

**STATE OF ARKANSAS
DEPARTMENT OF FINANCE & ADMINISTRATION
OFFICE OF HEARINGS & APPEALS
ADMINISTRATIVE DECISION**

IN THE MATTER OF [REDACTED]
[REDACTED]

**GROSS RECEIPTS
TAX ASSESSMENT**

ACCT. NO.: [REDACTED]

AUDIT NO.: [REDACTED]

**DOCKET NOS.: 16-348
16-493**

([REDACTED] – SALES TAX)
([REDACTED] – USE TAX)

**TODD EVANS, ADMINISTRATIVE LAW JUDGE
APPEARANCES**

This case is before the Office of Hearings and Appeals upon a written protest dated September 24, 2015, signed by [REDACTED], the Taxpayer. The Taxpayer protested the assessments of Gross Receipts Tax (“sales tax”) and Arkansas Compensating (“use”) tax issued by the Department of Finance and Administration (“Department”). The Taxpayer was represented by [REDACTED] and [REDACTED], Attorneys at Law (“Taxpayer’s Representatives”). The Department was represented by Mary Kathryn Williams, Attorney at Law (Department’s Representative”).

At the request of the Taxpayer, this matter was taken under consideration of written documents. A briefing schedule was established by letter dated March 16, 2016. The Department’s Opening Brief was filed April 6, 2016. The Taxpayer’s Response Brief was filed May 17, 2016. The Department’s Reply Brief was filed May 26, 2016. This matter was submitted for a decision on May 27, 2016.

ISSUE

Whether the assessment made by the Department against the Taxpayer should be sustained? Yes.

FINDINGS OF FACT/CONTENTIONS OF THE PARTIES

The background for this proceeding was provided in the Department's Opening Brief which stated as follows:

Auditor Timothy Keltner (the "Auditor") initially contacted [REDACTED] (the "Taxpayer") regarding an unregistered taxpayer performing taxable services. On March 19, 2015, the Auditor mailed correspondence including an audit request letter and a taxpayer bill of rights. See letter, attached as Exhibit 2. The audit period covered Gross Receipt Tax and Compensating Use Tax for January 1, 2012, to March 27, 2015. The Taxpayer did not respond to the first letter and the Auditor mailed a second audit request letter with a taxpayer bill of rights on March 31, 2015. See letter, attached as Exhibit 3.

On April 1, 2015, the Auditor received a phone call from the Taxpayer to follow up on the audit request letter. The Taxpayer told the Auditor that she had obtained a d/b/a at the [REDACTED], Arkansas courthouse when she started her business and was told at the time that she did not have to pay tax on the service she provided. See Auditor's Narrative Comments & Audit Log, attached as Exhibit 4. The Taxpayer further stated that her accountant never told her that the services were taxable and that she had spoken to her attorney, who also told her that cleaning services are not taxable. *Id.* The Taxpayer and the Auditor also discussed the Taxpayer's service in more detail. *Id.*

The Auditor and Taxpayer met on April 3, 2015, at the Office of Field Audit in Bentonville, Arkansas, and Taxpayer provided a completed Power of Attorney form and a completed AR- 1R Permit Registration form. See Exhibit 4; Permit Registration form, attached as Exhibit 5; and Power of Attorney, attached as Exhibit 6. On April 28, 2015, the Auditor met with the Taxpayer and the Taxpayer's accountant, [REDACTED]. See Exhibit 4. The Taxpayer provided business documents for 2012, 2013 and 2014. The Taxpayer sold the business to [REDACTED] on March 6, 2015, and did not provide documentation for 2015. See 2015 Sale Agreement, attached as Exhibit 7.

Records reviewed for the Sales Tax audit were sales invoices, monthly sales summaries, and bank account records. See Exhibit 4. All taxable sales records for the entire audit period were reviewed and compiled in a spreadsheet. See Schedule of Unreported Taxable Sales, Schedule A, attached as Exhibit 8. Records reviewed for the Compensatory Use Tax audit were purchase invoices, credit card statements and purchase receipts. These records were also compiled into a spreadsheet. See Schedule

of Unreported Taxable Purchases, Schedule B, attached as Exhibit 9.

The Auditor mailed the Taxpayer a Summary of Findings on July 27, 2015. See Summary of Findings, attached as Exhibit 10. The Auditor sent out a Notice of Proposed Assessment dated July 27, 2015. See Notice of Proposed Assessment, attached as Exhibit 11. The Notice listed a tax liability of \$19,477.10, with \$4,143.46 in interest for a total of \$23,620.56. *Id.* No penalty was assessed. The Taxpayer filed a timely protest and brief in support. See Exhibit 1.

According to the Taxpayer's Response Brief, the Taxpayer provides the service of converting [REDACTED]

[REDACTED] Page 1. [REDACTED] is described by the Taxpayer's Representatives as "destroying or preventing the [REDACTED] [REDACTED]" Page 4. This service is accomplished through [REDACTED] [REDACTED] that are utilized by the Taxpayer. Additionally, the Taxpayer's Response Brief explains that the Taxpayer assembled and sold [REDACTED] during the audit period and paid sales tax on the materials used in those devices.

The Taxpayer's Representatives argued that: (1) the Taxpayer's services are not taxable explaining that the [REDACTED] is not taxable and are excluded under Arkansas Gross Receipts Tax Rule GR-9.4(D); (2) the Taxpayer's sales of [REDACTED] qualify as exempt isolated sales; and (3) the assessed materials purchased to construct the [REDACTED] should qualify as sales for resale.

The Department's Representative argued that : (1) the Taxpayer's services qualify as taxable janitorial or cleaning services under Arkansas Gross Receipts Tax Rule GR-9.4(A) and (2) the Taxpayer cannot qualify for the sale for resale

exemption under Ark. Code Ann. 26-52-401(12)(A) (Supp. 2015) because she did not possess a sales tax permit at the time of the purchases.

After a general discussion of the burdens of proof in tax proceedings and the relevant law, the legal issues shall be addressed in turn.

CONCLUSIONS OF LAW

Standard of Proof

Ark. Code Ann. § 26-18-313(c) (Supp. 2015) provides, in pertinent part, as follows:

The burden of proof applied to matters of fact and evidence, whether placed on the taxpayer or the state in controversies regarding the application of a state tax law shall be by preponderance of the evidence.

A preponderance of the evidence means the greater weight of the evidence.

Chandler v. Baker, 16 Ark. App. 253, 700 S.W.2d 378 (1985). In *Edmisten v. Bull Shoals Landing*, 2014 Ark. 89, at 12-13, 432 S.W.3d 25, 33, the Arkansas Supreme Court explained:

A preponderance of the evidence is “not necessarily established by the greater number of witnesses testifying to a fact but by evidence that has the most convincing force; superior evidentiary weight that, though not sufficient to free the mind wholly from all reasonable doubt, is still sufficient to incline a fair and impartial mind to one side of the issue rather than the other.

The Department bears the burden of proving that the tax law applies to an item or service sought to be taxed, and a taxpayer bears the burden of proving entitlement to a tax exemption, deduction, or credit. Ark. Code Ann. § 26-18-313(d) (Supp. 2015). Statutes imposing a tax or providing a tax exemption, deduction, or credit must be reasonably and strictly construed in limitation of their application, giving the words their plain and ordinary meaning. Ark. Code

Ann. § 26-18-313(a), (b), and (e) (Supp. 2015). If a well-founded doubt exists with respect to the application of a statute imposing a tax or providing a tax exemption, deduction, or credit, the doubt must be resolved against the application of the tax, exemption, deduction, or credit. Ark. Code Ann. § 26-18-313(f)(2) (Supp. 2015).

Tax Assessments

Arkansas Gross Receipts (sales) Tax generally applies to the entire gross proceeds of all sales of tangible personal property and certain specifically enumerated services within the State of Arkansas. Ark. Code Ann. § 26-52-301 (Repl. 2014). Cleaning and janitorial services are specifically enumerated as taxable services under Ark. Code Ann. § 26-52-301(3)(D)(i) (Repl. 2014). Cleaning and janitorial services are defined as: “services to rid the interior or exterior of any building, dwelling, or other structure of dirt, impurities, or extraneous matter.” Arkansas Gross Receipts Tax Rule GR-9.4(A).

Two exemptions are potentially relevant to this proceeding. Ark. Code Ann. § 26-52-401(12) (Supp. 2015) exempts sales for resale to persons regularly engaged in reselling the articles purchased “if the sales within the state are made to persons to whom gross receipts permits have been issued as provided in 26-52-202. [Emphasis supplied.]” Ark. Code Ann. § 26-52-401(17) (Supp. 2015) exempts “isolated sales not made by an established business.”

A. Whether the provision of [REDACTED] services is taxable.

Here, the Taxpayer’s Representatives have explained that the Taxpayer provides [REDACTED] that performs [REDACTED] and [REDACTED]. Further, the

Taxpayer described her business as “[REDACTED]” and “[REDACTED]” in her application for an Arkansas sales tax permit which was attached as Exhibit 5 to the Department’s Opening Brief. Additionally, a cached image of the Taxpayer’s old website (attached as Exhibit 12 to the Department’s Opening Brief) provides the following description of the Taxpayer’s business: “[REDACTED]

[REDACTED]
[REDACTED] [REDACTED] [REDACTED] [REDACTED] [REDACTED] [REDACTED] [REDACTED] [REDACTED] [REDACTED] [REDACTED]
[REDACTED]
[REDACTED]” That cached image also included a message from the [REDACTED] group.

The website for the [REDACTED] supports the asserted benefits of [REDACTED] explained by the Taxpayer and Taxpayer’s Representatives by explaining that [REDACTED]

[REDACTED]”¹ The [REDACTED] further explains that: “[REDACTED]

[REDACTED]
[REDACTED]

[REDACTED]”² That organization further explains that [REDACTED] is effective in killing [REDACTED] that are present in an area being treated. ³

[REDACTED]
[REDACTED]
[REDACTED]

The Department's Representative argued that the Taxpayer's activities do clean the interior of a building by affecting the walls, floors, ceilings, and fixtures of an environment that receives a treatment. The Department's argument is persuasive. Based on the above information, the [REDACTED] effects of increased [REDACTED] is not limited to the [REDACTED] but affects the entire structure, [REDACTED] that are present in the [REDACTED] and upon the interior surfaces of the structure. The governing statute and rule do not distinguish between taxable cleaning accomplished through the use [REDACTED] applied to the interior of a building (which is clearly taxable under Arkansas Gross Receipts Tax Rule GR-9.4(D)(Example 1)) or cleaning accomplished through the use of [REDACTED] to those surfaces.

The Taxpayer's Representatives argued that the [REDACTED] is not a taxable service and any [REDACTED] is merely a byproduct of the [REDACTED]. Here, it is clear that the Taxpayer's customers are not paying the Taxpayer merely for the [REDACTED] but for the [REDACTED] or [REDACTED] services performed within the [REDACTED] and upon a building's interior services utilizing the [REDACTED]. The Arkansas Supreme Court has held that a taxpayer's structuring of a transaction and the terms affixed to particular charges are not controlling, rather the economic reality of a transaction must govern over form when addressing the tax implications. *Rineco Chemical Industries, Inc. v. Weiss*, 344 Ark. 118, 40 S.W.3d 257 (2001).

The Taxpayer's Representatives further argue that [REDACTED] is not a component part of the exterior or interior of a building and, consequently, the cleaning of the [REDACTED] cannot qualify under the definition of cleaning services provided in Arkansas

Gross Receipts Tax Rule GR-9.4(A). As stated above, the Taxpayer's [REDACTED] or [REDACTED] services are not limited to [REDACTED] within a structure but also affects [REDACTED] [REDACTED] upon the interior surfaces of building components as well. Consequently, the [REDACTED] services do affect "interior or exterior of any building, dwelling, or other structure."

Additionally, the Taxpayer's Representatives argued that any [REDACTED] [REDACTED] are not removed from the structure but altered or deconstructed and the resulting component parts remain in the structure and, thus, the activity cannot qualify as taxable cleaning services, which requires the removal of "dirt, impurities, or extraneous matter." The governing regulation (Arkansas Gross Receipts Tax Rule GR-9.4(A)) requires that cleaning services "rid the interior or exterior of any building, dwelling, or other structure of dirt, impurities, or extraneous matter [Emphasis Supplied]." To "rid" is defined as "to free from." American Heritage Dictionary 1173. "Extraneous matter" is defined as coming from without or not belonging. *Collins English Dictionary - Complete & Unabridged 10th Edition*. HarperCollins Publishers. 3 Jun. 2016. <Dictionary.com <http://dictionary.reference.com/browse/extraneous>>. "Impurities" are defined as something that makes an item soiled or contaminated. "impurities," "impure," "tainted," and "sullied." *Collins English Dictionary - Complete & Unabridged 10th Edition*. HarperCollins Publishers. 3 Jun. 2016. <Dictionary.com <http://dictionary.reference.com/browse/impurities>>. Here, it is apparent that the destruction of [REDACTED] within a structure removes impurities or extraneous matter from the structure by destroying the [REDACTED] to prevent their further [REDACTED] effects.

Though the inactive components of these organisms remain in a structure, the [REDACTED] no longer exist. Consequently, the removal of [REDACTED] [REDACTED] qualifies as ridding the structure of dirt, impurities, or extraneous matter.

Any remaining arguments raised by the Taxpayer's Representatives regarding this portion of the assessment are rendered moot and will not be addressed because, as explained above, the Taxpayer's [REDACTED] services qualify as taxable cleaning services as defined by GR-9.4(A). Though some transactions are described as [REDACTED] to remove [REDACTED] rather than [REDACTED] [REDACTED] in the Schedule of Unreported Taxable Sales (attached as Exhibit 8 to the Department Opening Brief). Based on the information presented above, an [REDACTED] will result in [REDACTED] or [REDACTED] surfaces within a structure (and thus a taxable cleaning service) regardless of whether the primary objective was merely [REDACTED] which may or may not have required the [REDACTED] of structural components to accomplish that goal.

B. Whether the sale of [REDACTED] is taxable.

As stated above, Arkansas sales tax generally applies to all sales of tangible personal property within the State of Arkansas. Ark. Code Ann. § 26-52-401(17) (Supp. 2015) does provide an exemption for "isolated sales not made by an established business." An "isolated sale" is defined as a "one-time sale of an item or group of items not made by an established business of any kind of character." Arkansas Gross Receipts Tax Rule GR-49.

The Taxpayer's Representatives argue that, over the entire audit period, the Taxpayer only sold six (6) machines⁴ that she assembled and, at the time, did not have an established business; consequently, that representatives argue that the transactions should qualify as isolated sales. A review of the Schedule of Unreported Taxable Sales (attached as Exhibit 8 to the Department's Opening Brief) shows that the Taxpayer sold five (5) [REDACTED], two (2) [REDACTED], and two (2) [REDACTED] from April through July of 2013. The Taxpayer has not demonstrated that these transactions as "one-time" sales of items not made by an established business of any kind of character. Consequently, the Taxpayer's exemption claim was properly denied and this portion of the assessment is sustained as taxable sales of tangible personal property.

C. Whether the parts purchased to create the [REDACTED] could be purchased exempt as sales for resale.

The Department's Representative argues that the Taxpayer cannot qualify for the sale for resale exemption because it did not possess a sales tax permit, as required by statute. The Department's Representative further argues that the taxation of material purchases and the taxation of items built utilizing those materials is not an instance of double taxation because two separate transactions have occurred. The Department's Representative also states that the Taxpayer has not presented adequate proof of which materials become a component part of the units sold. The Taxpayer's Representatives argue that denying the Taxpayer

⁴ According to the Schedule of Unreported Taxable Sales (attached as Exhibit 8 to the Department's Opening Brief), the Taxpayer actually sold three (3) [REDACTED] and one (1) [REDACTED] in April 2013; sold two (2) [REDACTED] in July 2013; and sold two (2) [REDACTED] and one (1) [REDACTED] in June 2013.

the benefit of the sale for resale exemption for its material purchase is contrary to the legislative intent for that exemption which intends to prevent double taxation of the same materials.

The record demonstrates that the Taxpayer did not possess a sales tax permit until April of 2015. Based on the Schedule of Unreported Taxable Purchases (attached as Exhibit 9 to the Department's Opening Brief), all of the assessed transactions occurred before she obtained an Arkansas sales tax permit and those transactions represent internet and other out-of-state purchases that were shipped into Arkansas.

Arkansas Compensating (use) Tax generally applies to privilege of storing, using, distributing, or consuming tangible personal property within the State of Arkansas. Ark. Code Ann. § 26-53-106 (Repl. 2014). Sales tax exemptions are applied uniformly with use tax exemptions. Ark. Code Ann. § 26-53-112 (Repl. 2014). A narrow exemption is provided from Arkansas sales tax for:

[g]ross receipts or gross proceeds derived from sales for resale to persons regularly engaged in the business of reselling the articles purchased whether within or without the state if the sales within the state are made to **persons to whom gross receipts tax permits have been issued** as provided in § 26-52-202 [Emphasis supplied].

Ark. Code Ann. § 26-52-401(12)(A)(Supp. 2015). Additionally, Arkansas Gross Receipts Tax Rule GR-53(A) requires that exempt sales for resale may only occur to "persons to whom a permit has been issued" Further, the Arkansas Supreme Court has explained that, when the language of a statute is clear and unambiguous, the plain meaning of the statute must be followed rather than resorting to rules of construction. *National Home Centers, Inc. v. Coleman*, 373 Ark. 246, 283 S.W.3d 218 (2008).

Here, the statute is unambiguous that products must be sold to an entity possessing a sales tax permit to qualify for the sale for resale exemption. Since the Taxpayer did not possess a permit at the time of purchase, the exemption was properly denied and this portion of the assessment is sustained.

Interest

Interest is required to be assessed upon tax deficiencies for the use of the State's tax dollars. Ark. Code Ann. § 26-18-508 (Repl. 2012). However, the Department's Representative conceded that more than 180 days has passed since the Taxpayer's protest of the assessment for reasons beyond the Taxpayer's control. Consequently, interest that accrues from the date of the Taxpayer's protest to the issuance of the final assessment must be waived under Ark. Code Ann. § 26-18-405(d)(1)(C) (Supp. 2015). Any remaining interest after this adjustment is sustained.

DECISION AND ORDER

The proposed assessment is sustained after the interest adjustment. The file is to be returned to the appropriate section of the Department for further proceedings in accordance with this Administrative Decision and applicable law. Pursuant to Ark. Code Ann. § 26-18-405 (Supp. 2015), unless the Taxpayer requests in writing within twenty (20) days of the mailing of this decision that the Commissioner of Revenues revise the decision of the Administrative Law Judge, this decision shall be effective and become the action of the agency. The revision request may be mailed to the Assistant Commissioner of Revenues - Policy & Legal, P.O. Box 1272, Rm. 2440, Little Rock, Arkansas 72203. The Commissioner of Revenues, within twenty (20) days of the mailing of this Administrative

Decision, may revise the decision regardless of whether the Taxpayer has requested a revision. The Taxpayer may seek relief from the final decision of the Administrative Law Judge or the Commissioner of Revenues on a final assessment of a tax deficiency by following the procedure set forth in Ark. Code Ann. § 26-18-406 (Supp. 2015).

OFFICE OF HEARINGS & APPEALS



TODD EVANS
ADMINISTRATIVE LAW JUDGE

DATED: June 7, 2016