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

ADMINISTRATIVE DECISION

IN THE MATTER OF [redacted] **(ACCT. NO.:** [redacted] **)**	**GROSS RECEIPTS TAX ASSESSMENT**
DOCKET NO.: 18-211	**AUDIT ID:** [redacted] **($** [redacted] **)**[1]

RAY HOWARD, ADMINISTRATIVE LAW JUDGE

APPEARANCES

This case is before the Office of Hearings and Appeals upon a written protest dated on or about August 28, 2017, signed by [redacted], President, on behalf of [redacted], the Taxpayer. The Taxpayer protested the assessment of Gross Receipts Tax ("sales tax") resulting from an audit conducted by Stan Kesterson, Tax Auditor - Southwest Audit District of the Office of Field Audit, for the Department of Finance and Administration ("Department"). The audit period was from January 1, 2012, to May 31, 2017.

A hearing was held on February 8, 2018, at 1:00 p.m., in Arkadelphia, Arkansas. The Department was represented by Lauren Ballard, Attorney at Law, Office of Revenue Legal Counsel ("Department's Representative"). The Tax Auditor and Vanessa Smith - Audit Supervisor, appeared for the Department. The Taxpayer was represented by the Taxpayer's President and [redacted], Secretary ("Taxpayer's Representatives").

[1] The reflected amount consists of tax ($[redacted]) and interest ($[redacted]).

ISSUE

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

FINDINGS OF FACT/CONTENTIONS OF THE PARTIES

The documents contained in the case file were received into evidence and the Taxpayer's Protest Form stated that, "[i]n 2002 I contacted DFA & was told did not need Sales tax permit as long as collected sales taxes with no mark up & no tax on labor. Then 2011, because my company had grown, contacted DFA once again & told to get permit, I did, & still told labor was NOT taxable. So I have not collected on Labor because that is what I was told. I DO NOT feel I'm in the wrong here. [P. 1]."

The Department's Answers to Information Request addressed the facts of the case and stated, in pertinent part, as follows:

> Taxpayer has a large scope of activities ranging from repair of [redacted] to installation of [redacted] etc. Taxpayer employs approximately [redacted] full or part time employees and provides services to most of the State of Arkansas and parts of [redacted]. Many of Taxpayer's services are exempt from tax, because they are only inspection or monitoring and do not involve a taxable activity or transfer of tangible personal property. The Taxpayer performs a small amount of work for Direct Pay Permit holders . . ..
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> On June 26, 2017, the Department commenced an audit of Taxpayer by and through its auditor, Stan Kesterson ("Auditor"). The Auditor reviewed sales invoices, sales journals, ledgers, income tax returns, bank statements, and other pertinent documentation. In reviewing Taxpayer's sales, Auditor noted that Taxpayer had failed to collect sales tax on the cleaning and labor performed on [redacted]. During the audit, Taxpayer's representative indicated that he had been instructed in the past by former CPAs and verbally by a state agency representative that repair labor was not taxable.

> Taxpayer began business in January of 2012 and the audit period was extended back to this period due to the taxpayer being more than 25% underreported. During the review of the records, Taxpayer explained that [redacted] for year 2012. Taxpayer agreed to use an error percentage based on year 2013 to derive audit numbers for 2012, Taxpayer agreed to use and error percentage based on 2013. It was determined that using 2013 alone as a basis for the error percentage was fairer to the taxpayer and would more readily mirror the 2012 business activity. The percentage was derived by taking additional taxable sales for 2013 and dividing it by total sales shown on the Income tax return. This error percentage was then applied to gross sales for 2012 and applied to the State of Arkansas and the locals in question. A copy of Auditor's complete schedules, including the error percentage calculation, is attached as Exhibit 1.
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> The Department reviewed the activities conducted by Taxpayer and determined that, where the taxpayer merely observed the [redacted] and did not perform any service, no tax was due. However, where Taxpayer actually performed a service of calibration or cleaning, Auditor assessed the appropriate rate of tax on that service. The assessment was of taxable service and was appropriate. At this time, Taxpayer has raised no claim of entitlement to exemption or provided any evidence to refute that the service was taxable.
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> In its protest, Taxpayer claimed to have received advice on the taxability of its services from the Department and claims to have relied on those statements. However, there is neither written evidence of any improper actions or statements nor a compelling reason for the Department to be estopped from enforcing the tax law. [Footnote omitted, P. 1-5].

The Tax Auditor presented testimony consistent with the information contained in the Department's Answers to Information Request and also testified that: (1) he conducted the audit by reviewing sales invoices and bank records; (2) since the Taxpayer was more than 25% underreported, the audit was extended to six [6] years; (3) the Taxpayer's employees perform services for sellers of [redacted] including the maintenance of [redacted]

[redacted]; (4) the Taxpayer's President contacted the Sales and Use Tax Section on multiple occasions to make sure that the correct items were being taxed and he thinks the Taxpayer's President was given some bad information; (5) the Taxpayer's President was told by different people that repair labor was not taxable but repairing machinery (or electrical devices) is a taxable service under Arkansas law; (6) the Taxpayer collected tax on all materials but not on charges for labor relating to taxable repairs or cleaning; (7) he did not assess tax on invoices for inspection services; and (8) the Taxpayer did not obtain a written legal opinion for the Department.

The Taxpayer's President testified that: (1) taxes were under-collected and it was his responsibility to know the law; (2) the Department has not made it easy to know the law; (3) he has researched the Department's website and reviewed the sales tax rules and it is difficult to determine how to correctly collect taxes; (4) he has culpability but the Department has equal culpability; (5) sales tax information is not readily accessible or available; (6) he is asking for a little fairness in this situation; (7) he is not disputing anything done in the audit by the Tax Auditor; (8) the Tax Auditor did a good job and was fair; and (9) he thought he was complying with the tax laws.

The Taxpayer's Secretary stated that the hearing was a "mercy visit" and they will be alright either way.

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).

Sales Tax Assessment

As a general rule, sales tax applies to the entire gross receipts from sales of tangible personal property and certain specifically enumerated services within

the State of Arkansas. See Ark. Code Ann. § 26-52-301 et seq. (Repl. 2014 & Supp. 2017). Arkansas Gross Receipts Tax Rule GR-9 provides that the services of "alteration, addition, cleaning, refurbishing, replacement and repair" of electrical devices and machinery of all kinds are subject to sales tax. The liability for collecting and reporting sales tax on the sale of a taxable service is upon the seller of the service unless the purchaser claims an exemption.[2] See Arkansas Gross Receipts Tax Rule GR-79(C).

The audit methodology and calculations used by the Tax Auditor are not in dispute. The Taxpayer's Representatives requested equitable relief based upon fairness. This Office has no equitable power to grant the Taxpayer equitable relief based upon fairness. An administrative tribunal can only operate within the powers granted to it by the legislature. There is considerable doubt whether the Arkansas General Assembly may even constitutionally grant equitable powers to an administrative agency, since the granting of equity is purely a judicial power. Provenzano v. Long, 64 Nev. 412, 183 P.2d 639 (1947); Mich. Mut. Liability Co. v. Baker, 295 Mich. 237, 294 N.W. 168 (1940), Ford v. Barcus, 261 Iowa 616, 155 N.W.2d 507 (1968) (citing Doyle v. Dugan, 229 Iowa 724, 295 N.W. 128 (1940)). Ark. Code Ann. § 26-18-405 (Supp. 2017) clearly indicates the decision of a hearing officer is limited to the application of the law to a proposed assessment or refund denial and does not grant authority for decisions based in equity, even assuming that such a power could be constitutionally granted and exercised by this tribunal.

[2] The Taxpayer was not collecting sales tax during the audit period so there was no evidence introduced to establish that any of the Taxpayer's customers claimed an exemption.

While the Taxpayer did not expressly assert the defense of estoppel, the contentions regarding incorrect information received from employees of the Department implicate that legal doctrine. With respect to the estoppel defense, the Arkansas Supreme Court has held that the State can be estopped by the actions of its agents. See Foote's Dixie Dandy, Inc. v. McHenry, 270 Ark. 816, 607 S.W.2d 323 (1980). However, the doctrine of estoppel should only be applied against the State where there is substantial proof and a compelling reason. See Everett v. Jones, 277 Ark. 162, 639 S.W.2d 739 (1982). In Duchac v. City of Hot Springs, 67 Ark. App. 98, 992 S.W.2d 174 (1999), the Arkansas Court of Appeals addressed the requirements for an estoppel defense against a governmental entity and stated, as follows:

> . . . In *City of Russellville v. Hodges,* 330 Ark. 716, 957 S.W.2d 690 (1997), our supreme court set out the elements of estoppel:
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> > Four elements are necessary to establish estoppel. They are: (1) the party to be estopped must know the facts; (2) the party to be estopped must intend that the conduct be acted on or must act so that the party asserting the estoppel had a right to believe it was so intended; (3) the party asserting the estoppel must be ignorant of the facts; and (4) the party asserting the estoppel must rely on the other's conduct and be injured by that reliance. [Citations omitted.] Additionally, we have specifically held that a sovereign is not bound by the unauthorized acts of its employees. [Citations omitted.] ....
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> 330 Ark. at 719, 957 S.W.2d at 691–92. The trial court also cited *Hope Educ. Ass'n v. Hope School Dist.*, 310 Ark. 768, 839 S.W.2d 526 (1992), which applied the same elements of estoppel, with a few wording changes, to a sovereign. In applying these elements of estoppel to the facts of this case, the chancellor found they were not all satisfied.
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> According to appellant, the second element of estoppel, that the party to be estopped must intend that the conduct be relied on, is satisfied by the City billing and collecting occupational taxes,

> thereby acquiescing in appellant's use of the house as an apartment building. The Arkansas Supreme Court has held that estoppel may only be applied against the State when there has been an "affirmative misrepresentation by an agent or agency of the State." *Arkansas Dep't of Human Servs. v. Estate of Lewis*, 325 Ark. 20, 922 S.W.2d 712 (1996).

Id. at 67 Ark. App. at 105–106, 992 S.W.2d at 179–180.

The Taxpayer failed to obtain a binding Letter Opinion regarding the taxability of its services under Arkansas Gross Receipts Tax Rule GR-75. This case illustrates the necessity of obtaining a Letter Opinion since the Taxpayer performed both taxable services and non-taxable services. The verbal responses given to inquiries by the Taxpayer's President could have been affirmative responses or negative responses based upon the facts and information presented to the person giving the opinion.

Lack of actual or constructive knowledge of a tax levy is inadequate to avoid imposition of the tax. Every person is presumed to know the law and lack of knowledge is not an excuse for failure to comply with the mandates of the law. See Duchac v. City of Hot Springs, supra. Absent a binding Letter Opinion issued pursuant to Arkansas Gross Receipts Tax Rule GR-75, informational assistance provided by an employee of the Department does not relieve a Taxpayer of this presumption or the requirement of compliance. Under the facts and circumstances of this case, the Department correctly assessed sales tax against the Taxpayer.

Interest was also properly assessed on the tax deficiency for the use of the State's tax dollars. See Ark. Code Ann. § 26-18-508 (Repl. 2012). No penalty was assessed against the Taxpayer.

DECISION AND ORDER

The assessment is 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. 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.[3]

OFFICE OF HEARINGS & APPEALS

RAY HOWARD
ADMINISTRATIVE LAW JUDGE

DATED: March 12, 2018

[3] See Board of Trustees of Univ. of Arkansas v. Andrews, 2018 Ark. 12.