

DECISION OF MUNICIPAL TAX HEARING OFFICER

Decision Date: November 8, 2010

Decision: MTHO #554

Taxpayer:

Tax Collector: City of Nogales

Hearing Date: September 13, 2010

DISCUSSION

Introduction

On August 6, 2009, a letter of protest was filed by ***Taxpayer*** of a tax assessment made by the City of Nogales (“City”). A hearing was commenced before the Municipal Tax Hearing Officer (“Hearing Officer”) on September 13, 2010. Appearing for Taxpayer was their ***C.P.A.*** and ***Owners of Taxpayer***. Appearing for the City were the ***Tax Auditors***. At the conclusion of the September 13, 2010 hearing, the parties agreed to a briefing schedule. On September 29, 2010, the Hearing Officer closed the record and indicated a written decision would be issued on or before November 12, 2010.

DECISION

Taxpayer operated in the City at two separate and distinct locations. The City conducted an audit of Taxpayer’s first location for the period of December 2004 through November 2008 for Business License Number ***ABCD***. The City assessed License Number ***ABCD*** for additional taxes in the amount of \$14,771.30, interest up through February 2009 in the amount of \$3,211.10, and penalties for failure to timely pay in the amount of \$1,477.18. In addition, License Number ***ABCD*** was assessed an occupational license tax for the period of April 2005 through March 2009 in the amount of \$4,800.00 of tax and \$480.00 in penalties for failure to file. The City conducted an audit of the second location for the period of February 2006 through November 2008 for Business License Number ***EFGH***. The City assessed License Number ***EFGH*** for taxes in the amount of \$16,242.46, interest up through February 2009 in the amount of \$1,833.87, and penalties for failure to timely pay taxes in the amount of \$1,624.29. In addition, License Number ***EFGH*** was assessed an occupational license tax for the period of February 2006 through March 2009 in the amount of \$3,800.00 of tax and \$380.00 in penalties for failure to file.

The City utilized block samples for each of the audits. The City selected three months in different seasons and then simply selected a different day for each month selected. The City argued that block sampling of Taxpayer in this matter was a permissible sampling

methodology to conduct an audit. Taxpayer argued that the samples selected by the City were not valid and not randomly selected. Taxpayer asserted that the randomness of the three days selected for each year or less than one percent of the population was questionable since the auditor had access to all sales records. While the City offered to expand the sample size, Taxpayer did not believe changing the sample size would change the results. We note that the Model City Tax Code Section 555 (“Section 555”) does permit sampling techniques to determine the tax liability as long as the procedures used are in accordance with generally accepted auditing standards. In this case, we have concerns with the use of less than one percent of the records being used to determine the tax liability of Taxpayer. We believe the auditor should have reached an agreement with Taxpayer regarding the sampling methodology prior to commencing with the audit. The record reflects that the City did make an offer to Taxpayer after the conclusion of the audit to expand the sample. Taxpayer turned that offer down and stated a belief that a larger sample size would not change the results. Since Taxpayer has concluded that a larger sample size would not change the results, we conclude that the City’s sampling methodology was proper. While Taxpayer expressed concern that the City had deliberately selected samples with significant Mexico trucking company sales, we can find no evidence to support such allegation. Since Taxpayer has failed to demonstrate the City’s methodology was erroneous, the City’s sampling methodology is approved.

The City disallowed numerous sales claimed by Taxpayer to be exempt sales. There was no dispute that the sales disallowed were sales to Mexican companies that were for consumption in Mexico. The Mexican companies would bring their trucks to one of Taxpayer’s business locations in the City and purchase tires that were installed on the Mexican trucks at Taxpayer’s business locations in the City. The trucks were then driven back to Mexico for use. City Code Section 15A-705 (“Section 705”) provides a “reasonable prudent businessman standard” for assessing exemptions under the ordinance. Taxpayer asserted this standard applies to exemptions of sales to foreign commerce and as a result the claimed exemptions should be allowed. Taxpayer opined that having a business on the border presents unique circumstances wherein sales will be made to customers who obviously do not intend to consume or use the items purchased in the U.S. Taxpayer provided Mexico business licenses and exemption certificates to demonstrate that the businesses were in fact doing business in Mexico. In addition, Taxpayer provided evidence that customers got back all Federal Excise taxes. Taxpayer acknowledged that it did not meet all the requirements for exempt sales to purchasers from Mexico since the tires were not actually delivered to Mexico. However, Taxpayer argued that it met the reasonable prudent businessman standard set forth in Section 705 based on the information gathered from the Mexico trucking or transportation firms. Taxpayer asserted that retailers near the border have historically exempted what were obviously purchases for foreign consumption.

The City asserted that the sales in question were clearly not sales for resale. The City noted that the burden of proof is on the seller to prove a transaction is not a retail sale pursuant to City Code Section 15A-702 (“Section 702”). In addition; the sales to purchasers from Mexico are not exempt pursuant to City Code Section 15A-701 (“Section 701”).

We concur with the City. While there was no dispute the disputed exempt sales were being purchased by Mexicans to use in Mexico, there was no evidence that Taxpayer met the requirements of Section 701. Section 701 makes it clear that privilege tax must be paid on all retail sales to purchasers from Mexico and other foreign countries unless there is evidence as to place and conditions of delivery to Mexico or other foreign country. Based on the evidence, the tires were not delivered by Taxpayer to Mexico but were delivered to the buyer at Taxpayer's business locations in the City. Further, there was not sufficient evidence that the tires were being purchased for resale. While there were signed Arizona Form 5000 ("Form 5000") exemption certificates for the disputed sales, it was clear that the sales were to transportation companies or furniture store companies, etc and not to resellers of tires. We must conclude that pursuant to City Code Section 15A-705 ("Section 705"), a reasonably prudent businessman would not consider these sales to be wholesale sales. As a result, Taxpayer has failed to meet its burden of proof pursuant to City Code Section 702. Section 702 makes it clear that the burden of proof is on Taxpayer to prove a transaction is not a retail sale. We note that Taxpayer provided a bill of lading for a delivery to Mexico for a customer named *Customer #1*. At first blush, this appeared to meet the requirements for an exempt sale to a purchaser from Mexico. After careful review, we conclude the requirements of Section 701 were not met. The sale in question was listed on *invoice # 12345*, dated 10/03/2006, as a sale of a radiator and a racing bumper. The undated bill of lading referred to delivery of auto accessories, tires, and wheels. We are unable to conclude the undated bill of lading has any relationship to the 10/03/2006 invoice. Accordingly, we conclude Taxpayer has failed to meet its burden of proof that the 10/03/2006 sale was an exempt sale. Based on all the above, we must deny Taxpayer's claim the disputed sales were exempt.

Since Taxpayer failed to timely pay taxes, the City was authorized pursuant to Model City Tax Code Section 540 ("Section 540") to impose penalties. Those penalties may be abated for reasonable cause. Based on the circumstances previously discussed, we conclude Taxpayer has demonstrated reasonable cause to have all penalties waived in this matter.

We have the additional issue in this case regarding the imposition of an occupational tax. The City noted that Taxpayer's business consisted of selling tires both at retail and wholesale. There appeared to be no dispute that Taxpayer owed an occupational tax pursuant to City Code Section 11-10 ("Section 10"). The dispute occurred because the City assessed an occupational tax on both of Taxpayer's locations located in the City. The City relied on City Code Section 11-14 ("Section 14") which states that a separate license must be obtained for each branch establishment or separate place of business in which a business is carried on. Taxpayer argued that City Code Section 15A-300(b) ("Section 300(b)") provides that a person engaged in more than one activity subject to City Privilege and Use taxes at any one business location is not required to obtain a separate license for each activity. As a result, Taxpayer argued that it should not be required to have a separate license for both the retail activity as well as the wholesale

activity.

Section 14 makes it clear that a separate occupational license must be obtained for each separate place of business in which a business is carried on. There was no dispute, that Taxpayer had two separate business locations in the City. As a result, Taxpayer was required to have a separate occupational license for each location. There is an exemption set forth in City Code Section 11-40 (“Section 40”) for occupations paying other taxes such as the transaction privilege tax. Section 40 makes it clear that the exemption only applies to that portion of the business activity for which the privilege tax is paid. Since Taxpayer’s wholesale activity is not subject to the privilege tax, the exemption does not apply to those activities. As a result of Taxpayer having retail and wholesale activities at two separate locations in the City, Taxpayer is required to have both a transaction privilege license and an occupational tax license for both locations. Section 300(b) does not permit the City to require a separate transaction privilege license for each activity subject to the transaction privilege tax. In this case, the City only required one transaction privilege license for each of Taxpayer’s two separate locations. Based on all the above, the City’s occupational tax assessment is upheld.

The City assessed Taxpayer for penalties of ten percent pursuant to City Code Section 11-6 (“Section 6”) for failure to timely file the occupational tax forms. While Section 6 clearly authorizes the City to assess a penalty for late filing, we conclude based on the totality of the circumstances that Taxpayer has demonstrated reasonable cause to have all penalties waived.

FINDINGS OF FACT

1. On August 6, 2009, Taxpayer filed a protest of a tax assessment made by the City.
2. Taxpayer operated in the City at two separate and distinct locations.
3. The City conducted an audit of Taxpayer for the period of December 2004 through November 2008 for Business License Number **ABCD** and for the period February 2006 through November 2008 for Business License Number **EFGH**.
4. The City assessed License Number **ABCD** for additional taxes in the amount of \$14,771.30, interest up through February 2009 in the amount of \$3,211.10, and penalties for failure to timely pay totaling \$1,477.18.
5. The City assessed License Number **EFGH** for additional taxes in the amount of \$16,242.46, interest up through February 2009 in the amount of \$1,833.87, and penalties for failure to timely pay in the amount of \$1,624.29.

6. License Number **ABCD** was assessed an occupational license tax for the period of April 2005 through March 2009 in the amount of \$4,800.00 of tax, and \$480.00 in penalties for failure to file.
7. License Number **EFGH** was assessed an occupational license tax for the period of February 2006 through March 2009 in the amount of \$3,800.00 of tax and penalties for failure to file totaling \$380.00.
8. The City utilized block samples for each of the audits.
9. The City selected three months in different seasons and then simply selected a different day for each month selected.
10. The City selected less than one percent of the population to sample.
11. The City offered to expand the sample size but Taxpayer turned down the offer because it did not believe it would change the results of the audit.
12. The City disallowed numerous sales claimed by Taxpayer to be exempt sales.
13. There was no dispute that the disallowed sales were sales to Mexican companies that were for consumption in Mexico.
14. The Mexican companies would bring their trucks to one of Taxpayer's business locations in the City and purchase tires that were installed on the Mexican trucks at Taxpayer's business locations in the City.
15. The trucks were then driven back to Mexico for use.
16. Taxpayer provided Mexico business licenses and exemption certificates to demonstrate that the businesses were in fact doing business in Mexico.
17. Taxpayer provided evidence that its customers got back all Federal Excise taxes.
18. Taxpayer acknowledged that it did not meet all the requirements for exempt sales to purchasers from Mexico since the tires were not delivered to Mexico.
19. The signed Form 5000's for the disputed sales were sales to transportation companies or furniture stores, etc. and not to resellers of tires.
20. The sale to **Customer #1** was listed on invoice # **12345**, dated 10/03/2006, and was for the sale of a radiator and racing bumper.

21. The bill of lading for a delivery to Mexico for a customer named *Customer #1* referred to delivery of auto accessories, tires, and wheels.

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. Section 555 permits sampling techniques to determine the tax liability as long as the procedures used are in accordance with generally accepted auditing standards.
3. There was no evidence that the City had deliberately selected samples with significant Mexico trucking company sales.
4. Taxpayer failed to demonstrate that the City's sampling methodology was erroneous.
5. Section 701 requires privilege tax to be paid on all retail sales to purchasers from Mexico and other foreign countries unless there is evidence as to place and conditions of delivery to Mexico or other foreign country.
6. There was no evidence that any of the disputed sales were delivered to Mexico by Taxpayer.
7. A reasonably prudent businessman would not consider the disputed sales to be sales for resale pursuant to Sections 702 and 705.
8. Taxpayer failed to demonstrate that the undated bill of lading for customer *Customer #1* had any relationship to the 10/03/2006 invoice for the same customer.
9. The City was authorized to impose penalties for failure to timely pay taxes pursuant to Section 540.
10. Based on the totality of the circumstances, Taxpayer has demonstrated reasonable cause to have all penalties waived.

11. Taxpayer owed an occupational tax pursuant to Section 10.
12. Section 14 requires a separate occupational license for each branch establishment or separate place of business in which a business is carried on.
13. Since Taxpayer had two separate business locations in the City, it was required pursuant to Section 14 to have a separate occupational license for each location.
14. Since Taxpayer's wholesale activity is not subject to the transaction privilege tax, the exemption set forth in Section 40 does not apply.
15. As a result of Taxpayer having retail and wholesale activities at two separate locations in the City, Taxpayer is required to have both a transaction privilege license and an occupational tax license for each location.
16. The City was authorized to impose a penalty for failure to timely file the occupational tax forms.
17. Based on the totality of the circumstances, we conclude that Taxpayer has demonstrated good cause to have all penalties waived.
18. Taxpayer's protest should be denied with the exception of the penalties, consistent with the Discussion, Findings, and Conclusions, herein.

ORDER

It is therefore ordered that the August 6, 2009 protest by *Taxpayer* of a tax assessment made by the City of Nogales is hereby partly denied and partly granted, consistent with the Discussion, Findings, and Conclusions, herein.

It is further ordered that the City of Nogales shall remove all transaction privilege tax and occupational tax penalties assessed in this matter.

It is further ordered that this Decision is effective immediately.

Municipal Tax Hearing Officer