

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

Decision Date: June 2, 2006  
Decision: MTHO #292  
Tax Collector: City of Nogales  
Hearing Date: April 20, 2006

### **DISCUSSION**

#### **Introduction**

On October 28, 2005, *Taxpayer* filed a protest of a tax assessment made by the City of Nogales (“City”). After review, the City concluded on January 10, 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 March 7, 2006, the City filed a response. On March 13, 2006, the Hearing Officer ordered the Taxpayer to file any reply on or before April 3, 2006. On April 7, 2006, a Notice of Tax Hearing (“Notice”) scheduled this matter for hearing commencing on April 20, 2006. Both parties appeared and presented evidence at the April 20, 2006 hearing. On April 24, 2006, the Hearing Officer indicated the record was closed and a written decision would be issued on or before June 8, 2006.

#### **City Position**

The City audited the Taxpayer for the period January 1999 through February 2005. The City concluded the Taxpayer had understated restaurant income for the audit period with taxes due in the amount of \$4,472.43 plus interest until paid. The City assessed the Taxpayer for penalties totaling \$1,148.36 for failure to timely pay and for failure to timely file reports. The City also assessed the Taxpayer \$125.00 for a sales tax license.

On April 22, 2005, the City advised the Taxpayer on what records were needed for the audit. Subsequently, the Taxpayer provided copies of bank statements showing only deposits and copies of sales tax returns that corresponded to the amount of the monthly reports. The City asserted the information provided was inadequate for the following reasons:

- A. The bank statements do not provide information on checks written.
- B. No federal or state income tax returns were provided.
- C. There was no schedule of expenses provided.
- D. There was no additional information other than those listed on A and B above.

The City was informed that the Taxpayer paid for expenses and food purchases in cash. According to the City, the Taxpayer maintained no schedule of expenses. The City

indicated the Taxpayer stated he only deposited enough money to pay for his mortgage and other miscellaneous expenses. The City asserted they could not complete the audit without additional information requested and as a result had to estimate the Taxpayer's income. The City noted the Taxpayer had a duty pursuant to City Code Section 15A-350 ("Section 350") to maintain suitable records. The City argued that they had the authority pursuant to City Code Section 15A-545 ("Section 545") to estimate income because the Taxpayer's records were inadequate or insufficient. Based on discussions with customers of the Taxpayer, the City estimated an income amount of \$300.00 per day for twenty-two working days per month. The City noted this compared to the Taxpayer's average bank deposits of \$91.00 per day. The City prepared a schedule of bank deposits that showed deposits were over \$5,000.00 per month in the earlier years of audit and a low of none in subsequent months.

### **Taxpayer Position**

The Taxpayer asserted he had supplied all the necessary documents and did not understand the City's claim that the Taxpayer had not provided sufficient information. The Taxpayer argued that the City's estimated revenue amounts were too high. The Taxpayer indicated he stopped filing monthly reports and paying taxes in February 2000 after it was determined that his wife had cancer. According to the Taxpayer, all of his money went for medical bills.

### **ANALYSIS**

There was no dispute that the Taxpayer was in the restaurant business during the audit period. It was also clear that the Section 350 requires the Taxpayer to "keep and preserve suitable records and such other books and accounts as may be necessary to determine the amount of tax for which he is liable..." The bank statement deposits were not sufficient to determine the gross income since the Taxpayer acknowledged expenses and food purchases were paid for with cash. The fact that the deposit amounts varied from zero to over \$5,000.00 further substantiated the deposits were not reliable to determine the amount of gross income of the Taxpayer.

As a result of the Taxpayer's failure to provide suitable records, the City was authorized to make a reasonable estimate. We also find the City's use of the Taxpayer's customers to be a reasonable approach to estimate the Taxpayer's monthly gross income. Based on the Taxpayer's testimony and the fact the estimate was over two hundred percent higher than the average bank deposit, it would appear the City's estimate would be on the high end of the reasonableness range. However, Section 545 makes it clear that the burden of proof is on the Taxpayer to prove the City's estimate was not reasonable. The Taxpayer failed to meet that burden of proof.

As to the interest, Section 540 indicates no interest can be abated by the Hearing Officer with the exception of interest assessed on taxes abated. Since no taxes were abated, no interest can be abated. The City was authorized pursuant to Section 540 to assess

penalties for failure to file and failure to timely pay taxes. Those penalties may be waived if the Taxpayer demonstrates reasonable cause for his actions. In this case, the Taxpayer stopped filing reports and stopped paying taxes because his wife had cancer. For approximately eighteen months, all of the Taxpayer's monies were used to pay medical bills. While we would have preferred the Taxpayer to have at least kept filing returns, we find a reasonable person could have acted in the same manner if their spouse had a serious illness. Accordingly, we conclude the Taxpayer has demonstrated reasonable cause to have the penalties waived.

### **FINDINGS OF FACT**

1. On October 28, 2005, the Taxpayer filed a protest of a tax assessment made by the City.
2. After review, the City concluded on January 20, 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 March 7, 2006, the City filed a response.
5. On March 13, 2006, the Hearing Officer ordered the Taxpayer to file any reply on or before April 3, 2006.
6. On April 7, 2006, a Notice scheduled this matter for hearing commencing on April 20, 2006.
7. Both parties appeared and presented evidence at the April 20, 2006 hearing.
8. On April 24, 2006, the Hearing Officer indicated the record was closed and a written decision would be issued on or before June 8, 2006.
9. The City audited the Taxpayer for the period January 1999 through February 2005.
10. The City concluded the Taxpayer had understated restaurant income for the audit periods with taxes due in the amount of \$4,472.43 plus interest until paid.
11. The City assessed the Taxpayer for penalties totaling \$1,148.36 for failure to timely pay and for failure to timely file reports.
12. The City also assessed the Taxpayer \$125.00 for a sales tax license.
13. On April 22, 2006, the City advised the Taxpayer on what records were needed

for the audit.

14. Subsequently, the Taxpayer provided bank statements showing only deposits and copies of sales tax returns that corresponded to the amount of monthly reports.
15. During the audit period, the Taxpayer paid for expenses and food purchases in cash.
16. During the audit period, the Taxpayer only deposited enough money to pay for his mortgage and other miscellaneous expenses.
17. The City could not complete the audit without additional information requested from the Taxpayer.
18. The City estimated the Taxpayer's income based on discussions with customers of the Taxpayer.
19. The City estimated an income amount of \$300.00 per day for twenty-two working days per month.
20. During the audit period, the Taxpayer's average bank deposits were \$91.00 per day.
21. During the earlier years of the audit period, the Taxpayer had some bank deposits over \$5,000.00 per month and during the later years some were as low as none.
22. The Taxpayer stopped filing tax returns and paying taxes in February 2000 after it was determined his wife had cancer.

### **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 had unreported restaurant income pursuant to City Code Section 15A-455.
3. The Taxpayer failed to keep and preserve suitable records pursuant to Section 350.
4. The City's estimate for taxable income was reasonable.
5. Since no taxes were abated, no interest can be abated pursuant to Section 540.

6. The City was authorized pursuant to Section 540 to assess penalties for failure to timely file reports and for failure to timely pay taxes.
7. The Taxpayer demonstrated reasonable cause to have the penalties waived.
8. The Taxpayer's protest should be denied with the exception of the penalties.

**ORDER**

It is therefore ordered that the October 28, 2005 protest filed by *Taxpayer* of a tax assessment made by the City of Nogales is hereby denied with the exception of the penalties.

It is further ordered that the City of Nogales shall remove all penalties from the assessment.

It is further ordered that this Decision is effective immediately.

Jerry Rudibaugh  
Municipal Tax Hearing Officer