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

IN THE MATTER OF [redacted] **(ACCT. NO.:** [redacted]	**INDIVIDUAL INCOME TAX ASSESSMENT LETTER ID.:** [redacted]
DOCKET NO.: 17-113 (2015)	**(**[redacted]**)**[1]

TODD EVANS, ADMINISTRATIVE LAW JUDGE
APPEARANCES

This case is before the Office of Hearings and Appeals upon a written protest received August 15, 2016, signed by [redacted] on behalf of the [redacted], the Taxpayers. The Taxpayers protested an assessment issued by the Department of Finance and Administration ("Department") through Wade Gambill, Tax Auditor – Individual Income Tax Section.

The hearing in this matter was held on December 6, 2016, at 1 p.m. in Little Rock, Arkansas. The Department was represented by Michael Wehrle, Attorney at Law, Office of Revenue Legal Counsel ("Department's Representative"). Present for the Department was Ben Johns, Tax Auditor. [redacted] appeared at the hearing and represented the Taxpayers.

ISSUE

Whether the assessment issued against the Taxpayers should be sustained? Yes.

[1] This amount does not account for an adjustment by the Department to include a [redacted] Arkansas Historic Rehabilitation Tax Credit which reduced the outstanding tax balance to the following: [redacted] (tax), [redacted] (failure to pay penalty) and [redacted] (interest) as of December 9, 2016.

FINDINGS OF FACT/CONTENTIONS OF THE PARTIES

[redacted] summarized the relevant facts in this matter in his Answers to Information Request stating, in part:

> We filed our Arkansas tax return in a timely manner and owed [redacted] in state tax.
>
> To pay this tax liability we attached to our tax return our Arkansas Historic Rehabilitation Certificate of Income Tax Credit ["Relevant Credit"].
>
> The Notice of Proposed Assessment was sent because the Tax Credit Certificate was not in our individual names but in the name of our company ([redacted]) that earned the credits (attached). The tax credits were included in the company's return which flowed to our personal return as owners. Immediately upon receipt of the Notice of Proposed Assessment we contacted the DFA. To solve the issue of the credits not being applied to our personal return, the tax credits were transferred from [redacted] to [redacted] at the request of Eileen Henderson at DFA. Once [redacted] with the Department of Arkansas Heritage sent the transfer form over to Ms. Henderson our return was to be processed by Ron Mitchell using the tax credit.
>
> The Notice of Final Assessment was sent because the return was not processed after [redacted] sent the transfer to Ms. Henderson. We called Ms. Henderson and were transferred to Ron Mitchell, an auditor with DFA, who then reviewed our return and explained that because we filed as nonresidents the [redacted] in taxes owed could not be offset by our [redacted] of Arkansas tax credits since tax credits are applied to our total income and then prorated and reduced by 75% so that we still owed approximately [redacted] in state taxes. This was the first we had heard that nonresidents with Arkansas tax credits were treated differently than residents.

The Tax Auditor testified as follows: (1) for nonresidents, a Taxpayer must initially calculate their Arkansas income tax liability as if all income was earned within Arkansas; (2) then, a taxpayer determines the percentage of income that is sourced to Arkansas; (3) the previously calculated tax liability is multiplied by

that percentage to determine the tax owed to the State of Arkansas;[2] (4) all tax credits must be applied in the initial calculation of the tax liability before the apportionment of the tax liability; (5) this methodology is required by Ark. Code Ann. § 26-51-435(a) – (e) (Repl. 2012); (6) a failure to pay penalty was assessed due to the Taxpayer's failure to pay their tax liability when it was originally assessed; (7) the application of the Relevant Credit after issuance of the Notice of Proposed Assessment reduced the tax, penalty, and interest from the amount shown in the Notice of Proposed Assessment; (8) a tax credit reduces the tax balance owed on a tax return while a tax deduction reduces the taxable income; (9) a tax credit is not necessarily the same thing as cash by creating a dollar for dollar reduction in the tax liability; (10) the matter at hand is an instance where a tax credit does not result in a dollar for dollar reduction of an Arkansas tax liability since the credit must be applied before the apportionment of the tax liability; and (11) he cannot testify to the legislative intent and budgeting when the Relevant Credit was originally adopted.

[redacted] testified as follows: (1) in 2009, the Relevant Credit was created as an offset of the state income taxes that would otherwise be received; (2) the Arkansas General Assembly budgeted for the credit to be used as a total offset of a tax liability by a holder without any limitation; (3) the regulations and tax forms have not been amended to incorporate the 2009 act that created the Relevant Credit; and (4) apportionment of the tax liability after application of the Relevant Credit is improper because it does not allow the dollar for dollar

[2] This step in the calculation is referred to as the "apportionment of the tax liability" within this decision.

reduction in the Taxpayers' tax liability that was intended by the Arkansas General Assembly.

In his Answers to Information Request and during the administrative hearing, [redacted] argued that the Arkansas legislature intended and budgeted for the Relevant Credit to apply as a dollar for dollar offset of a taxpayer's tax liability and the Department's methodology violates that legislative intent since the tax credit does not result in a straight dollar for dollar offset of the Taxpayers' tax liability.[3] Further, [redacted] stated that the Relevant Credit could only be used to offset an Arkansas tax liability. He asserted that the Department's methodology (which applies the Relevant Credit against a tax liability calculated based on the total in state and out of state income before the apportionment of the tax liability) causes a portion of the tax credit to be improperly applied against income taxed outside the state and results in double taxation.[4]

In his Answers to Information Request and during the administrative hearing, the Department's Representative argued that Ark. Code Ann. § 26-51-435 (Repl. 2012) and the Arkansas Nonresident Individual Income Tax Return (AR1000NR) requires that any applicable tax credits be applied before the apportionment of the tax liability for a nonresident. Consequently, he argued that the Department correctly calculated the Taxpayers' tax liability under Arkansas law.

CONCLUSIONS OF LAW

Standard of Proof

[3] This argument shall be referred to as the "Taxpayers' Legislative Intent Argument."
[4] This argument shall be referred to as the "Taxpayers' Double Taxation Argument."

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).

Legal Analysis

Tax Assessment

Ark. Code Ann. § 26-51-202 (Repl. 2012) imposes the Arkansas individual income tax upon, and with respect to, the entire net income from "all property owned and from every business, trade, or occupation carried on in this state by individuals, corporations, partnerships, trusts, or estates not residents of the State of Arkansas." Ark. Code Ann. § 26-51-2204 (Supp. 2015) creates the Relevant Credit, providing as follows, in part:

> (a) (1) There is allowed an income tax credit up to the amount of tax imposed by the Income Tax Act of 1929, § 26-51-101 et seq., or the premium tax to a holder of an Arkansas historic rehabilitation income tax credit.
>
> (2) Beginning March 20, 2015, the income tax credit allowed under subdivision (a)(1) of this section is allowed only one (1) time in a twenty-four-month period for each eligible property.
>
> (b) The Arkansas historic rehabilitation income tax credit shall be in an amount equal to twenty-five percent (25%) of the total qualified rehabilitation expenses incurred by the owner to complete a certified rehabilitation up to the first:
>
> (1) Five hundred thousand dollars ($500,000) of qualified rehabilitation expenses on income-producing property; or
>
> (2) One hundred thousand dollars ($100,000) of qualified rehabilitation expenses on nonincome-producing property. . . .

See also Ark. Code Ann. § 26-51-513 (Repl. 2012).

Ark. Code Ann. § 26-51-435 (Repl. 2012) governs the calculation of a nonresident's Arkansas Individual Income Tax liability, stating the following, in pertinent part:

> (a) Nonresidents or part-year residents of Arkansas shall compute their taxable income as if all income were earned in Arkansas.
>
> (b) Using Arkansas income tax rates, nonresident or part-year residents of Arkansas shall compute their tax liability on the amount computed in subsection (a) of this section.
>
> **(c) From the tax liability computed in subsection (b) of this section there shall be deducted all allowable credits to determine the amount of tax due.**

(d) (1) Nonresidents shall divide adjusted gross income from Arkansas sources by the adjusted gross income from all sources to arrive at the applicable percentage that Arkansas adjusted gross income represents of all adjusted gross income received by the taxpayer in the income year.

(2) Part-year residents shall divide adjusted gross income received while an Arkansas resident by the adjusted gross income from all sources to arrive at the applicable percentage that the adjusted gross income received while an Arkansas resident represents of all adjusted gross income received by the taxpayer in the income year.

(e) **Nonresidents and part-year residents shall multiply the amount computed in subsection (c) of this section by the applicable percentage from subsection (d) of this section in order to determine the amount of income tax which must be paid to the State of Arkansas.** [Emphasis Supplied.]

Regarding the Taxpayers' Legislative Intent Argument, the Arkansas Supreme Court has explained the rules to be followed when interpreting statutory provisions, stating as follows:

> Statutes relating to the same subject should be read in a harmonious manner if possible. *City of Ft. Smith v. Tate,* 311 Ark. 405, 844 S.W.2d 356 (1993). **All legislative acts relating to the same subject are said to be *in pari materia* and must be construed together and made to stand if they are capable of being reconciled.** *Id*. We adhere to the basic rule of statutory construction, which gives effect to the intent of the legislature, making use of common sense and giving the words their usual and ordinary meaning. *Kyle v. State,* 312 Ark. 274, 849 S.W.2d 935 (1993). In attempting to construe legislative intent, we look to the language of the statute, the subject matter, the object to be accomplished, the purpose to be served, the remedy provided, legislative history, and other appropriate matters that throw light on the subject. *Tate,* 311 Ark. 405, 844 S.W.2d 356. The commentary to a statute is a highly persuasive aid to construction, although it is not controlling over the clear language of the statute. *Kyle,* 312 Ark. 274, 849 S.W.2d 935.
>
> In construing two acts on the same subject, **we first must presume that when the General Assembly passed the later act, it was well aware of the prior act.** *Salley v. Central Arkansas Transit Auth.,* 326 Ark. 804, 934 S.W.2d 510 (1996). We must also presume that the General Assembly did not intend to pass an act without purpose. *See Clark v. State,* 308 Ark. 84, 308 Ark. 453, 824 S.W.2d 345 (1992). Furthermore, the General Assembly is presumed to have enacted a law with the full knowledge of court decisions on the subject and with reference to those

> decisions. *See, e.g., Scarbrough v. Cherokee Enter.*, 306 Ark. 641, 816 S.W.2d 876 (1991); *Tovey v. City of Jacksonville*, 305 Ark. 401, 808 S.W.2d 740 (1991); *J.L. McEntire & Sons, Inc. v. Hart Cotton Co., Inc.*, 256 Ark. 937, 511 S.W.2d 179 (1974). [Emphasis supplied.]

Reed v. State, 330 Ark. 645, 649-50, 957 S.W.2d 174, 176 (1997).

Initially, Ark. Code Ann. § 26-51-2204 (Supp. 2015) simply creates, "an income tax credit up to the amount of tax imposed" and Ark. Code Ann. § 26-51-435 (Repl. 2012) states that nonresidents shall deduct tax credits prior to apportionment of their tax liability. A clear conflict is not demonstrated between these two statutes. Even assuming, however, that these two provisions are in some disagreement, the Arkansas Supreme Court has explained that the provisions must be reconciled to read as harmonious and consistent with each other if possible. A harmonious reading of these code sections (which necessarily presumes that the legislature was aware of the requirements of Ark. Code Ann. § 26-51-435 (Repl. 2012) at the time of adoption of the Relevant Credit) is possible. A harmonious interpretation of the relevant code sections requires a finding that the Arkansas General Assembly intended the Relevant Tax Credit to be treated similar to other tax credits and be deducted before the apportionment of the tax liability. Consequently, the Department properly applied the Relevant Credit before the apportionment of the Taxpayers' tax liability on their nonresident tax returns as required by Ark. Code Ann. § 26-51-435 (Repl. 2012).

Regarding the Taxpayers' Double Taxation Argument, administrative tribunals, such as the Office of Hearings and Appeals, do not have jurisdiction or authority to determine the constitutionality of a statute. See generally *Arkansas Tobacco Control Bd. v. Sitton*, 357 Ark. 357, 166 S.W.3d 550 (2004).

Consequently, the Taxpayers' arguments regarding the constitutionality of the language codified Ark. Code Ann. § 26-51-435 (Repl. 2012) (applying Arkansas tax credits before apportionment of the tax liability on nonresidents' income tax returns) cannot and will not be addressed by this decision.

Consequently, the tax assessment is sustained in full.

Failure to Pay Penalty

With respect to the failure to pay penalty, Ark. Code Ann. § 26-18-208(2)(B) (Repl. 2012) provides as follows:

> In case of failure to pay the amount shown as tax on any individual income tax return required to be filed, on or before the date prescribed for payment of the tax, unless it is shown that the failure to pay is due to reasonable cause and not to willful neglect, there shall be added to the amount shown as tax on the return one percent (1%) of the amount of the tax if the failure is for not more than one (1) month, with an additional one percent (1%) for each additional month or fraction of a month during which the failure continues, not to exceed thirty-five percent (35%) in the aggregate . . . .

Lack of knowledge of publicly available statutes and rules cannot be recognized as a defense to the enforcement of these penalties. 29 Am. Jur. 2d Evidence 290; see also *Edward v. US*, 334 F.2d 360 (1964) and *Jellico Coal Min. Co. v. Commonwealth*, 96 Ky. 373, 29 S.W. 26 (Ky. App. 1895). The U.S. Supreme Court has explained the reason for this legal principle as follows:

> The whole course of the jurisprudence, criminal as well as civil, of the common law, points to a different conclusion. It is a common maxim, familiar to all minds, that ignorance of the law will not excuse any person, either civilly or criminally; and it results from the extreme difficulty of ascertaining what is, bonâ fide, the interpretation of the party; and the extreme danger of allowing such excuses to be set up for illegal acts, to the detriment of the public.

Barlow v. US, 32 U.S. 404, 411 (1833). The Arkansas Supreme Court has also provided that the maxim that lack of knowledge of the law is no defense applies in equal force "to acts committed or omitted in violation of the criminal or civil laws of the land." *State v. Simmons*, 1 Ark. 265, 266 (1839). Consequently, the lack of knowledge of the legal requirements cannot be considered in the analysis regarding alleged violations.

Here, the Taxpayer failed to pay the amount of tax that was due based on the state income tax return filed by the Taxpayers after the Department had adjusted that amount to include the Relevant Credit. The Taxpayers' lack of knowledge of the proper method for calculating their income tax liability (codified at Ark. Code Ann. § 26-51-435 (Repl. 2012)) cannot be used as a defense to the assessment of the penalties. The facts presented meet the requirements for assessment of the failure to pay penalty. Consequently, the assessment of the failure to pay penalty is sustained.

Interest

Interest must be assessed on tax delinquencies for use of the state's tax dollars. Ark. Code Ann. § 26-18-508 (Repl. 2012).

DECISION AND ORDER

The assessment is sustained in full. 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 Taxpayers request 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 Administrative Decision shall be effective and become the action of the agency. The revision request may be mailed to the Assistant Commissioner of Revenues, 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 Taxpayers have requested a revision. The Taxpayers may seek relief from the final decision of the Administrative Law Judge or the Commissioner of Revenues on a final assessment 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: December 16, 2016