

DECISION OF MUNICIPAL TAX HEARING OFFICER

Decision Date: September 13, 2004

Decision: MTHO #158

Tax Collector: City of Prescott

Hearing Date: May 7, 2004

DISCUSSION

Introduction

On August 15, 2003, *Taxpayer* (“Taxpayer”) filed a protest of a tax assessment made by the City of Prescott (“City”). After review, the City concluded on November 25, 2003 that the protest was timely and in the proper form. On November 29, 2003, the Municipal Tax Hearing Officer (“Hearing Officer”) ordered the City to file any response to the protest on or before January 13, 2003. The City filed a response on December 10, 2003. On December 17, 2003, the Hearing Officer ordered the Taxpayer to file any reply on or before January 7, 2004. A Notice of Tax Hearing (“Notice”) was issued on January 7, 2004 setting the matter for hearing commencing on February 12, 2004. On February 2, 2004, the Taxpayer requested the hearing be continued. On February 5, 2004, the Hearing Officer granted the continuance. On March 8, 2004, A Notice was issued setting the matter for hearing commencing on May 7, 2004. Both parties appeared and presented evidence at the May 7, 2004 hearing. On May 10, 2004, the Hearing Officer ordered the City to provide a copy of the Taxpayer’s Tax License Application (“Application”) on or before May 14, 2004; the Taxpayer was to file an opening brief on or before June 11, 2004; the City was to file a response brief on or before July 9, 2004; and, the Taxpayer was to file a reply brief on or before July 16, 2004. On May 14, 2004, the City filed an Affidavit with exhibits. On June 3, 2004, the Taxpayer filed a request for an extension for their opening brief. On June 4, 2004, the City filed a response indicating they had no opposition to an extension as long as the City received a corresponding extension. On June 7, 2004, the Hearing Officer granted the Taxpayer an extension for their opening brief until June 25, 2004; the City was granted an extension for their response brief until July 23, 2004; and, the Taxpayer was granted an extension for their reply brief until July 30, 2004. On June 17, 2004, the Taxpayer filed their opening brief. On July 19, 2004, the City filed their response brief. On July 23, 2004, the Taxpayer filed their reply brief. On July 28, 2004, the Hearing Officer closed the record and indicated a written decision would be issued on or before September 13, 2004.

City Position

The Taxpayer was originally licensed in August of 1987 as an individual contractor. The License was cancelled on December 31, 1999. The Taxpayer had filed tax reports declaring no taxable income and declared his work as either subcontracting or exempt. The City performed an audit of the Taxpayer for the period of May 1997 through April 2003. The City determined that the

Taxpayer had acted in the capacity of a general contractor on some construction projects. The Taxpayer was unable to provide records requested by the City and as a result the City utilized building permits to determine taxable income. The City assessed the Taxpayer for additional taxes due on contracting income in the amount of \$9,532.42. In addition, the City assessed penalties totaling \$2,363.46 plus interest up through May 2003 in the amount of \$7,071.65.

The City asserted that if a taxpayer files tax returns that the City is not satisfied with, the City is authorized pursuant to City Tax Code Section 4-1-545(a)(1) and (2) (“Section 545(a)”) to “redetermine the amount of the tax, penalties and interest ... based on any information within his possession or which comes into his possession”. In addition, City Code Section 4-1-545(b) (“Section 545(b)”) authorizes the City to make an estimate of a taxpayer’s liability “on any reasonable basis.” It is further stated in Section 545(b) that it is the responsibility of the taxpayer to prove that the City’s method is not reasonable and correct, by providing sufficient documentation. The City also noted that City Tax Code Section 370 (“Section 370”) places the burden on the taxpayer to produce or reconstruct records to overcome the City’s reasonable estimate. While the Taxpayer attacked the correctness of the City’s estimate, the City argued that the Taxpayer did not present any records to show any other reasonable method to estimate the taxes. The City asserts that its method of estimating the tax liability based on the value of building permit applications submitted by the Taxpayer and issued by the City is a reasonable method. In response to the Taxpayer’s loss of his records to his BookkeeperS, the City argued that the Taxpayer’s dispute with his BookkeeperS does not relieve him from the obligation to produce or reconstruct records.

According to the City, the Taxpayer did not, until the hearing, raise the issued that the tax liability was that of a corporation and not his personal obligation. Based on the City records, the Taxpayer filed for individual tax license application in August of 1987. At that time, the business name was “*Firstname Lastname* Gen. Contr.”. There was no subsequent license issued in the name of the corporation, even though the Taxpayer claimed in a 1995 tax return that he had incorporated and changed the name to “*Firstname MI Lastname* Sr., Gen. Contracting, Inc.”. The City indicated that City Tax Code Section 4-1-300 (“Section 300”) requires persons to make an application for a license, and prohibits them from doing business until they have a license. The City also noted that the corporation was administratively dissolved by the Arizona Corporation Commission (“ACC”) in February 2001. The City argued that because the corporation never applied for or held a tax license, and the only license ever held was held by *Firstname Lastname* in his individual capacity from the time of the application in 1987, he is still individually liable for the tax obligation. Based on the above, the City urges the Hearing Officer determine that *Firstname MI Lastname* is the responsible entity for the assessment.

Taxpayer Position

According to the Taxpayer, the audit was based on the speculative building cost of the *Location* Self Storage (“*Location*”) located at 706 *Location* Road in the City. The Taxpayer asserted that it was the general contractor on the *Location* project and had pulled the building permit. However, the Taxpayer argued that his partner and client was *Mr. XYZ* (“*Mr. XYZ*”) and that *Mr. XYZ* was to be responsible for all sales taxes on the project. The Taxpayer indicated they would provide the City a copy of the contract with *Mr. XYZ* to demonstrate that *Mr. XYZ* was

responsible for the taxes owed on the **Location** project. The Taxpayer asserted that it was the City's position that the corporation is the taxpayer responsible for the payment of taxes. The Taxpayer argued there was no evidence that **Principal**, in his personal capacity, should be held responsible for the corporation's obligation. According to the Taxpayer, there is ample legal authority that shareholders, directors, and officers are not personally responsible for the obligations of the corporation absent an agreement to the contrary.

The Taxpayer argued that the City is barred from assessing any taxes against **Firstname MI Lastname** in his personal capacity. In addition, the Taxpayer argued that the City is barred from assessing any transaction privilege taxes against the corporation until such time as the City has determined the actual amount of taxes owed. According to the Taxpayer, the City has conceded that the calculation of taxes was based entirely on estimates set forth in building permits filed by the corporation. The Taxpayer argued that the City did not even attempt to verify the amounts paid to the corporation. The Taxpayer asserted that the City knows the Taxpayer only constructed 75 percent of the **Location** project and that another contractor had to complete the project. According to the Taxpayer, the City was aware that **Ms. A and Ms. B** (collectively, the "Bookkeepers") were engaged by the Taxpayer to compile accounting records and to prepare the transaction privilege tax returns. The Taxpayer asserted that the Bookkeepers failed to return the accounting records to **Principal**. The Taxpayer argued that the City proceeded with the tax assessment based on information known to be inaccurate and that the assessment very likely imparts a windfall on the City through a collection of "double-tax" on a significant portion of the construction of the mini-storage facility.

During the audit process and at the hearing, the Taxpayer asserts the City's position was always that the Corporation is the taxpayer responsible for the payment of the taxes. The Taxpayer extracted the following from the City's April 23, 2003 "Preliminary Taxpayer Notification of Audit-Results-10-Day Review Period:

"A privilege tax assessment has been calculated for **Taxpayer** for the audit period beginning May 1997 and ending April 23, 2003."

The Taxpayer extracted the following from a September 12, 2002 letter from the City addressed to the Corporation:

"This letter is to advise you that the City of Prescott intends to make an examination of the books and records of **Taxpayer** with respect to Privilege and Use Tax for the 48 months ended August 2002."

Based on all the above, the Taxpayer requested the Hearing Officer hold that **Principal** is not personally responsible for the payment of the taxes and that the City is barred from assessing the taxes against the corporation until such time as the City has determined the amount of taxes owed based on the known facts and circumstances.

ANALYSIS

The first issue is who is the “person” that conducted the contracting activities that the City found to be taxable. We find that the City was notified of the change from an individual ownership business to a corporation when the privilege and use tax return was filed on October 20, 1995. While the corporation may not have been properly license with the City, we do note that the corporation requested at the bottom of the October 20, 1995 return for the City to send a new license application since the business was now incorporated. As a result, we find the proper taxpayer for the period October 20, 1995 through February 7, 2001 was the corporation. Any taxable activities outside that time period would be the individual responsibility of *Principal*. Whether *Principal* would have any individual responsibility for the corporation liability can not be determined from the record. It is not clear if the corporation properly notified the City of its dissolution in 2001 and how the assets, if any, were distributed.

The second issue is the amount of tax obligation. Clearly, the tax code requires the Taxpayer to maintain books and records to support the amount of taxable income. In this case, the City requested books and records and the Taxpayer failed to provide such records. As a result, the City was authorized pursuant to Section 545(a) to make an estimate of the Taxpayer’s liability on any reasonable basis. We find the City’s use of the values on the building permits to be a reasonable basis of estimation. While the Taxpayer argued the City’s estimation was not reasonable, the Taxpayer failed to provide any books and records or offer any other estimation. Further, while the Taxpayer argued that *Mr. XYZ* was the responsible party to pay the taxes, the Taxpayer failed to produce any documentation to support that assertion. As a result, we conclude that the City’s assessment was proper.

FINDINGS OF FACT

1. On August 15, 2003, the Taxpayer filed a protest of a tax assessment made by the City.
2. After review, the City concluded on November 25, 2003 that the protest was timely and in proper form.
3. On November 29, 2003, the Hearing Officer ordered the City to file any response to the protest on or before January 13, 2004.
4. The City filed a response on December 10, 2003.
5. On December 17, 2003, the Hearing Officer ordered the Taxpayer to file any reply on or before January 7, 2004.
6. A Notice was issued on January 7, 2004, setting the matter for hearing commencing on February 12, 2004.
7. On February 2, 2004, the Taxpayer requested the hearing be continued.

8. On February 5, 2004, the Hearing Officer granted the continuance.
9. On March 8, 2004, a Notice was issued setting the matter for hearing commencing on May 7, 2004.
10. Both parties appeared and presented evidence at the May 7, 2004 hearing.
11. On May 10, 2004, the Hearing Officer ordered the City to provide a copy of the Taxpayer's Application on or before May 14, 2004; the Taxpayer was to file an opening brief on or before June 11, 2004; the City was to file a response brief on or before July 9, 2004; and, the Taxpayer was to file a reply brief on or before July 16, 2004.
12. On May 14, 2004, the City filed an Affidavit with exhibits.
13. On June 3, 2004, the Taxpayer filed a request for an extension for their opening brief.
14. On June 4, 2004, the City filed a response indicating they had no opposition to the extension as long as the City received a corresponding extension.
15. On June 7, 2004, the Hearing Officer granted the Taxpayer an extension for their opening brief until June 25, 2004; the City was granted an extension for their response brief until July 23, 2004; and, the Taxpayer was granted an extension for their reply brief until July 30, 2004.
16. On June 17, 2004, the Taxpayer filed their opening brief.
17. On July 19, 2004, the City filed their response brief.
18. On July 23, 2004, the Taxpayer filed a reply brief.
19. On July 28, 2004, the Hearing Officer closed the record and indicated a written decision would be issued on or before September 13, 2004.
20. The Taxpayer was originally licensed in August 1987 as an individual contractor.
21. The license was cancelled on December 31, 1999.
22. The Taxpayer had filed tax reports declaring no taxable income and declared his work as either subcontracting or exempt.
23. The City performed an audit of the Taxpayer for the period of May 1997 through April 2003.
24. The Taxpayer had acted in the capacity of a general contractor on some construction contracts.

25. The Taxpayer was unable to provide records requested by the City and as a result the City utilized building permits to determine taxable income.
26. The City assessed the Taxpayer for additional taxes due on contracting income in the amount of \$9,532.42.
27. The City also assessed penalties totaling \$2,363.46 plus interest up through May 2003 in the amount of \$7,071.65.
28. The Taxpayer did not present any records to show any other reasonable method to estimate the taxable income.
29. The City was notified of the change from an individual ownership business to a corporation when the privilege and use tax return was filed by the Taxpayer on October 20, 1995.
30. At the bottom of the October 20, 1995 tax return, the Taxpayer requested the City to send a new license application since the business was now incorporated.
31. The corporation was dissolved in February of 2001.
32. There was no evidence that the City was notified of the corporation dissolution in 2001.
33. The Taxpayer was the general contractor on the *Location* project and had pulled the building permit.
34. Prior to completion of the *Location* project, the Taxpayer had a disagreement with his partner and client, *Mr. XYZ*, and the Taxpayer did not complete the project.
35. There was no evidence presented to demonstrate the City was notified, prior to the hearing, of the dissolution of the corporation, and how the assets, if any, were distributed.

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 proper taxpayer for the period October 20, 1995 through February 7, 2001 was the corporation.
3. Pursuant to Section 370, the Taxpayer is required to keep and preserve suitable records.
4. The City is authorized pursuant to Section 545 to use estimates when the Taxpayer fails to maintain or provide necessary books and records.

5. The Taxpayer failed to maintain or provide necessary books and records to the City.
6. The City's estimation method was made on a reasonable basis.
7. The Taxpayer has failed to provide documentation to demonstrate that the City's estimate was not reasonable.
8. The Taxpayer's protest should be granted, in part, and denied, in part, consistent with the Findings, Conclusions, and Discussion herein.

ORDER

It is therefore ordered that the August 15, 2003 protest of *Taxpayer* of a tax assessment made by the City of Prescott is hereby denied, in part, and granted, in part, consistent with the Discussion, Findings, and Conclusions, herein.

It is further ordered that the corporation was the proper taxpayer during the period of October 20, 1995 through February 7, 2001.

It is further ordered that the City's amount of tax assessment was proper.

It is further ordered that this Decision is effective immediately.

Jerry Rudibaugh
Municipal Tax Hearing Officer