owed additional taxes for the audit period in the amount of \$10,711.93.
15. The City assessed interest up through May 2004 in the amount of \$3,608.67 plus penalties in the amount of \$7,498.48.

16. The Taxpayer had underreported gross income of \$199,944.18 during the audit period.
17. The City utilized the Taxpayer's weekly recap sheets to determine the amount of underreported income.
18. The City adjusted the income amount to include two invoices for conventions that did not appear on the weekly recap sheets.
19. While the Taxpayer claimed deductions totaling \$575,923.98, the City disallowed all the deductions except \$10,745.82.
20. The majority (\$548,963.92) of the disallowed deductions were for disallowed out-of-State sales.
21. The Taxpayer has undergone four previous audits and was assessed for tax due in the same areas in every audit.
22. The Taxpayer had previously been provided with sections of the Tax Code and the requirements that explained how to collect and pay the tax correctly.

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 had understated retail sales pursuant to City Code Section 460 during the audit period.
3. The Taxpayer failed to provide sufficient documentation to support the claimed out-of-State sales.
4. The Taxpayer failed to provide documentation to support any Federal Government exemption or any sale-for-resale.
5. Pursuant to Section 540(a), interest may not be waived unless the underlying tax is determined to be not valid.
6. The City was authorized pursuant to Section 540(b)(2) to assess a penalty when taxes were not paid in a timely manner.
7. The Taxpayer has not demonstrated reasonable cause for failing to timely pay taxes.

8. The City was authorized pursuant to Section 540(b)(4) to impose a penalty for negligence but without the intent to defraud.
9. Since the Taxpayer was assessed for similar disallowances in four other audits, we conclude the Taxpayer's actions were characterized by inattention.
10. We do not find any intent by the Taxpayer to evade taxes.
11. The Section 540(b)(5) penalty should be waived.
12. With the exception of the Section 540(b)(5) penalty, the Taxpayer's protest should be denied.

ORDER

It is therefore ordered that the June 25, 2004 protest of *Taxpayer* of a tax assessment made by the City of Scottsdale is hereby denied with the exception of the Section 540(b)(5) penalty.

It is further ordered that the City of Scottsdale shall revise the assessment by removal of the Section 540(b)(5) penalty.

It is further ordered that this Decision is effective immediately.

Jerry Rudibaugh
Municipal Tax Hearing Officer