

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

**ADMINISTRATIVE DECISION**

**IN THE MATTER OF** [REDACTED]  
[REDACTED]  
**(ACCT. NO.:** [REDACTED] **)**

**DOCKET NOS.:** 17-485

17-486

**WITHHOLDING  
PASS-THROUGH  
TAX ASSESSMENTS**

**PERIOD ENDING: 12/31/10**  
**(\$ [REDACTED])<sup>1</sup>**

**PERIOD ENDING: 12/31/11**  
**(\$ [REDACTED])<sup>2</sup>**

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**RAY HOWARD, ADMINISTRATIVE LAW JUDGE**

**APPEARANCES**

This case is before the Office of Hearings and Appeals upon a written protest dated October 11, 2016, signed by [REDACTED], on behalf of [REDACTED] [REDACTED] (“Taxpayer” or “Taxpayer 4”). The Taxpayer protested assessments of Withholding Pass-through Tax resulting from an audit conducted by Nancy Robertson, Tax Auditor – Sales and Use Tax/Withholding, for the Department of Finance and Administration (“Department”). The Letter ID Numbers are [REDACTED] and [REDACTED].

A telephone hearing was originally scheduled in this matter on June 19, 2017. The telephone hearing was rescheduled for August 23, 2018, but prior to the hearing, the parties requested that the matter be submitted for a decision based upon consideration of written documents. A Briefing Schedule was mailed to the parties on August 22, 2018. The Department was represented by Alicia

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<sup>1</sup> The reflected amount includes tax (\$ [REDACTED]), penalty (\$ [REDACTED]), and interest (\$ [REDACTED]).

<sup>2</sup> The reflected amount includes tax (\$ [REDACTED]), penalty (\$ [REDACTED]), and interest (\$ [REDACTED]).

Austin Smith, Attorney at Law, Office of Revenue Legal Counsel. The Taxpayer was represented by [REDACTED]. The Department's Opening Brief was filed on September 24, 2018. The Taxpayer's Response Brief was filed on October 26, 2018. The Department's Reply Brief was filed on November 27, 2018.

### **ISSUE**

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

### **FINDINGS OF FACT/CONTENTIONS OF THE PARTIES**

The Department's Opening Brief addressed facts and issues involved in this case and stated, in pertinent part, as follows:

These matters arise from the tax relationships among several entities. Because the issues in the assessments involve the same set of facts and law, this brief consolidates the protests filed by these interrelated entities. The entities hold stock interests in [REDACTED] and [REDACTED]. Each of these tax-structured entities has reporting and payment requirements with which it has not complied, as detailed herein. The Department correctly assessed each of these taxpayers and the assessments should be sustained.

**Exhibit 1** is an ownership chart received from the Taxpayers which shows that the relationships between the entities are structured in such a way that taxable income passes down at least two times before it is paid out to the end recipient in the chain. Although the Taxpayers have created tax structures that seem complex, in order to invest in either [REDACTED] or [REDACTED] stock, **Exhibit 1** demonstrates that the relationships between the entities are actually very simple.

Generally, these types of investment vehicles are structured as follows. A primary entity is formed as a partnership which holds investments in items such as stocks, bonds, commodities, and other valuable instruments. The partners in a primary entity are known as lower-tier entities. The primary entity calculates its income and losses to determine the amount of net share of income to distribute to each of its lower-tier entities. The primary entity is required to file a tax return to report identifying information for its lower-tier

entities and the amount of income disbursed to each of them on Form AR1050—Partnership Return. Some lower-tier entities are the end recipient of the income. Primary entities are required to withhold income taxes for lower-tier entities unless the lower-tier entity presents an AR4PT. See Arkansas Code Annotated § 26-51-905. Form AR4PT, the Nonresident Member Withholding Exemption Affidavit, allows the lower-tier entity to forego withholding by the primary entity and file and pay income taxes on its own behalf. The election must be memorialized on Form AR4PT and filed with the Department. See Ark. Code Ann. § 26-51-919(c)(5)(A).

Other lower-tier entities may be pass-through entities, meaning that income is diverted to this lower-tier entity before being disbursed to the entity which is the end recipient of the income. Depending on the type of pass-through entity, it may be required to file a corporate income tax return if it has elected to be treated as a corporation, or an individual income tax return if it is treated as a disregarded entity. Single-member LLCs are eligible to be treated as disregarded entities. The pass-through lower-tier entity forwards the income from the primary entity to the next lower-tier entity. If that entity is the end recipient of the income, it files an income tax return on its share. If that entity is another pass-through entity, it forwards the income it received from the first pass-through entity on to the end recipient, or another pass-through entity, which continues the cycle until the income reaches the final recipient. All pass-through entities, including disregarded entities, are required to withhold income taxes for lower-tier entities unless the lower-tier entity presents an AR4PT to elect to forego withholding by that entity and file and pay income taxes on its own behalf. See Ark. Code Ann. § 26-51-919(c)(5)(A).

The primary entity is allowed to take deductions necessary to generate the income at the top level, which in this case is investments in either ██████ or ██████ stock. As the income continues to pass down, lower-tier entities are only allowed to take deductions necessary to generate the income at their level, which in this case is income from holding an interest in a primary entity which owns stock.

It is not necessary to create a system of structured tax entities in order to hold stock investments. In this case, given the various taxpayers' failure to comply with reporting, withholding, and payment requirements, what is a simple transaction is transformed into a series of efforts to obfuscate the true amount of income received and taxes owed.

**FACTS**

The facts leading to these assessments came to light in [REDACTED] when [REDACTED] was required to file an amended return for fiscal year [REDACTED] due to an audit by the Internal Revenue Service because it failed to report over \$ [REDACTED] of taxable income. [REDACTED] is the primary entity in the [REDACTED] investment arrangement. When [REDACTED] filed its amended return, [REDACTED] reported that it disbursed income in the amount of \$ [REDACTED] to [REDACTED] and in the amount of \$ [REDACTED] to [REDACTED]. **Exhibit 2**, [REDACTED] AR1050 Partner's Share of Income Report. Tax Auditor Nancy Robertson ("Auditor") examined records of the Arkansas Department of Finance and Administration (the "Department") and discovered that neither [REDACTED] nor [REDACTED] had filed an income tax return.

[REDACTED]

[REDACTED] ("Taxpayer 1") and [REDACTED] ("Taxpayer 2") are partners in an investment group, [REDACTED]. When [REDACTED] filed the amended return for fiscal year [REDACTED], it reported that it disbursed \$ [REDACTED] to Taxpayer 1 but did not withhold income taxes. **Exhibit 2, Page 3**. On the same amended return, [REDACTED] reported that it disbursed \$ [REDACTED] to Taxpayer 2 but did not withhold income taxes. **Exhibit 2, Page 2**. The Department assessed Taxpayer 1 for its income taxes based on the direct allocation. The Department assessed Taxpayer 2 for its income taxes based on the direct allocation.

... According to the document provided by the Taxpayer (**Exhibit 1**), [REDACTED] ("Taxpayer 3"), is the sole member/owner of Taxpayer 1 and is the lower-tier entity. Taxpayer 1 did not withhold income taxes for [REDACTED], and [REDACTED] did not file an AR4PT with the Department. Instead, [REDACTED] filed an income tax return for year [REDACTED] showing that it had no income from partnerships or fiduciaries in Arkansas but instead suffered a loss of \$ [REDACTED]. The return reflected no ownership interest in Taxpayer 1. **Exhibit 6**. The Auditor asked the Taxpayer for verification of the loss and documentation as to why Taxpayer 1 had not filed a withholding return or remitted payment for the disbursement of \$ [REDACTED]. The Taxpayer did not provide any of the requested documentation and has not met its burden in refuting the assessment.

...

... According to the document provided by the Taxpayer (**Exhibit 1**), [REDACTED] (“Taxpayer 4”), is the sole member/owner of Taxpayer 2 and is the lower-tier entity. Taxpayer 2 did not withhold income taxes for [REDACTED], and [REDACTED] did not file an AR4PT with the Department. [REDACTED] did not file a partnership return for year [REDACTED]. **Exhibit 10.** The Auditor asked the Taxpayer for documentation as to why Taxpayer 2 had not filed a withholding return or remitted payment for the disbursement of \$ [REDACTED]. The Taxpayer did not provide any of the requested documentation and has not met its burden in refuting the assessment.

[REDACTED]

#### Tax Year 2010

While the lower-tier entities, [REDACTED] and [REDACTED], did not report an interest in Taxpayer 1 or Taxpayer 2, they did report an interest in [REDACTED]. **Exhibits 1 and 6.** [REDACTED] is a lower-tier entity in the [REDACTED] investment arrangement. **Exhibit 1.** [REDACTED] filed an amended return for fiscal year 2010 in 2015. [REDACTED] reported that it disbursed income in the amount of \$ [REDACTED] to [REDACTED] in 2010. **Exhibit 11,** [REDACTED] AR1050 Partner’s Share of Income Report. On its AR1050, [REDACTED] indicated the receiver of \$ [REDACTED] of the distribution was [REDACTED] (“Taxpayer 3”) and the receiver of \$ [REDACTED] of the distribution was [REDACTED] (“Taxpayer 4”). **Exhibit 12.** The Department assessed Taxpayers 3 and 4 for its income taxes based on the direct allocation.

#### Tax Year 2011

[REDACTED] reported that it disbursed income in the amount of \$ [REDACTED] to [REDACTED] in 2011. **Exhibit 12-B,** [REDACTED] AR1050 Partner’s Share of Income Report. [REDACTED] indicated the receiver of \$ [REDACTED] of the distribution was [REDACTED] (“Taxpayer 3”) and the receiver of \$ [REDACTED] of the distribution was [REDACTED] (“Taxpayer 4”). **Exhibit 13.** The Department assessed Taxpayers 3 and 4 for its income taxes based on the direct allocation.

[REDACTED] (“Taxpayer 3”) is located at [REDACTED]. Taxpayer 3 executed Powers of Attorney appointing [REDACTED] to act as [REDACTED]

the Taxpayer's representatives herein. **Exhibit 14.** As a result of the Auditor's findings for tax year 2010, the Department assessed tax in the amount of \$ [REDACTED], penalty in the amount of \$ [REDACTED], and interest in the amount of \$ [REDACTED] for a total assessment of \$ [REDACTED]. **Exhibit 15.** The Notice of Proposed Assessment was mailed to the Taxpayer on September 1, 2016. As a result of the Auditor's findings for tax year 2011, the Department assessed tax against Taxpayer 3 in the amount of \$ [REDACTED], penalty in the amount of \$ [REDACTED], and interest in the amount of \$ [REDACTED] for a total assessment of \$ [REDACTED]. **Exhibit 16.** The Notice of Proposed Assessment was mailed to Taxpayer 3 on September 15, 2016. Taxpayer 3 protested the assessments on October 11, 2016. **Exhibit 17.**

In its Protest, Taxpayer 3 simply stated that Arkansas only requires withholding for individuals with a state income allocation of greater than \$1,000, and that no partner had met the \$1,000 threshold in either tax year. Taxpayer 3 did not provide any documents which prove the partner's share of income.

[REDACTED] ("Taxpayer 4") is located at [REDACTED]. Taxpayer 4 executed Powers of Attorney appointing [REDACTED] to act as the Taxpayer's representatives herein. **Exhibit 18.** As a result of the Auditor's findings for tax year 2010, the Department assessed tax in the amount of \$ [REDACTED], penalty in the amount of \$ [REDACTED], and interest in the amount of \$ [REDACTED] for a total assessment of \$ [REDACTED]. **Exhibit 19.** The Notice of Proposed Assessment was mailed to the Taxpayer on September 15, 2016. As a result of the Auditor's findings for tax year 2011, the Department assessed tax against Taxpayer 4 in the amount of \$ [REDACTED], penalty in the amount of \$ [REDACTED], and interest in the amount of \$ [REDACTED] for a total assessment of \$ [REDACTED]. **Exhibit 20.** The Notice of Proposed Assessment was mailed to Taxpayer 4 on September 15, 2016. Taxpayer 4 protested the assessments on October 11, 2016. **Exhibit 21.**

In its Protest, Taxpayer 4 simply stated that Arkansas only requires withholding for individuals with a state income allocation of greater than \$1,000, and that no partner had met the \$1,000 threshold in either tax year. Taxpayer 4 did not provide any documents which prove the partner's share of income.

...

#### Pass-Through Entities

Pass-through entities are required to withhold Arkansas income tax at the highest income tax rate levied under §§ 26-51-201, 26-51-202, and 26-51-205 on the share of income of the pass-through entity that is derived from or attributable to sources within this state and distributed to each nonresident member. Ark. Code Ann. § 26-51-919(b)(1)(A)(i) (Repl. 2012). The pass-through entity is liable to the Director of the Department for the payment of the tax required to be withheld. Ark. Code Ann. § 26-51-919(b)(1)(A)(ii) (Repl. 2012). On or before the due date for the pass-through entity's composite income tax return described in subsection (d) of this section, a pass-through entity shall file an annual return with the director showing the total amount of income distributed or credited to its nonresident members and the amount of tax withheld and shall remit the amount of tax withheld. Ark. Code Ann. § 26-51-919(b)(2)(A) (Repl. 2012).

For Arkansas Corporate Income Tax purposes, pass-through income is treated as partnership income under Arkansas Individual Income Tax Regulation 1.26-51-802. For a tax year in which a partnership receives any income from Arkansas sources, a partnership return (AR1050) must be filed on behalf of the partnership and must be signed by at least one (1) of the partners. The partnership return must include the names and addresses of all partners of whatever nature who are entitled to a share of the partnership's income and the percentage or amount of each such partner's share. All partnership income from activities carried on within Arkansas or from real or personal property located within Arkansas must be allocated to Arkansas. Arkansas Individual Income Tax Regulation 1.26-51-802(a-b).

...

### Partnerships

Partnerships are to be classified and taxed for Arkansas income tax purposes in the same manner as they are classified and taxed for federal income tax purposes. Ark. Code Ann. § 26-51-802 (Repl. 2012). Partnerships are treated as a conduit or pass-through entity and are, therefore, not subject to taxation. The various items of partnership income, gains and losses, etc., flow through to the individual partners and are reported on their individual income tax returns. Arkansas Individual Income Tax Regulation 2.26-51-102(4). Partnership income must be allocated to the state where it was actually earned. All partnership income from activities carried on within Arkansas shall be allocated to Arkansas. Individual Income Tax Regulation 1.26-51-405. The portion of the partnership's income which is allocable to Arkansas must be

reported on a partnership tax return (AR1050) with the State of Arkansas. Partnerships are required to make a return of income which properly reflects the net income for each partner. Individual partners are required to include distributive shares (whether distributed or not) in their individual returns. See Ark. Code Ann. § 26-51-802 and Individual Income Tax Regulation 1.26-51-405(a).

...

██████████ reported that it disbursed income in the amount of \$██████████ to Taxpayer 3 and \$██████████ to Taxpayer 4 and did not withhold income tax from either Taxpayer for tax year 2010. ██████████ reported that it disbursed income in the amount of \$██████████ to Taxpayer 3 and \$██████████ to Taxpayer 4 and did not withhold income tax from either Taxpayer for tax year 2011. The primary entity for Taxpayers 3 and 4 did not withhold and remit taxes on the disbursement. Taxpayers 3 and 4 did not report and remit taxes on the disbursement. Taxpayers 3 and 4 claim that "Arkansas only requires withholding for individuals with a state income allocation of greater than \$1,000, and that no partner had met the \$1,000 threshold in either tax year." Taxpayers 3 and 4 did not provide any documents to prove the partner's share of income, which was required to be reported on their returns. In the absence of proof, the assessments were proper. [P. 2-9].

The Taxpayer's Response Brief addressed the contentions of the Department and stated, in part:

This matter arises from the Arkansas Department of Finance and Administration ("Department") examination of ██████████  
██████████ (collectively known as "Taxpayers") tax records. The examination resulted in an assessment for each of the entities listed above.

## **FACTS**

### Ownership Structure

...

██████████

Taxpayers respectfully provide the following additional clarifying facts with respect to ██████████. ██████████ is an LLC



treated as a partnership for federal income tax purposes. [REDACTED]  
[REDACTED] ("Taxpayer 3") holds a [REDACTED] interest in [REDACTED].  
[REDACTED] ("Taxpayer 4") holds a [REDACTED]  
interest in [REDACTED]. **Appendix 3.**

Taxpayers contest the following facts outlined in the Department's Opening Brief:

...

[REDACTED]

*Department assertion:* In its Protest, [REDACTED] ("Taxpayer 3") simply stated that Arkansas only requires withholding for individuals with a state income allocation of greater than \$1,000 and that no partner had met the \$1,000 threshold in either tax year.

*Response:* There were subsequent communications whereby Taxpayer 3 stated that there was no one partner (with the exception of an exempt partner) that received Arkansas allocable income greater than \$1,000. Taxpayer 3 provided Auditor with K-1 equivalents. For tax years 2010 and 2011 Arkansas as a taxing authority did not provide separate state K-1s. **Appendix 7 and Appendix 8.** We would also direct the Department to copy of [REDACTED] return for documentation of Taxpayer 3 status as a partner. **Appendix 9.**

19. *Department assertion:* Taxpayer 3 did not provide any documents which prove the partner's share of income.

*Response:* For tax years 2010 and 2011 Arkansas did not provide separate state K-1s. Taxpayer 3 provided K-1 equivalents for all partners with their 2010 and 2011 returns. With the exception of an exempt partner, no one partner received Arkansas allocable income greater than \$1,000. We would direct the Department to the previously provided information contained with said K-1 equivalents. **Appendix 7 and Appendix 8.**

20. *Department assertion:* In its Protest, [REDACTED] ("Taxpayer 4") simply stated that Arkansas only requires withholding for individuals with a state income allocation Of greater than \$1,000 and that no partner had met the \$1,000 threshold in either tax year.

*Response:* There were subsequent communications whereby Taxpayer 4 stated that there was no one partner (with the exception of an exempt partner) that received Arkansas allocable income

greater than \$1,000. Taxpayer 4 provided Auditor with K-1 equivalents. For tax years 2010 and 2011 Arkansas did not provide separate state K-1s. **Appendix 10 and 11.** We would also direct the Department to copy of [REDACTED] return for documentation of Taxpayer 3 status as a partner. **Appendix 9.**

21. *Department assertion:* Taxpayer 4 did not provide any documents which prove the partner's share of income.

Response: For tax years 2010 and 2011 Arkansas did not provide separate state K-1s. Taxpayer 4 provided K-1 equivalents for all partners with their 2010 and 2011 returns. With the exception of an exempt partner, no one partner received Arkansas allocable income greater than \$1,000. We would direct the Department to the previously provided information contained with said K-1 equivalents. **Appendix 10 and 11.**

...

The Department asserts that Taxpayer 3 and Taxpayer 4 did not provide any documents to prove the partner's share of income. However, Taxpayer 3 and Taxpayer 4 provided copies of K-1 equivalents for tax years 2010 and 2011 showing that, with the exception of one exempt partner, none of the partners were receiving Arkansas distributable income greater than \$1,000. Taxpayer 3 and Taxpayer 4 provided sufficient proof that they are not subject to nonresident withholding and that the assessments were improper. [P. 1-8].

With respect to Taxpayer 4, the Department's Reply Brief stated, in pertinent part, as follows:

[REDACTED]

[REDACTED] reported that it disbursed income in the amount of \$ [REDACTED] to Taxpayer 3 and \$ [REDACTED] to Taxpayer 4 and did not withhold income tax from either Taxpayer for tax year 2010. **Exhibits 11-12.** [REDACTED] reported that it disbursed income in the amount of \$ [REDACTED] to Taxpayer 3 and \$ [REDACTED] to Taxpayer 4 and did not withhold income tax from either Taxpayer for tax year 2011. **Exhibits 12B-13.** The primary entity for Taxpayers 3 and 4 did not withhold and remit taxes on the disbursement. Taxpayers 3 and 4 did not report and remit taxes on the disbursement. Taxpayers 3 and 4 failed to identify the partners who received the distributions detailed above. Taxpayers

3 and 4 failed to provide a return of income which properly reflects the net income for their partners.

The portion of the partnership's income which is allocable to Arkansas must be reported on a partnership tax return (AR1050) with the State of Arkansas. Partnerships are required to make a return of income which properly reflects the net income for each partner. Individual partners are required to include distributive shares (whether distributed or not) in their individual returns. See Ark. Code Ann. § 26-51-802 and Individual Income Tax Regulation 1.26-51-405(a).

Taxpayers 3 and 4 claim that "Arkansas only requires withholding for individuals with a state income allocation of greater than \$1,000, and that no partner had met the \$1,000 threshold in either tax year." Taxpayers 3 and 4 failed to provide documents which prove this assertion. Taxpayers 3 and 4 failed to provide documents which prove which partners received the distributions detailed above. Taxpayers 3 and 4 failed to provide documents which prove each partner's share of income.

...

In the absence of proof that the partners reported the appropriate income to Arkansas, Taxpayers 3 and 4 are responsible for the income distributed to them from the primary entity. The Taxpayers failed to present evidence that income tax was withheld on the distributions. Pass-through entities are required to withhold Arkansas income tax and the pass-through entity is liable to the Director of the Department for the payment of the tax required to be withheld.

The Taxpayers failed to present sufficient documents or records and thus had the burden of refuting the Department's assessment. The Taxpayers failed to establish that the proposed assessments were in error. The Taxpayers failed to meet their burden by a preponderance of the evidence.

### **CONCLUSION**

Here, the Department has met its burden of proof in this case by a preponderance of the evidence. The Taxpayers failed to present evidence to refute the proposed assessments or to establish that the proposed assessments were in error. Therefore, the Taxpayers failed to meet their burden by a preponderance of the evidence. Consequently, the Auditor correctly assessed Withholding Pass Through Tax against the Taxpayers for tax years 2009-2011.

The assessment of penalty at the rate of thirty-five percent (35%) by the Tax Auditor is also in accordance with Arkansas statutory law, which provides as follows in relevant part:

In the case of a taxpayer's failure to file any return required by any state tax law on or before the date prescribed determined with regard to any extension of time for filing the return, unless it is shown that the failure is due to reasonable cause and not to willful neglect, there shall be added to the amount required to be shown as tax on the return five percent (5%) of the amount of the tax if the failure is not more than one (1) month, with an additional five percent (5%) for each additional month or fraction of a month during which the failure continues, not to exceed thirty-five (35%) in the aggregate.

Ark. Code Ann. § 26-18-208(1) (Repl. 2012). Interest is owed upon the tax deficiency for the use of the State's tax dollars. See Ark. Code Ann. § 26-18-508 (Repl. 2012). For the reasons set forth above, it is respectfully requested that the assessments against the Taxpayers be sustained in full.

The Department has established by a preponderance of the evidence that the Taxpayers were required to withhold and remit income tax. The assessment of withholding pass through tax against the Taxpayers is proper. The assessment of interest against the Taxpayers is proper because the tax was due, but not paid, thereby depriving the State of the use of such funds during those periods. Ark. Code Ann. § 26-18-508 (Repl. 2012). The assessment of a 35% penalty against the Taxpayers is proper because the Taxpayers failed to file proper returns. Ark. Code Ann. § 26-18-208(1). [P. 4-5].

## **CONCLUSIONS OF LAW**

### **Standard of Proof**

Ark. Code Ann. § 26-18-313(c) (Supp. 2017) 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. 2017). 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. 2017). 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. 2017).

### **Withholding Pass-Through Tax Assessments**

Pass-through entities are required to withhold income tax on a nonresident member’s share of income that is attributable to sources within this state and distributed to the nonresident member unless an exemption applies.

See Ark. Code Ann. § 26-51-919 (Repl. 2012)<sup>3</sup> and Income Tax Rule 2006-3. The Taxpayer contended that the assessments should be set aside pursuant to the exemption provided by Income Tax Rule 2006-3(D)(3)<sup>4</sup> which states:

D. Members not subject to withholding: The following persons and organizations are not subject to withholding by a pass-through entity:

...

3. Non-resident members who have a pro rata or distributive share of income of the pass-through entity from doing business in or deriving income from sources within Arkansas of less than \$1,000 per year[.]

Ark. Code Ann. § 26-18-506(a) (Repl. 2012) requires the Taxpayer to maintain suitable records and states that, “[i]t is the duty of every taxpayer required to make a return of any tax due under state law to keep and preserve suitable records as are necessary to determine the amount of tax due or to prove the accuracy of any return.” Income Tax Rule 2006-3(F) also contains reporting requirements and provides, in part:

1. A pass-through entity is required to provide the Department with an annual return (Form AR941PT) that includes magnetic media (a CD or 3.5" diskette) showing to whom the distribution was paid on or before the fifteenth day of the fourth month following the close of the pass-through entity's tax year. The magnetic media must also include the non-resident member's address, social security number or federal employer identification number, the amount of taxable income distributed and the amount of Arkansas income tax withheld and paid on the member's behalf. The magnetic media should be labeled with the form number "AR941PT", the pass-through entity's name, federal employer identification number and the number of records contained on the disk or CD. The final version of the media layout will be posted on the Withholding Website. The annual return may be amended if necessary.

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<sup>3</sup> The 2017 Supplement contains a version of Ark. Code Ann. § 26-51-919 which is applicable to tax years 2018 and thereafter.

<sup>4</sup> Unlike companion taxpayers that asserted Income Tax Rule 2006-3(E) as a defense to assessments.

The Taxpayer's Response Brief asserted that the Taxpayer provided copies of K-1 equivalents showing (with the exception of one exempt partner) "none of the partners were receiving Arkansas distributable income greater than \$1,000. [P. 8]." The Department's Reply Brief asserted that the Taxpayer "failed to provide documents which prove each partner's share of income. [P. 4]." The burden of proving entitlement to the exemption provided by Income Tax Rule 2006-3(D)(3) is upon the Taxpayer. A review of the documents contained in Appendixes 7 – 11 failed to establish that the evidence weighs in favor of a finding that the Taxpayer proved entitlement to the exemption provided by Income Tax Rule 2006-3(D)(3). Consequently, the Department correctly assessed Withholding Pass-through Tax against the Taxpayer.

Interest was properly assessed upon the tax deficiency for the use of the State's tax dollars. See Ark. Code Ann. § 26-18-508 (Repl. 2012). The penalty was properly assessed under Ark. Code Ann. § 26-18-208(1).

### **DECISION AND ORDER**

The proposed assessments are sustained. 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. 2017), 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 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. A revision request may also be faxed to the

Assistant Commissioner of Revenues at (501) 683-1161 or emailed to [revision@dfa.arkansas.gov](mailto:revision@dfa.arkansas.gov). 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.

Ark. Code Ann. § 26-18-406 (Supp. 2017) provides for the judicial appeal of a final decision of an Administrative Law Judge or the Commissioner of Revenues on a final assessment or refund claim denial; however, the constitutionality of that code section is uncertain.<sup>5</sup>

**OFFICE OF HEARINGS & APPEALS**



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**RAY HOWARD**  
**ADMINISTRATIVE LAW JUDGE**

DATED: April 4, 2019

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<sup>5</sup> See Board of Trustees of Univ. of Arkansas v. Andrews, 2018 Ark. 12.