

**Jerry Rudibaugh
Municipal Tax Hearing Officer**

DECISION OF MUNICIPAL TAX HEARING OFFICER

Decision Date: February 16, 2004

Decision: MTHO #111

Tax Collector: City of Flagstaff

Hearing Date: March 13, 2003

DISCUSSION

Introduction

On January 15, 2003, *Taxpayer* ("Taxpayer") filed a protest of a tax assessment made by the City of Flagstaff ("City"). After review, the City concluded on March 31, 2003 that the protest was timely and in the proper form. On April 11, 2003, the Municipal Tax Hearing Officer ("Hearing Officer") ordered the City to file a response to the protest on or before May 26, 2003. On May 21, 2003, the City requested an extension to file its response. On May 23, 2003, the Hearing Officer granted the City an extension until July 1, 2003. On June 30, 2003, the City filed its response. On July 10, 2003, the Hearing Officer granted the Taxpayer until July 31, 2003 to file a reply to the City. On July 15, 2003 the Taxpayer requested an extension to file its reply. On July 25, 2003, the Hearing Officer granted the Taxpayer an extension until August 29, 2003. On August 1, 2003, the City filed a letter indicating it would provide additional information requested by the Taxpayer. On August 22, 2003, A Notice of Tax Hearing ("Notice") was issued setting the matter for bearing commencing on September 5, 2003. On August 25, 2003, the Taxpayer requested the hearing date be changed. On August 26, 2003, the Taxpayer filed a reply. On August 29, 2003, the hearing date was rescheduled until October 31, 2003. On September 11, 2003, the hearing date was again rescheduled until November 13, 2003. Both parties appeared and presented evidence at the November 13, 2003 hearing. On November 17, 2003, the Hearing Officer set forth the following deadlines: The Taxpayer would provide additional documentation to the City on or before November 24, 2003; The City would file a closing brief on or before December 15, 2003; The Taxpayer would file any reply brief on or before January 15, 2004; and, both parties could file proposed Findings of Fact and Conclusions of Law on or before January 30, 2004. On December 15, 2003, the City filed a closing brief On January 13, 2004, the Taxpayer filed a reply brief On January 28, 2004, the City filed proposed Findings of Fact and Conclusions of Law. On February 2, 2004, the Hearing Officer issued a letter indicating the record was closed and a written decision would be issued on or before March 17, 2004.

City Position

The City conducted an audit of the Taxpayer for the period March 1997 through February 2001.

The assessment was primarily based on disallowed deductions for sales made to Native Americans and out-of-state sales. The initial assessment resulted in a liability of \$51,229.45 for taxes due, interest, and penalties. Subsequently, the City revised the assessment as a result of additional documentation provided by the Taxpayer. The revised assessment was for taxes in the amount of \$31,508.43, interest in the amount of \$6,770.10 and \$3,449.99 for penalties for late payment and late filing.

Sales to Native Americans

The City imposed taxes on sales to Native Americans when all three criteria set forth in City Regulation 3-5-100.4 (“Regulation 100.4”) were not met. The criteria are as follows:

- (1) The vendor has properly accounted for such sales, in a manner similar to the recordkeeping requirements for out-of-city sales; and
- (2) All of the following elements of the sale exist:
 - (A) solicitation and placement of the order occurs on the reservation; and
 - (B) delivery is made to the reservation; and
 - (C) payment originates from the reservation.

According to the City, the Taxpayer did not have sufficient documentation to support the claimed exemption for Mr. *W* and Mr. *T*. As a result, the City disallowed the claimed exemption. Subsequent to the hearing, the Taxpayer provided documents to demonstrate that payments for Mr. *W* and Mr. *T* originated from the reservation. After review of the documentation, the City agreed that the claimed exemption for Mr. *W* and Mr. *T* should be allowed.

Sales Tax Liability of Predecessor Company

While the Taxpayer did not purchase the business until January 1998, the City assessed the Taxpayer back to March 1997 as a successor in business. City Code Section 3-05-005-0595(d)(2) (“Section 0595”) provides as follows:

“If the purchaser of a business or *stock of goods* fails to obtain a certificate as provided by this Section, he is personally liable for payment of the amount of taxes required to be paid by the former owner on account of the business so purchased, with interest and penalties accrued by the former owner or assignees.”

According to the City, the Taxpayer failed to obtain a certificate and thus is liable for the previous owner’s unpaid taxes pursuant to Section 0595. The City disputed the Taxpayer’s argument that it had only purchased assets and had not assumed any liabilities of the former owner. The City argued the Taxpayer purchased the business. The City asserted the Taxpayer purchased the inventory, name, goodwill, covenant not to compete, vendor agreements and other assets and that the purchase was accomplished through use of a promissory note. The City concluded the Taxpayer either purchased the business or was the purchaser of a stock of goods within the meaning of Section 0595. As a result, the City argued the Taxpayer is liable for the taxes accrued by the former owner, with interest and penalties.

K and N Sales do not Qualify as Exempt Sales

The City opposed the Taxpayer's claim that sales to John **K** and Herb **N** should be exempt as out-of-state sales based upon state tax exemption certificates provided by the Taxpayer. According to the City, both **K** and **N** marked the box on the state form indicating they were temporarily within Arizona. City Code Section 3-05-005-0 100 ("Section 0100") requires all of the following to exist to qualify as an out-of-state sale:

- (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 to be determined in a manner similar to "resides within the City"; 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.

The City asserted both **K** and **N** appear to have placed their orders from within the State of Arizona ("State"). Further the City indicates that **K** had a local address in Sedona, Arizona and that **K** had signed an affidavit indicating that he had picked up the equipment in Arizona. The City argued that the Taxpayer has failed to meet its burden of proof of demonstrating that all of the criteria set forth in Section 0100 have been met for either the **K** or **N** Orders.

Taxpayer Position

Sales to Native Americans

The Taxpayer asserted that the sales to Mr. **T** and Mr. **W** were exempt sales to Native Americans. After providing additional documentation to the City after the hearing, the City has conceded that the assessment for Mr. **T** and Mr. **W** was improper.

Sales Tax Liability of Predecessor Company

The Taxpayer indicated that prior to January 5, 1998, the business was owned and operated by Robert and Barbara **D** ("**D**'s"). According to the Taxpayer, they purchased all of the assets from the **Ds** on January 5, 1998. The Taxpayer argued that longstanding corporate law provides that if one corporation purchases the assets of another corporation and pays a fair consideration for the assets, the corporation purchasing the assets is not liable for the debts of the selling corporation in the absence of fraud or an agreement to assume the debts. The Taxpayer further asserted that the Courts have held that tax laws must be construed in favor of taxpayers. As a result, the Taxpayer argued that the City Tax Code cannot reasonably be interpreted to impose liability on the Taxpayer for the sales tax liability of the **Ds**.

K and N Sales Qualify as Exempt Sales

The Taxpayer argued that the sales to **K** and **N** were not subject to the City Sales Tax because they are exempt "out-of-City" sales. According to the Taxpayer, both **K** and **N** signed Arizona Department of Revenue Transaction Privilege Tax Exemption Certificates ("DOR Exemption Certificates") for Non-Residents stating the transactions were exempt. Further, the Taxpayer

asserts that **K** stated in his Affidavit of Order and Delivery (“Affidavit”) under the penalty of perjury that he ordered and took delivery of the equipment in question in San Diego, California. The Taxpayer argued that the Affidavit was consistent with the testimony at the hearing that the equipment was purchased and delivered out-of-state (to San Diego, California for **K** and to Los Alamos, New Mexico for **N**) to persons who are not residents of Arizona. As a result, the Taxpayer argued the sales to **K** and **N** were exempt from the City Sales Tax Code.

Penalties

The Taxpayer requested the penalties assessed in this matter be waived. The Taxpayer argued that City Code Section 3-5-540(b) (“Section 540(b)”) provides that a taxpayer who fails to pay a tax when due shall not be subject to any penalty if the failure to pay or file the return is due to reasonable cause and not willful neglect. According to the Taxpayer, these criteria were satisfied and the penalties should be dropped. The Taxpayer noted that the City subsequently agreed to waive the penalties for late payment and late filing.

ANALYSIS

Sales to Native Americans

Subsequent to the hearing, the Taxpayer provided documentation to demonstrate that the sales to Mr. **W** and Mr. **T** were exempt sales to Native Americans. The assessment will need to be adjusted to reflect these sales were exempt.

Sales Tax Liability of Predecessor Company

In reviewing the Asset Purchase Agreement (“Agreement”) between the Taxpayer and the **D**’s, the Hearing Officer must conclude the Taxpayer purchased more than the assets of the **D**’s. As set forth in the Agreement, the Taxpayer purchased the tangible assets of the **D**’s as well as intangible assets, which included the company name, goodwill, covenant not to compete, vendor agreements, etc. Based on the evidence presented, the Hearing Officer concludes that the Taxpayer purchased the business of the **D**’s. Further, the Taxpayer failed to obtain a certificate from the City showing that all City tax has been paid at the time of purchase of the business. As a result, the Taxpayer is liable pursuant to City Code Section 3-05-005-0595(d)(2) (“Section 0595”) for the tax liability of the **D**s for the business purchased.

K and N Sales

There was conflicting evidence whether the **K** and **N** sales occurred in or out of the State of Arizona. However, based on the exemption certificate, the Affidavit, and the testimony at the hearing, the Hearing Officer concludes the preponderance of the evidence supports the sales occurring out-of-state. Accordingly, the assessment should be revised to reflect the **K** and **N** sales were exempt out-of-state sales.

Penalties

The Taxpayer has demonstrated the failure to timely pay or file timely returns was due to reasonable cause. As a result, the City has now agreed the penalties should be waived. Accordingly, the assessment should be revised to remove all penalties assessed.

FINDINGS OF FACT

1. On January 15, 2003, the Taxpayer filed a protest of a tax assessment by the City.
2. After review, the City concluded on March 31, 2003 that the protest was timely and in proper form.
3. On April 11, 2003, the Hearing Officer ordered the City to file a response to the protest on or before May 26, 2003.
4. On May 21, 2003, the City requested an extension to file its response.
5. On May 23, 2003, the Hearing Officer granted the City an extension until July 1, 2003.
6. On June 30, 2003, the City filed its response.
7. On July 10, 2003, the Hearing Officer granted the Taxpayer until July 31, 2003 to file its reply.
8. On July 15, 2003, the Taxpayer requested an extension to file its reply.
9. On July 25, 2003, the Hearing Officer granted the Taxpayer an extension until August 29, 2003.
10. On August 1, 2003, the City filed a letter indicating it would provide additional information requested by the Taxpayer.
11. On August 22, 2003, a Notice was issued setting the matter for hearing commencing on September 5, 2003.
12. On August 25, 2003, the Taxpayer requested the hearing date be changed
13. On August 26, 2003, the Taxpayer filed a reply.
14. On August 29, 2003, the hearing date was rescheduled until October 31, 2003.
15. On September 11, 2003, the hearing date was again rescheduled until November 13, 2003.

16. Both parties appeared and presented evidence at the November 13, 2003 hearing.
17. On November 17, 2003, the Hearing Officer set forth the following deadlines: The Taxpayer would provide additional documentation to the City on or before November 24, 2003; The City would file a closing brief on or before December 15, 2003; The Taxpayer would file any reply brief on or before January 15, 2004; and both parties could file proposed Findings of Fact and Conclusions of Law on or before January 30, 2004.
18. On December 15, 2003, the City filed a closing brief.
19. On January 13, 2004, the Taxpayer filed a reply brief.
20. On January 28, 2004, the City filed proposed Findings of Fact and Conclusions of Law.
21. On February 2, 2004, the Hearing Officer issued a letter indicating the record was closed and a written decision would be issued on or before March 17, 2004.
22. The City conducted an audit of the Taxpayer for the period March 1997 through February 2001.
23. The assessment was primarily based on disallowed deductions for sales made to Native Americans and out-of-state sales.
24. The initial assessment resulted in a liability of \$51,229.45 for taxes due, interest, and penalties.
25. Subsequently, the City revised the assessment as a result of additional documentation provided by the Taxpayer.
26. The revised assessment was for taxes in the amount of \$31,508.43, interest in the amount of \$6,770.10, and \$3,449.99 for penalties for late payment and late filing.
27. The Taxpayer did not have sufficient documentation to support the claimed exemptions for Mr. *W* and Mr. *T*.
28. Subsequent to the hearing, the Taxpayer provided documents to demonstrate that payments for Mr. *W* and Mr. *T* originated from the reservation.
29. The Taxpayer purchased the business in January of 1998.
30. The City assessed the Taxpayer back to March 1997 as a successor in business.
31. The Taxpayer failed to obtain a certificate from the previous owner.

32. The Taxpayer purchased the inventory, name, goodwill, covenant not to compete, vendor agreements and other assets.
33. Both **K** and **N** marked the box on the state form indicating they were temporarily within Arizona.
34. Both **K** and **N** signed DOR Exemption Certificates for Non-Residents stating the transactions were exempt.
35. **K** stated in his Affidavit that he ordered and took delivery of the equipment in question in San Diego, California.

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 was engaged in the business of selling tangible personal property pursuant to City Code 3-5-460.
3. The sales to Mr. **W** and Mr. **T** were exempt pursuant to Regulation 100.4.
4. The sales to **K** and **N** were exempt pursuant to Section 0100.
5. Taxpayer purchased the business from the **D**'s.
6. Taxpayer is liable pursuant to Section 095 for the tax liability of the **D**'s.
7. Taxpayer has demonstrated the failure to timely pay and timely filing of tax returns was due to reasonable cause.
8. All penalties should be waived.
9. The Taxpayer's protest should be partly granted consistent with the Conclusions of Law Nos. 3, 4, and 8.
10. The remainder of the Taxpayer's protest should be denied.

ORDER

It is therefore ordered that the January 13, 2003 protest of **Taxpayer** of a tax assessment made by the City of Flagstaff is hereby partly granted and partly denied consistent with the Discussion herein.

It is further ordered that the City of Flagstaff shall revise the assessment to reflect the sales to Mr. *W* and Mr. *T* were exempt.

It is further ordered that the City of Flagstaff shall revise the assessment to reflect the sales to *K* and *N* were exempt.

It is further ordered that the City of Flagstaff shall remove all penalties assessed.

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

Jerry Rudibaugh
Municipal Tax Hearing Officer