

STATE OF MINNESOTA

TAX COURT

COUNTY OF HENNEPIN

REGULAR DIVISION

HBM Services, Inc.,

Appellant,

vs.

Commissioner of Revenue,

Appellee.

**FINDINGS OF FACT
CONCLUSIONS OF LAW
ORDER FOR JUDGMENT**

Docket 8004
No.

Dated: June 2, 2011

The Honorable Kathleen H. Sanberg, Judge of the Minnesota Tax Court, heard this matter, on July 15 and November 1, 2010, at the Minnesota Tax Court Courtroom 210, Minnesota Judicial Center, St. Paul, Minnesota.

Wally Mafe, represented the Appellant pro se.

Mark Levinger, Assistant Attorney General, represented the Appellee.

Both parties submitted post trial briefs. The matter was submitted to the court for decision pursuant to Minn. Stat. § 271.20 on June 2, 2011.

The Court, having heard and considered the evidence adduced at the hearing, and upon all of the files, records and proceedings herein, now makes the following:

FINDINGS OF FACT

1. Appellant HBM Services, Inc. ("HBM") is engaged in the business of primarily cleaning and janitorial services, and some snow plowing services.

2. Wally Mafe is the sole owner of HBM.
3. Most of HBM's customers are public entities, with Hennepin County and the City of Minneapolis being consistent customers. HBM also has private customers.
4. In 2005, the Department of Revenue ("Department") completed an audit of HBM for the tax period 1999 – 2004. In an order dated September 2, 2005, the Commissioner assessed additional taxes, penalties and interest in the amount of approximately \$89,000. HBM did not have invoices for the first four years, 1999 – 2002, of the audit period and invoices for 2003 and 2004 were incomplete. Because HBM's invoices were incomplete or inaccurate, the Department used HBM's bank deposits as a basis to calculate actual sales.
5. Initially, the Department assumed that all of the deposits going into HBM's bank account resulted from HBM sales of services. HBM provided information to show that some deposits were not from sales of services; the Department removed those from the sales totals.
6. The Department used the available bank deposits to calculate a monthly average of sales and used this average to determine sales for the years in which there were no records.
7. Invoices made available to the Department show that HBM usually collected sales tax when it should have collected sales tax and did not collect sales tax when it should not have.

8. HBM filed some sales and use tax returns for 1999, but none for the remainder of the tax audit period. HBM collected sales tax on some of its sales, but did not remit the tax to the state of Minnesota. HBM has never filed a corporate franchise tax return, so there are no other returns upon which to calculate the amount of sales.
9. HBM had sales to both exempt and non-exempt entities within Hennepin County during the tax period 1999 – 2004.
10. HBM collected some sales taxes from its customers but did not remit the taxes to the state of Minnesota.
11. HBM filed an administrative appeal of the Order on September 16, 2005.
12. On March 5, 2008, the Commissioner issued a Notice of Determination on Appeal assessing HBM taxes, penalties and interest for the tax period 1999 through 2004. The Order includes penalties for the periods 01/01/00 through 12/31/04 because the returns for these periods were filed or paid late. An additional 10% penalty was added to the tax amount for negligence or intentional disregard of the provisions of Minnesota sales and use tax law, Minn. Stat. § 289A.60, subd. 5. Specifically, the March 5, 2008, Order assesses HBM \$52,317.78 in tax; \$4,831.67 in penalties; \$5,231.79 for negligence; and \$20,309.54 in interest, for a total of \$82,690.78.
13. HBM filed an Appeal with the Minnesota Tax Court on April 15, 2008.

14. After receiving documentation at trial and after trial, the Commissioner recalculated taxable sales for a sample period of 18 months. The Commissioner calculated that there were taxable sales of approximately \$376,000. After subtracting taxable sales reported for 1999, the taxable sales not reported was approximately \$370,000. After application of the tax rate of 6.5%, the total tax due was calculated to be \$24,074.03.

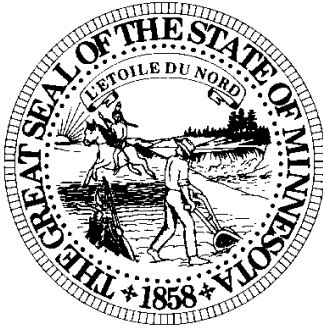
CONCLUSIONS OF LAW

The March 5, 2008, Order of the Commissioner of Revenue, for the tax periods 01/01/00 through 12/31/04 is hereby affirmed in part and reversed in part. After recalculation of the tax and interest, the total taxable sales due is \$24,074.03 plus interest and penalties.

The Commissioner of Revenue shall recalculate:

1) the interest; 2) the 20% penalty for failing to file tax returns for 2003 and 2004; and 3) the 5% penalty for filing tax returns late in 2000 through 2002 in accordance with this Order.

IT IS SO ORDERED. LET JUDGMENT BE ENTERED ACCORDINGLY.
A STAY OF FIFTEEN DAYS IS HEREBY ORDERED. THIS IS A FINAL
ORDER.



BY THE COURT,

Kathleen H. Sanberg, Judge
MINNESOTA TAX COURT

DATED: June 2, 2011

Memorandum

In this sales tax case, the Commissioner of Revenue ("Commissioner") has assessed taxes, interest and penalties against Appellant HBM Services, Inc. ("HBM") for sales of services. HBM argues that the Commissioner's Order should be reversed because it was based on calculation errors made by the Department of Revenue ("Department") in its audit of HBM's business. For the reasons discussed below, we affirm in part and reverse in part.

Background

HBM is a business owned by Mr. Wally Mafe and provides snow plowing and janitorial services. HBM started doing business in 1998. The janitorial services at issue in this case were performed for three public entities and two private clients.¹ The public entities included the City of Minneapolis, the City of St. Paul and Hennepin County. The snow plowing services were also provided to a number of HBM's clients.²

¹ Tr. at 241; Ex. 116.

² Janitorial services were also provided to the Hennepin County Family Medical Clinic. These transactions are not at issue because a sales tax exemption certificate was provided.

HBM filed some sales and use tax returns for 1999, but none for the remainder of the tax years 2000 – 2004. Also, HBM collected sales tax on some of its sales, but did not remit the taxes to the state. Finally, HBM has never filed a corporate franchise tax return, so there are no other returns upon which to calculate the amount of sales.³

In 2005, the Department did an audit of HBM for the tax period 1999 – 2004. In the audit, the Department used the records that HBM had for a test period. The test period results were used to calculate sales for the entire period from 2000 – 2004. Taxes were assessed based on the calculated sales.

In an Order dated September 2, 2005, the Commissioner assessed taxes, penalties and interest in the amount of approximately \$89,000.

HBM filed an administrative appeal of the Order from the audit. On March 5, 2008, the Commissioner issued a Notice of Determination on Appeal wherein it assessed HBM about \$52,000 in taxes. The Order includes penalties for the periods January 1, 2000, through December 31, 2004, because the returns for these periods were filed and/or paid late. Also, an additional 10% penalty was added to the tax amount for negligence in failing to file returns.⁴ The March 5, 2008, Order assessed HBM as follows:

Tax	\$52,317.78
Penalty	\$ 4,831.67
Neg. Penalty	\$ 5,231.79
Interest	<u>\$20,309.54</u>
Total	\$82,690.78.

³ Mr. Mafe has filed individual income tax returns, but these returns do not give any specific information about HBM's sales, expenses, or profits.

⁴ Minn. Stat. § 289A.60, subd. 5.

HBM timely filed an Appeal with the Tax Court on April 15, 2008.

Legal Issues

There are two main legal issues in this case. The first is whether the methodology used by the Commissioner was a reasonable and accurate method for reconstructing HBM's sales. The second issue is whether the Commissioner's assessment for false or fraudulent return penalties was appropriate.

Standard of Review

Orders of the Commissioner of Revenue are prima facie correct and valid.⁵ The taxpayer bears the burden of demonstrating that the challenged order is incorrect.⁶

The standard of proof required to overturn an order of the Commissioner is a preponderance of the evidence.⁷ The same standard and burden apply to the determination of fraud and the imposition of penalties, including the civil fraud penalty.⁸ We will review each issue using these standards.

Sales Tax on Services

Under the Minnesota Sales and Use Tax Act, all gross receipts are presumed subject to tax until the contrary is established. Minn. Stat. § 297A.665. There are, however, certain exceptions and exemptions. Snow plowing services are exempt from tax.⁹

⁵ Minn. Stat. § 271.06 subd. 6 (2008); Lifer v. Commissioner of Revenue, Docket No. 7417 (Minn. Tax Ct. Sept. 5, 2002).

⁶ Wybierala v. Commissioner of Revenue, 587 N.W.2d 832, 835 (Minn. 1998).

⁷ Wright v. Commissioner of Revenue, Docket. No. 4498 (Minn. Tax Ct. Apr. 22, 1987).

⁸ F-D Oil Co. v. Commissioner of Revenue, 560 N.W.2d 701 (Minn. 1997); Beaudet & Beaudet v. Commissioner of Revenue, Dckt. No. 6949 (May 19, 1999).

⁹ Minn. Stat. § 297A.61.

Building and residential cleaning, maintenance, and disinfecting services and pest control and exterminating services are generally taxable as are sales to local governmental units, such as cities and counties.¹⁰ Sales of cleaning services to governmental units, however, are exempt. Sales to public school districts are exempt. Sales to hospitals and nursing homes owned and operated by political subdivisions of the state of taxable services are also exempt.¹¹ Thus, HBM had exempt sales and non-exempt sales to exempt entities within Hennepin County.

Audit

HBM did not have complete or sufficient records to allow for a direct audit for the test year or any previous years. It is undisputed that the only course open to the Department was to perform an indirect audit to calculate liability for the test year. The Department used available invoices and bank records to determine sales for a test period, which was then applied to all tax years. The audit determined that taxes are owed because of unreported sales.

Parties' Arguments

HBM argues that the taxes assessed are due to errors made by the Department in the audit as calculations were based, in part, on HBM's bank deposits and invoices. HBM asserts that certain bank deposits were not taxable sales as they were not revenue from the sales of services. Rather some of the amounts were refunds from public entities, funds from exempt entities and funds from exempt sales. HBM admits that taxes are due and it filed a document with

¹⁰ Minn. Stat. § 297A.70, subd. 2(a)(2).

¹¹ Minn. Stat. § 297A.70, subd. 2(a)(3).

the Court after the trial indicating that total tax amount due is \$6,540. HBM argues that only two of its private customers' sales should be taxed.

The Commissioner admits that, for the most part, HBM collected sales tax when it should have collected sales tax and did not collect sales tax when it should not have so collected. However, HBM failed to remit the sales tax it collected to the state of Minnesota. The Commissioner also concedes that a number of the payments were incorrectly classified as taxable sales. At trial the Commissioner introduced a recalculation of taxes in Trial Exhibit 116. After recalculation, the total tax due according to the Commissioner was \$24,074.03. The Commissioner does not concede that HBM's calculations are correct. Exhibit 116, which was not contested by HBM, sets out the recalculations based on the late-produced documents. The Commissioner argues that HBM failed to report sales to other clients, including the City of St. Paul and McCoys, and failed to acknowledge that taxes were due from some public entities.

In this case, Mr. Mafe failed to produce all of HBM bank records and financial documents during the audit and during discovery. After discussion in court on the first day of trial, Mr. Mafe obtained and produced a large volume of bank records and financial documents on the second day of trial, and also, produced more documents after the trial was over.

After receiving the documents at and after trial, the Commissioner recalculated the tax liability based on information and provided a spread sheet that sorts the financial information and bank deposits by client and job. The Commissioner determined that the taxable sales for the entire sample period of

18 months totaled \$94,097.91. Thus, the taxable sales per month were \$5,227.66. For the entire tax period at issue, 72 months, the total taxable sales were approximately \$376,000.¹² After subtracting the taxable sales that had previously been reported, the amount of taxable sales not reported is approximately \$370,000. The resulting total tax liability, after applying a 6.5% sales rate, is thus, approximately \$24,000.

We find the Commissioner's recalculation to be more accurate than HBM's calculation of taxes due. The Commissioner used the documents provided to calculate the sales for a period of time and used that time as the basis for calculating total sales during the entire tax period. We find this reasonable because HBM has failed to provide documentation or adequate explanation for many of its sales. Mr. Mafe was unable or unwilling to provide all of the documents or information that would support his claim. Mr. Mafe denied that sales to certain public entities were taxable even though he had collected sales tax from those entities.¹³ Thus, we find that the total tax due is \$24,074.03.

We turn to the issue of penalties.

Penalties

The Commissioner imposed two different penalties. The first penalty is for late filing or failing to file tax returns pursuant to Minn. Stat. § 289A.60, subd. 2 as follows:

1999 – 0
2000 – 5%
2001 – 5%

¹² Tr. at 248-49; Ex. 116.

¹³ See, Exs. 21-22; Tr. at 205-26. HBM collected sales tax from Hennepin County/Shops, City of St. Paul, City of Minneapolis, Hennepin County/Environmental Services Building.

2002 – 5%
2003 – 20%
2004 – 20%

The second penalty is a negligence penalty of 10% for each year at issue pursuant to Minn. Stat. § 289A.60, subd. 5 (2008). This section provides that “there must be added to the tax amount equal to ten percent of the additional assessment ... if part of an additional assessment is due to negligence or intentional disregard of the provisions of the applicable tax laws or rules of the commissioner, but without intent to defraud.” Id.

An appellant has the burden of proving that the Commissioner’s penalty assessment is erroneous.¹⁴ HBM argues that it should not be required to pay the penalties. The Commissioner argues that HBM has not presented any reason that the penalties should be abated. Rather, the Commissioner argues that HBM should be required to pay the penalties because HBM failed to remit taxes collected to the state of Minnesota, failed to keep adequate records, and failed to file returns.¹⁵

We agree with the Commissioner. Taken together the evidence and the testimony support the conclusion that the penalties are reasonable. First, HBM collected sales taxes but did not remit them to the state. Second, while HBM filed tax returns for 1999, it did not do so for later years, subjecting HBM to penalties pursuant to Minn. Stat. § 289A.60, subd. 2, for failure to file returns. HBM failed to keep adequate records as required by Revenue Rule 8130.7500, subp. 6. HBM was dilatory in presenting the records it had to the Commissioner, either in

¹⁴ F-D Oil, 560 N.W.2d at 706.

¹⁵ Tr. at 82-83,131.

the audit or during this appeal. HBM did not have an adequate explanation for its failure to keep records or pay the taxes. HBM knew that sales tax should have been remitted to the state and returns filed, but it did not do so. We find that HBM has failed to prove that the imposition of penalties is erroneous.

Conclusion

The Order is affirmed in part and reversed in part. The Commissioner shall recompute interest and penalties based upon our finding that HBM is liable for taxes in the amount of \$24,074.03.

K. H. S.