

## **DECISION OF MUNICIPAL TAX HEARING OFFICER**

Decision Date: August 8, 2006

Decision: MTHO #293

Tax Collector: City of Tucson

Hearing Date: April 11, 2006

### **DISCUSSION**

#### **Introduction**

On January 5, 2006, *Taxpayer ABC* (“Taxpayer”) filed a protest of a tax assessment made by the City of Tucson (“City”). After review, the City concluded on January 13, 2006 that the protest was timely and in the proper form. On January 21, 2006, the Municipal Tax Hearing Officer (“Hearing Officer”) ordered the City to file a response to the protest on or before March 7, 2006. On February 23, 2006, the City filed a response to the protest. On March 1, 2006, the Hearing Officer ordered the Taxpayer to file a reply on or before March 22, 2006. On March 6, 2006, a Notice of Tax Hearing (“Notice”) scheduled this matter for hearing commencing on April 11, 2006. On March 8, 2006, the Taxpayer filed a reply. On April 4, 2006, the Taxpayer requested the auditor be available at the hearing. On April 6, 2006, the Hearing Officer informed the City of the need for the auditor at the hearing. Both parties appeared and presented evidence at the April 11, 2006 hearing. On April 19, 2006, the Hearing Officer indicated the Taxpayer would file additional documentation for the City’s review on or before May 11, 2006; the City would file any response on or before June 12, 2006; and, the Taxpayer would file any reply on or before June 26, 2006. On May 11, 2006, the Taxpayer filed additional documentation with the City. On May 25, 2006, the City filed a response. On May 27, 2006, the Taxpayer filed a reply. On May 31, 2006, the Hearing Officer sent the Taxpayer’s reply to the City and granted the Taxpayer an opportunity to request the hearing be reopened. On June 1, 2006, the Taxpayer indicated he did not want to reopen the hearing but desired to refer the matter to a higher court. On June 5, 2006, the Hearing Officer sent a copy of the Taxpayer’s June 1, 2006 letter to the City and indicated the record was closed and a written decision would be issued on or before July 20, 2006. On June 8, 2006, the Taxpayer indicated he would now like the hearing reopened and to have the City present evidence that the Taxpayer was in business. On June 16, 2006, the Hearing Officer sent a copy of the Taxpayer’s June 8, 2006 letter to the City and ordered the City to file any comments/objections on or before June 30, 2006. On June 27, 2006, the City filed a response. On July 1, 2006, the Hearing Officer stayed the decision and ordered the Taxpayer to file any reply on or before July 17, 2006. On July 10, 2006, the taxpayer filed a reply. On July 15, 2006, the Hearing Officer sent a copy of the Taxpayer’s July 10, 2006 letter to the City. On July 26, 2006, the Taxpayer filed additional documentation. On August 1, 2006, the Hearing Officer sent a copy of the Taxpayer’s July 26, 2006 letter to the City and indicated a written decision would be issued on or before August 30, 2006.

#### **City Position**

The City performed an audit of the Taxpayer for the period January 1999 through August 2005. The City concluded the Taxpayer owed taxes of \$48,996.80 and interest up through October 2005 of \$19,637.62. The City also assessed penalties for the failure to file reports and failure to timely pay taxes totaling \$4,900.00. According to the City, the Taxpayer sold foot orthotics which were placed in shoes to make customers walk better. The City indicated it would exempt any orthotic sale that was prescribed or recommended by a licensed medical professional. However, the City was not provided any documentation from the Taxpayer to support any medical exemption. During the audit process, the City had made several requests of the Taxpayer to provide accounting records, however, none were ever provided. As a result, the City utilized the tax payment history of two orthopedic sales companies licensed with the City to estimate the Taxpayer's taxable income pursuant to City Code Section 19-545(b) (Section 545"). The City asserted that Section 545 provides that "It is the responsibility of the taxpayer to prove that the tax collector's estimate is not reasonable and correct, by providing sufficient documentation". According to the City, no documentation was ever provided.

In reviewing the Taxpayer's post hearing documentation, the City opined that none of it proves the Taxpayer was not conducting business within the City. The City asserted that City Code Section 19-555 ("Section 555") provides the City authority to examine the books and records of the Taxpayer. The City argued that in the absence of any business records, the original audit assessment was fair and a reasonable assessment. The City also provided copies of phone book listings which showed that during the audit period the Taxpayer had a listing under *Business Name ABC* with a City business address. The City noted that the Taxpayer did not provide any accounting records or Federal and State Income Tax Returns to show he was not in business in the City.

### **Taxpayer Position**

The Taxpayer indicated he opened business in November 1985 after receiving a business license for the location on *Street 123* in the City. According to the Taxpayer, he stated at the time of his license application that he manufactured foot orthotics for customers based on prescriptions and/or TV advertising. The Taxpayer indicated he was told by a City employee that his products were non-taxable since the products were manufactured by hand and were considered a medical product. As a result, the Taxpayer stated that no taxes were charged on the products. The Taxpayer asserted that he had sought help from City agents on several occasions. According to the Taxpayer, the City has demonstrated a lack of attention to detail, lack of professionalism, and a lack of education on how to perform their jobs since the time the Taxpayer has been in business.

The Taxpayer disputed the assertion that the City had requested on several occasions for the Taxpayer's accounting records. The Taxpayer asserted he was only asked once for such records and only after he had closed his business. According to the Taxpayer, he refused to provide business records because of lies by the auditor. The Taxpayer questioned why he was being assessed taxes beginning in 1999 when his business was exempt for the previous fifteen years. The Taxpayer also disputed the City's statement

that orthotics meet the definition of a “prosthetic device”. The Taxpayer opined that he didn’t know anyone in the medical field that thinks a foot orthotic is a “prosthetic device”. The Taxpayer indicated in his March 8, 2006 reply letter that he had been in business for over twenty years from November 1985 to December 2005. At the hearing, the Taxpayer opined that he was in the orthotic business for fifteen years and subsequently his business activity changed to the Tin Can Art business. According to the Taxpayer, the reason he had claimed to be in the orthotic business for twenty years was because he didn’t want to divulge to the City that his business had closed. The Taxpayer asserted that he wanted it to appear like he was still in business in order to see where the audit was going.

The Taxpayer concluded the City’s assessment amount was a “very realistic figure based on the findings that the City...” had furnished in their report. The Taxpayer asserted that the auditor for the City was aware of the Taxpayer violations in 1999, but did not notify the Taxpayer. According to the Taxpayer, if he had been timely notified, he would have started to charge his customers for the tax. The Taxpayer indicated he attempted to close his business license in August 2005. The Taxpayer asserted the City would not allow him to close the license until the audit was closed. The Taxpayer closed the license on January 3, 2006.

At the hearing, the Taxpayer provided copies of the following:

- A copy of a credit card bill which showed there were several purchases totaling \$42.99 from gas stations in the State of California (“California”) during the period May 26, 1999 through June 1, 1999;
- The Taxpayer provided a copy of a credit card bill which showed a lodging purchase in the City of Flagstaff, Arizona for the night of June 29, 1998;
- A copy of a credit card bill showing several purchases from gas stations in California totaling \$79.06 for the period August 6, 1999 through August 16, 1999;
- A copy of a credit card bill which showed purchases were made in California during the period September 23 through September 27, 1999;
- A copy of a January 30, 2000 business license application for “*Business I*” for the address of *Location 1* City;
- A copy of a certificate to display art in the City and County of San Francisco, California;
- A copy of a credit card bill showing several purchases in Sedona, Arizona for the period May 18 through May 20, 1998;
- A copy of a credit card bill showing several purchases in California during the period February 5 through February 12, 1999;
- And a copy of a credit card bill showing a purchase of an airline ticket to Seattle, Washington on May 5, 1998.

The Taxpayer argued the copies provided at the hearing demonstrated he was not in the orthotic business during the audit period. The Taxpayer asserted that he could not provide documents requested by the City because of “privacy laws”.

Subsequent to the hearing, the Taxpayer provided the following:

- A printout dated April 20, 2006 which was titled “Taxable Activity Registration System” and listed the address of **Location 2** as the Taxpayer’s business dba **Business 2**;
- And, a copy of an envelope with a postmark sometime in the year 2000 which indicated **Business 3** had moved to **Location 3** in the City.

In response to the filing by the City of phone book listings, the Taxpayer asserted they were “free listings”. According to the Taxpayer, “free listings” are almost impossible to change once they begin to run. The Taxpayer opined that the City never asked him for any State or Federal Tax returns. Lastly, the Taxpayer provided a copy of a letter from **Real Estate Service** in support of the Taxpayer’s argument that he was not in business during the audit period.

In the Taxpayer’s May 27, 2006 letter, the Taxpayer complained the April 11, 2006 hearing was unfair because the City Attorney was present at the hearing. According to the Taxpayer, he was not made aware that he could have an attorney present at the hearing. In response to the Hearing Officer granting the Taxpayer an opportunity to reopen the hearing and be represented by a tax attorney, the Taxpayer indicated he did not want the hearing reopened and requested the matter be referred to a higher court. Subsequently, a week later, the Taxpayer requested a new hearing and opined that he did not see the need for an attorney. At the conclusion of the April 11, 2006 hearing, the Taxpayer stated, under oath, that the hearing process had been fair.

### ANALYSIS

There was no dispute that the Taxpayer commenced an orthotic business in the City in November 1985. These sales would be taxable retail sales pursuant to the City Code Section 19-460 (“Section 460”). While we would not normally consider orthotics as prosthetic devices, which are exempt from taxation pursuant to City Code Section 19-465 (“Section 465”), the City indicated they would allow the exemption if the Taxpayer provided documentation from a licensed medical professional. Since no documentation was provided, no exemption can be granted. We note the Taxpayer indicated concerns with possible violations of “privacy laws”. If there were such documents, the Taxpayer could have provided the information with customer names removed.

The Taxpayer provided documentation which he believed demonstrated he was not in the orthotic business during the audit period. After reviewing that documentation, we conclude the following: during the audit period, the Taxpayer started a new business entitled **Business 2**; there were days during the audit period that the Taxpayer was conducting business related to his art business in the State of California; and, there were days during the audit period the Taxpayer spent either in Sedona or Flagstaff, Arizona. We do not conclude that the Taxpayer has demonstrated he was not in the orthotic business during the entire audit period.

Based on the evidence presented, we conclude the Taxpayer was in the orthotic business in the City for the audit period. The primary evidence to support that conclusion was the

fact that the Taxpayer did not cancel his license to do orthotic business in the City until after the conclusion of the audit period. We also note that the Taxpayer consistently referred to his being in the orthotic business for over twenty years. This reference included Taxpayer Exhibit No. 5 which was a business card of the Taxpayer for *Business 3* – “20 years of Service”. Taxpayer Exhibit No. 8, Application For A Business Privilege License, demonstrates the Taxpayer was beginning his art business in the City effective January 30, 2000. That same exhibit describes the business activity of the Taxpayer to also include a medical business activity, orthotics business. The Qwest Dex Yellow Page ads further demonstrate that the Taxpayer was in the orthotic business in the City during the audit period.

Once the Taxpayer commenced business in the City, the Taxpayer had a duty pursuant to City Code Section 19-350 (“Section 350”) to “keep and preserve suitable books and records and such other books and accounts as may be necessary to determine the amount of tax for which he is liable....” As a result, the burden of proof is clearly on the Taxpayer to maintain books and records that will support the amount of taxable income. Section 555 authorizes the City to require the Taxpayer to provide appropriate books and records for the City to examine in order to determine the tax liability of the Taxpayer. The City requested such books and records from the Taxpayer. Since the Taxpayer failed to provide appropriate books and records requested by the City, the City was authorized pursuant to Section 555 to make an estimate of the amount of taxable income. That estimate pursuant to Section 545 must be made on a reasonable basis. Section 545 further provides that “It is the responsibility of the taxpayer to prove that the Tax Collector’s estimate is not reasonable and correct, by providing sufficient documentation of the type and form required by this chapter or satisfactory to the Tax Collector”. We conclude that the City’s use of similar business to make an estimate was reasonable. We further conclude that the Taxpayer has failed to meet his burden of proof of demonstrating the estimate was not reasonable.

In the Taxpayer’s initial protest, he complained that a City employee provided oral advice that the Taxpayer did not have to pay any tax. City Code Section 19-541 (“Section 541”) provides that the Tax Collector is not bound by such oral advice. While the Taxpayer may have had conversations with a City employee, there was no evidence of who that employee was and/or what was stated. Even if we had such information, it is clear from Section 541 that any oral advice would not affect the tax assessment in this matter.

Based on all the above, we conclude that the Taxpayer conducted orthotic business in the City during the audit period. Further, the City’s estimate of the taxable income was made on a reasonable basis. As a result, the Taxpayer’s protest should be denied for failing to meet his burden of proof of providing proper documentation.

### **FINDINGS OF FACT**

1. On January 5, 2006, the Taxpayer filed a protest of a tax assessment made by the City.

2. After review, the City concluded on January 13, 2006 that the protest was timely and in the proper form.
3. On January 21, 2006, the Hearing Officer ordered the City to file a response to the protest on or before March 7, 2006
4. On February 23, 2006, the City filed a response to the protest.
5. On March 1, 2006, the Hearing Officer ordered the Taxpayer to file a reply on or before March 22, 2006.
6. On March 6, 2006, a Notice scheduled this matter for hearing commencing on April 11, 2006.
7. On March 8, 2006, the Taxpayer filed a reply.
8. On April 4, 2006, the Taxpayer requested the auditor be available at the hearing.
9. On April 6, 2006, the Hearing Officer informed the City of the need for the auditor at the hearing.
10. Both parties appeared and presented evidence at the April 11, 2006 hearing.
11. On April 19, 2006, the Hearing Officer indicated the Taxpayer would file additional documentation for the City's review on or before May 11, 2006; the City would file any response on or before June 12, 2006; and, the Taxpayer would file any reply on or before June 26, 2006.
12. On May 11, 2006, the Taxpayer filed additional documentation.
13. On May 12, 2006, the Hearing Officer sent the documentation to the City.
14. On May 25, 2006, the City filed a response.
15. On May 27, 2006, the Taxpayer filed a reply.
16. On May 31, 2006, the Hearing Officer sent the Taxpayer's reply to the City and granted the Taxpayer an opportunity to request the hearing be reopened.
17. On June 1, 2006, the Taxpayer indicated he did not want to reopen the hearing but desired to refer the matter to a higher court.
18. On June 5, 2006, the Hearing Officer sent a copy of the Taxpayer's June 1, 2006 letter to the City and indicated the record was closed and a written decision would be issued on or before July 20, 2006.

19. On June 8, 2006, the Taxpayer indicated he would now like the hearing reopened and to have the City present evidence that the Taxpayer was in business.
20. On June 16, 2006, the Hearing Officer sent a copy of the Taxpayer's June 8, 2006 letter to the City and ordered the City to file any comments/objections on or before June 30, 2006.
21. On June 27, 2006, the City filed a response.
22. On July 1, 2006, the Hearing Officer stayed the decision and ordered the Taxpayer to file any reply on or before July 17, 2006.
23. On July 10, 2006, the Taxpayer filed a reply.
24. On July 15, 2006, the Hearing Officer sent a copy of the Taxpayer's July 10, 2006 letter to the City.
25. On July 26, 2006, the Taxpayer filed additional documentation.
26. On August 1, 2006, the Hearing Officer sent a copy of the July 26, 2006 Taxpayer letter to the City and indicated a written decision would be issued on or before August 30, 2006.
27. The City performed an audit of the Taxpayer for the period January 1999 through August 2005.
28. The City concluded the Taxpayer owed taxes of \$48,996.80 and interest up through October 2005 of \$19,637.62.
29. The City assessed penalties for the failure to file reports and failure to timely pay taxes totaling \$4,900.00.
30. During the audit period, the Taxpayer sold orthotics which were placed in shoes to make customers walk better.
31. The Taxpayer did not provide any documentation to support any medical exemption.
32. During the audit process, the City had made several requests of the Taxpayer to provide accounting records but none were ever provided.
33. The City utilized the tax payment history of two orthopedic sales companies licensed with the City to estimate the Taxpayer's taxable income.
34. The Taxpayer was listed in the Qwest Dex Yellow Pages as being in business in

- the City during the audit period.
35. The Taxpayer opened his business in November 1985 after receiving a business license for a City location.
  36. During the audit period, the Taxpayer made purchases in the State of California.
  37. In January, 2002, the Taxpayer applied for a business license for “*Business I*” at a City location.
  38. During the audit period, the Taxpayer made purchases in the Cities of Sedona and Flagstaff, Arizona.
  39. The Taxpayer closed his business license for the orthotic business on January 3, 2006.

### **CONCLUSIONS OF LAW**

1. Pursuant to ARS Section 42-6056, the Municipal Tax Hearing Officer is to hear all reviews of the petitions for hearing or redetermination under the Model City Tax Code.
2. During the audit period, the Taxpayer had underreported income from retail sales pursuant to Section 460.
3. The Taxpayer had a duty pursuant to Section 350 “to keep and preserve suitable books and records and such other books and accounts as may be necessary to determine the amount of tax for which he is liable...”.
4. Section 555 authorizes the City to require the Taxpayer to provided appropriate books and records for the City to examine in order to determine the tax liability of the Taxpayer.
5. The Taxpayer failed to maintain or provide necessary books and records to the City.
6. The City was authorized pursuant to Section 555 to use estimates when the Taxpayer failed to maintain or provide necessary books and records.
7. The Taxpayer failed pursuant to Section 545 to provide documentation to prove the City’s estimate was not reasonable.
8. The City is not bound by oral advice provided to the Taxpayer.
9. The City was authorized pursuant to City Code Section 540 to impose penalties



for failure to timely file and to timely pay taxes.

10. The Taxpayer failed to provide reasonable cause to waive the penalties.

11. The Taxpayer's protest should be denied for failing to meet his burden of proof of providing proper documentation.

**ORDER**

It is therefore ordered that the January 5, 2006 protest by *Taxpayer ABC* of a tax assessment made by the City of Tucson is hereby denied.

It is further ordered that this Decision is effective immediately.

Jerry Rudibaugh  
Municipal Tax Hearing Officer