

**Jerry Rudibaugh
Municipal Tax Hearing Officer**

DECISION OF MUNICIPAL TAX HEARING OFFICER

Decision Date: June 2, 2003
Decision: MTHO #76
Tax Collector: Town of Snowflake
Hearing Date: April 17, 2003

DISCUSSION

Introduction

On September 27, 2002, *Taxpayer* ("Taxpayer") filed a letter of protest of a tax assessment made by the Town of Snowflake ("Town"). After review, the Town concluded on October 11, 2002, that the protest was timely and in the proper form. On October 25, 2002, the Municipal Tax Hearing Officer ("Hearing Officer") ordered the Town to file a response to the protest on or before December 9, 2002. The Town filed a response on November 18, 2002. On November 21, 2002, the Hearing Officer ordered the Taxpayer to file any reply on or before December 12, 2002. On November 27, 2002, the Hearing Officer extended the reply deadline until December 18, 2002, since the Taxpayer did not receive a copy of the Town's response. On December 17, 2002, the Hearing Officer granted the Taxpayer's request for an additional extension for their reply until January 6, 2003. The Taxpayer filed a reply on January 6, 2003. On January 27, 2003, this matter was scheduled for hearing commencing on April 17, 2003. The Taxpayer and the Town both appeared and presented evidence at the April 17, 2003 hearing. The Hearing Officer filed a letter on April 18, 2003, indicating that a written ruling would be issued on or before June 2, 2003.

The Taxpayer is in the business of selling cellular telephone service to subscribers in Northeastern Arizona. The Taxpayer began operating in Arizona in 1994 with the company offices, data transmission switch, and equipment located in Navajo County, outside Holbrook, Arizona. In October 1999, the Taxpayer moved its offices, equipment, and data switch to Show Low, Arizona. From 1994-1999, the Taxpayer filed monthly sales tax returns with the Arizona Department of Revenue ("DOR"). Since the Taxpayer was located outside the legal boundaries of any municipality, all sales were reported to Navajo County and remitted to the DOR. After October 1999, the Taxpayer reported all sales on the DOR reports to Show Low, Arizona.

The Town audited the Taxpayer for the period July 1996 through April 2002. The audit resulted in an assessment of \$28,762.44 plus interest. An additional amount of \$30,234.50 was billed to the Town of Show Low for payments made to the wrong City or Town.

Town Position

Generally, ARS Section 42-1104 (“Section 1104”) provides for a four-year statute of limitation (“SOL”) from the date the tax return is filed. It provides an exception to the general rule if a taxpayer fails to report in excess of twenty-five percent of the gross income stated in the return. Under the twenty-five percent exception rule, the Town can audit for a six year period instead of the standard four year SOL. According to the Town, the Taxpayer failed to report any income to the Town for the extra two-year period and thus it was proper to conduct the audit for a six-year period.

The Town disputed the Taxpayer’s argument that the switch location was the appropriate location to impose the telecommunication tax for all customers. According to the Town, Regulation 8A-470. 1 (“Regulation 470”) provides that the tax will be imposed on customers “within the Town” when that customer’s billing address is also the customer’s permanent residence or business location. The Town argued that the Taxpayer failed to properly document the permanent residence or business address. The Town asserted that the Taxpayer merely had to ask the question through its normal business practices in order to comply with the regulation.

The Town argued that the Taxpayer’s books and records were unauditible for sale tax purposes. The Town asserted that Town Code Section 8A-555 (“Section 555”) authorizes the Town to use estimates when the Taxpayer fails to maintain or provide books and records necessary for the Town to determine the tax liability. According to the Town, the auditors estimated the Town’s percentage of the Taxpayer’s revenues based on information received from the Taxpayer. The Town asserted the five percent estimate was determined to be reasonable by comparing the population of the Town with the population of Navajo County. The Town included some retail sales as part of the assessment because there were sales locations of telecommunications equipment within the Town. The Town also included roaming charges as part of the Taxpayer’s revenues because there are no deductions for roaming charges contained in the Town Code.

The Town assessed the Taxpayer for a late payment penalty. The Town asserted that the Taxpayer has not demonstrated reasonable cause for failing to pay all taxes in a timely manner.

Taxpayer Position

The Taxpayer argued that the entire assessment should be thrown out because the location of the Taxpayer’s switch is the proper business location to impose the tax on telecommunications service. Prior to November 1999, the Taxpayer’s switch was located in the unincorporated area of Navajo County and the Taxpayer reported all of its communications income to the DOR as income from Navajo County. At that time, the Taxpayer moved its switch within the Town of Show Low and reported all of its communications income to the DOR as income from the Town of Show Low. The Taxpayer argued that it properly reported all communications income based on the location of its switch. Regulation 470 provides that the tax will be imposed on the provider’s customers “within this Town” when the billing address of the customer is a permanent residence or business location of the customer. Otherwise, the tax is imposed based on the business location of the telecommunications provider. According to the Taxpayer, until recently, customers did not have street addresses in the Town, but instead had billing addresses based on a

post office box number or HC box number. The Town has recently begun to change to street addresses, however, as of March 2003, the percentage of Town customers with a street address was only 31.8 percent. As a result, the Taxpayer argued it was appropriate to use the location of the switch to impose the tax on the telecommunications service.

The Taxpayer argued that the allocation percentage used in allocating cellular revenue to the Town was incorrect. According to the Taxpayer, the Town utilized a five percent allocation based on the Town population percentage of the Navajo County population. The Taxpayer asserted that since its service area covers both Navajo and Apache Counties that the appropriate allocation factor to the Town would be the Town population percentage of the two counties combined of 2.7 percent. In addition, the Taxpayer argued that the Town included retail sales in their assessment that were sales made in Winslow and Show Low, Arizona. The Taxpayer also argued that the Town included roaming charges in their assessment which are not services provided to consumers within the Town.

The Taxpayer argued that the assessment prior to July 1998 is barred by the four-year statute of limitations. Section 1104 provides that the SOL can be extended to six-years if a taxpayer omits in excess of twenty-five percent of the gross income that is properly includable. In this case, the Taxpayer reported 100 percent of its gross income to the State and reported it as income based on the location of the switch. Section 1104 makes no mention of reporting 100 percent of gross income per City/Town. Therefore, the Taxpayer argued the SOL couldn't be extended to six-years. Additionally, the Taxpayer argued the late payment penalty should be waived since the Taxpayer has demonstrated reasonable cause by reporting and paying taxes based on the location of its switch.

ANALYSIS

There is no dispute that the SOL can be extended from four-years to six-years if a taxpayer fails to report in excess of twenty-five percent of its gross income on the Arizona tax return. There was also no dispute that the Taxpayer had in fact reported all of its gross income to the State of Arizona. The issue arises because the Taxpayer reported all income based on switch location and not customer location. As a result, the Taxpayer failed to report 100 percent of the Town's gross income. While the Town has argued the wording is clear and the six-years SOL applies, the Hearing Officer must disagree. The Hearing Officer concludes that the Taxpayer did not omit gross income from its return filed with the State. The Taxpayer did fail to properly segregate the income to the appropriate city of town but the Taxpayer did not omit any gross income from its tax returns. We also find it important to note that the Taxpayer's failure to properly segregate the income was not due to any neglect or intent to defraud but was based on an industry practice of reporting income based on switch location. For that reason, we find that the Taxpayer has shown reasonable cause to have the late payment penalty waived.

There was also little dispute that an estimate to determine the tax liability of the Taxpayer to the Town was appropriate in this case. The Town brought forth evidence that the appropriate estimate was five percent of reported revenues while the Taxpayer brought forth evidence that 2.7 percent was the appropriate estimated allocation. The Hearing Officer finds both estimates to

be based on reasonable methodologies. While a two county comparison appears to be better than use of one county, we note that the Town based its original estimate based on input from the Taxpayer on percentage of active accounts in the Town. As a result, the Hearing Officer concludes five percent is a reasonable estimate of the number of Town customers. However, that takes us back to Regulation 470 that provides the tax will be based on customer location if the billing address of the customer is the same as the permanent or business location of the customer. It was clear from the evidence presented that in most cases the billing address and location of the customer in the Town was not the same. It was also clear from the evidence that there is an increasing trend to have the billing and location of the customer to be the same with the most recent figures showing that is the case in 31.8 percent of the time. The Hearing Officer concludes that percentage must also be taken into consideration in determining the appropriate gross income to be allocated to the Town. The Hearing Officer further concludes that multiplying the five percent estimated Town customer base by the 31.8 percent with the same billing and customer location is the appropriate allocation to use pursuant to the guidelines set forth in Regulation 470. Thus for the period July 1998 through October 1999, the Hearing Officer approves a revenue allocation factor to the Town of five percent times 31.8 percent or 1.6 percent. The Hearing Officer recognizes that based on the evidence the 31.8 percent is at the high end for the period in question. However, there was also evidence that some of the bigger accounts were contained in that grouping and thus it is appropriate to use the high end of the estimate for the entire period. The Hearing Officer also notes that the period after November 1999 was not in dispute because the Taxpayer had paid the tax to the Town of Show Low. Lastly, the Hearing Officer concurs with the Taxpayer's arguments that there were retail sales included that were not within the Town and that the roaming charges are not part of the gross income of the business of providing services to customers within the Town.

FINDINGS OF FACT

1. On September 27, 2002, the Taxpayer filed a letter of protest of a tax assessment made by the Town.
2. After review, the Town concluded on October 11, 2002, that the protest was timely and in the proper form.
3. On October 25, 2002, the Hearing Officer ordered the Town to file a response to the protest on or before December 9, 2002.
4. The Town filed a response on November 18, 2002.
5. On November 21, 2002, the Hearing Officer ordered the Taxpayer to file any reply on or before December 12, 2002.
6. On November 27, 2002, the Hearing Officer extended the reply deadline until December 18, 2002, since the Taxpayer did not receive a copy of the Town's response.

7. On December 17, 2002, the Hearing Officer granted the Taxpayer's request for an additional extension for their reply until January 6, 2003.
8. The Taxpayer filed a reply on January 6, 2003.
9. On January 27, 2003, this matter was scheduled for hearing commencing on April 17, 2003.
10. The Taxpayer and the Town both appeared and presented evidence at the April 17, 2003 hearing.
11. The Hearing Officer filed a letter on April 18, 2003, indicating that a written ruling would be issued on or before June 2, 2003.
12. The Taxpayer is in the business of selling cellular telephone service to subscribers in Northeastern Arizona.
13. The Taxpayer began operating in Arizona in 1994 with the company offices, data transmission switch, and equipment located in Navajo County, outside Holbrook, Arizona.
14. In October 1999, the Taxpayer moved its offices, equipment, and data switch to Show Low, Arizona.
15. Prior to October 1999, the Taxpayer reported all sales on the monthly DOR reports as being in Navajo County.
16. After October 1999, the Taxpayer reported all sales on the monthly DOR reports as being in the Town of Show Low, Arizona.
17. In all cases, the Taxpayer reported sales based on the location of the Taxpayer's switch.
18. The Town audited the Taxpayer for the period July 1996 through April 2002.
19. The audit resulted in an assessment of \$28,762.44 plus interest.
20. An additional amount of \$30,234.50 was billed to the Town of \$30,234.50 was billed to the Town of Show Low for payments made to the wrong city or Town.
21. The Taxpayer failed to report any gross income to the Town during the audit period.
22. The Taxpayer reported all gross income to the DOR during the audit period.
23. The Town estimated five percent of the Taxpayer's gross income was to customers in the Town based on information from the Taxpayer.

24. The population of the Town is approximately five percent of the population of Navajo County.
25. Until recently, Town customers of the Taxpayer did not, have street addresses in the Town, but had billing addresses based on a post office box number or HC box number.
26. As of March 2003, the percentage of Town customers with the same billing and street address was 31.8 percent.
27. The population of the Town is approximately 2.7 percent of the combined population of Navajo and Apache Counties.
28. The Town included retail sales in their audit assessment which were sales made in Winslow and Show Low, Arizona.

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. Generally, Section 1104 provides for a four-year SOL.
3. Section 1104 provides an exception to the general rule if a Taxpayer fails to report in excess of twenty-five percent of the gross income stated in the return.
4. Under the twenty-five percent rule, the Town can audit for a six-year period instead of the standard four-year SOL.
5. Regulation 470 provides that the tax will be imposed on customers “within this Town” when that customer’s billing address is also the customer’s permanent residence or business location.
6. The Taxpayer’s books and records were unauditible for sales tax purposes.
7. Section 555 authorizes the Town to use estimates when the Taxpayer fails to maintain or provide books and records necessary for the Town to determine the tax liability.
8. The roaming charges included as part of the Town’s assessment are not services provided to consumers within the Town.
9. The Taxpayer’s did not omit gross income from its tax returns.
10. Pursuant to Section 1104, the appropriate SOL for the audit in this case was four-years.

11. The Taxpayer has demonstrated reasonable cause to have the late payment penalty waived.
12. The Town's estimate that five percent of the Taxpayer's customers were located in the Town reasonable.
13. Based on all the evidence, it is reasonable to utilize a percentage of 31.8 percent of Taxpayer's customers located within the Town had the same billing and street address.
14. Retail sales made in Winslow and Show Low, Arizona were improperly included in the Town's audit assessment.
15. The appropriate revenue allocator factor for the Town for the period July 1998 through October 1999 is 1.6 percent.
16. The Taxpayer's protest should be granted consistent with the Discussion, Findings, and Conclusions contained herein.

ORDER

It is therefore ordered that the September 27, 2002, protest of *Taxpayer* is hereby approved consistent with the Discussion, Findings, and Conclusions contained herein. It is further ordered that the Town of Snowflake shall revise its assessment by removing all taxes outside of the four-year statute of limitations.

It is further ordered that the Town of Snowflake shall remove all retail sales consummated in Winslow and Show Low, Arizona from its tax assessment.

It is further ordered that the Town of Snowflake shall remove all roaming charges from its tax assessment.

It is further ordered that the Town of Snowflake shall revise its assessment for the period July 1998 through October 1999 to reflect a revenue allocator factor for the Town of 1.6 percent.

It is further ordered that the Town of Snowflake shall remove all penalty charges from its tax assessment.

It is further ordered that this Decision shall be effective immediately.

Jerry Rudibaugh
Municipal Tax Hearing Officer