

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

**ADMINISTRATIVE DECISION**

**IN THE MATTER OF** [REDACTED]  
[REDACTED]

**GROSS RECEIPTS TAX  
ASSESSMENT**

**DOCKET NO.: 18-294**  
**AUDIT NO.:** [REDACTED]

**ACCT. NO.:** [REDACTED]  
[REDACTED]<sup>1</sup>

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**TODD EVANS, ADMINISTRATIVE LAW JUDGE**

**APPEARANCES**

This case is before the Office of Hearings and Appeals upon a written protest dated February 21, 2018, signed by [REDACTED], the Taxpayer. The Taxpayer protested an assessment of Gross Receipts Tax (“sales tax”) resulting from an audit conducted by the Department of Finance and Administration (“Department”).

A hearing was held in this matter on May 30, 2018, at 10:00 a.m. in Little Rock, Arkansas. The Department was represented by Leslie Fryxell, Attorney at Law, Office of Revenue Legal Counsel (“Department’s Representative”). Also present for the Department was Tiffany Quillin (“Service Representative”) and Vanessa Smith (“Audit Supervisor”). The Taxpayer appeared at the hearing by telephone and represented himself.

**ISSUE**

Whether the Taxpayer has proven entitlement to the farm machinery and equipment exemption by a preponderance of the evidence. No.

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<sup>1</sup> This amount represents [REDACTED] (tax) and [REDACTED] (interest).

## FINDINGS OF FACT/CONTENTIONS OF THE PARTIES

### Prehearing Filings

The Department's Answers to Information Request summarized some relevant facts, providing in pertinent part, as follows<sup>2</sup>:

On or about March 18, 2015, the Taxpayer, [REDACTED] (hereafter "Taxpayer"), purchased an [REDACTED] (hereafter "pressure washer") from [REDACTED] located in [REDACTED], Arkansas, [REDACTED]. **(See Sales Invoice attached as Exhibit 1).**<sup>3</sup> At the time of the purchase of the pressure washer, the Taxpayer signed a Commercial Farming Machinery & Equipment Sales Tax Exemption Certification form, indicating that he is engaged in the production of "hogs and cattle" as a commercial farming business. **(See Taxpayer's Tax Exemption Certification attached as Exhibit 2).** The Seller noted "farm use tax exempt" on the invoice and no sales tax was paid on this purchase. **(See Exhibit 1).**

An audit was performed by DFA Service Representative, Tiffany Quillin, who concluded that the pressure washer was primarily used for maintenance and not used exclusively and directly in the agricultural production of food or fiber. As such, the purchase of the pressure washer did not qualify for the farm exemption and, therefore was a taxable transaction. On January 2, 2018, a Summary of Findings letter was issued to the Taxpayer notifying him that Gross Receipts (sales) tax was assessed on the purchase of the pressure washer. **(See Summary of Findings attached as Exhibit 3).** Also enclosed was a copy of Gross Receipts Rule 51 Exemptions from Tax - Farm Machinery and Equipment, Timber Harvesting Equipment (GR-51). **(See Gross Receipts Rule 51 attached as Exhibit 4).**

Subsequently, the Taxpayer called Ms. Quillin and explained that he is in the commercial farming business, that the pressure washer was necessary to clean his hog pens and for those reasons he should be entitled to claim the exemption.

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<sup>2</sup> The Service Representative confirmed the accuracy of this rendition of the facts in her testimony.

<sup>3</sup> This document states that the Taxpayer purchased an [REDACTED] for [REDACTED] on March 18, 2015, from [REDACTED] without paying any sales tax amount due to a farm use exemption claim.

On January 8, 2018, the Sales and Use Tax Section issued a Notice of Proposed Assessment letter to the Taxpayer advising him of the following tax assessment: tax of [REDACTED] and interest of [REDACTED] (10% per annum) for a balance of [REDACTED]. No penalty was assessed. **(See Notice of Proposed Assessment attached as Exhibit 5)**. On January 21, 2018, the Taxpayer timely filed a written protest of the assessment in which he stated that "[t]he pressure washer is a piece of equipment required" to fulfill a contractual obligation ("disinfecting" [sic]) with [REDACTED]. **(See Protest Form attached as Exhibit 6)**.

As an initial matter, the auditor learned that the Taxpayer filed Schedule F with [REDACTED] Tax Year Form 1040 indicating that he did claim a profit or loss from farming. The Auditor then reviewed Schedule F and learned that the taxpayer listed his principal crop or activity as **cattle** farming. (Emphasis Supplied.) **(See Redacted Schedule F attached as Exhibit 7)**.

Within her Answers to Information Request, the Department's Representative asserted that the pressure washer qualifies as tangible personal property and is generally taxable. Addressing the Taxpayer's farm machinery and equipment exemption claim, the Department's Representative stated as follows:

While the Taxpayer states in his Answers that [REDACTED] operated a **hog** farm contracted by [REDACTED]", his Schedule F filed with his [REDACTED] tax return asserts only a **cattle** farm. (Emphasis Supplied.) Thus, since hog farming was not on his tax return, it appeared that the Taxpayer was not in the hog farming business for profit at the time of the purchase.

Even if it were determined that the Taxpayer was in the business of hog farming for profit, he must also demonstrate that use of the pressure washer was "exclusively and directly for the agricultural production of food or fiber". **(See Arkansas Gross Receipts Tax Rule GR-51(C)(1)(2))**. In both his Protest and in his Answers, the Taxpayer states the pressure washer was purchased for farm use (disinfecting) and to fulfill contractual obligations. The pressure washer may be used on the farm to disinfect certain areas; however not all machinery and equipment purchased for farm use qualifies for the sales tax exemption. The pressure washer may, in fact, be necessary or required for the Taxpayer's use in fulfilling a contractual obligation, but that is not the test. To qualify, the pressure washer must contribute **directly** to the "**production**" of livestock for commercial purposes within the meaning of GR-51. (Emphasis Supplied.) It does not follow that "disinfecting" contributes **directly** to the **production** of hogs. (Emphasis Supplied.) For these

reasons, the auditor disallowed the exemption and assessed the appropriate amount of sales tax on the purchase.

Within his Answers to Information Request, the Taxpayer provided his objection to this assessment, stating as follows:

Pressure washer was purchased for farm use. [REDACTED] of [REDACTED] operated a hog farm contracted by [REDACTED], sanitizing was part of the contract. [REDACTED] of [REDACTED] is incorp. & has a Schedule F Form. This equipment was purchased for the farm To fulfill contract obligations.

### **Taxpayer's Testimony**

The Taxpayer explained that the farming operation is incorporated as [REDACTED] and operates in [REDACTED], Arkansas. [REDACTED] has two employees (including the Taxpayer) and occasionally hires temporary labor when the farm is particularly busy. [REDACTED] is a family business for his wife's family. He took over the farm to keep his wife's family afloat after his father-in-law [REDACTED]. The Taxpayer's primary employment is with the [REDACTED]. He never made enough money from the hog operation to compensate himself for his time after paying rent on the farm facilities to his wife's family. The Taxpayer further testified that he is not attempting to evade his tax liability; however, he is uncertain whether the pressure washer qualifies for the farm machinery and equipment exemption, especially considering that his accountant told him that it should be exempt. If it is ultimately determined that the tax is owed, he is ready and willing to pay the assessed amount.

The Taxpayer operated the hog farm for [REDACTED], [REDACTED]. [REDACTED] headquarters is in [REDACTED] Arkansas.

The pressure washer at issue is portable; however, it was attached to the plumbing within the hog houses. The pressure washer was exclusively utilized to sanitize the inside of the hog houses and their components and equipment. The actual pressure washer is so powerful that it could not be used to clean a motor vehicle. This pressure washer was purchased after an existing pressure washer broke down and required immediate replacement. The hog houses are separated based on purpose. [REDACTED]

[REDACTED] The hog houses are pristine enclosed buildings with [REDACTED].

The [REDACTED] building has [REDACTED] with feeders to accommodate [REDACTED] sows at a time. He had a total of [REDACTED] sows. [REDACTED] sows are bred each month and rotated in and out of the [REDACTED] area. In his contract with [REDACTED], he is required to have a pressure washer for sanitation and disease control within the hog houses, especially the [REDACTED]. He shipped [REDACTED] per week out of the facility at the time that the pressure washer was purchased. After each piglet shipment, he had twenty-four (24) hours to disinfect, wash, and dry the [REDACTED] areas before the next batch of mama pigs had to be transferred into the [REDACTED] areas for the next births. The mama pigs can give birth any minute at the point that they are transferred. The system works by a continuously cycling the sows.

If pigs got diseased, he stated that the farm would be out of business overnight. He asserted that disinfection is required by [REDACTED] and, without that

requirement, he could save a lot of money and time. He has no choice whether to own and use a pressure washer for disinfecting the [REDACTED]. The hog farm was eventually closed in [REDACTED], which explained why his tax return for [REDACTED] only lists the cattle operation. At the time that the [REDACTED] income tax return was filed, the hog operation had already ceased. The pressure washer, however, was purchased for the hog houses at the time when that facility was operating.

After a general discussion of the burdens of proof in tax proceedings, a legal analysis with associated conclusions shall follow.

## **CONCLUSIONS OF LAW**

### **A. 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**. [Emphasis Added.]

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).

### **B. Sales Tax Assessment**

Arkansas Gross Receipts (Sales) Tax generally applies to the entire gross proceeds for all sales of tangible personal property and certain specifically enumerated taxable services. Ark. Code Ann. § 26-52-301 (Supp. 2017). The pressure washer represents tangible personal property and is subject to Arkansas sales tax unless the Taxpayer demonstrates that an exemption applies.

Generally, the liability for collection and remittance of sales tax is upon the seller. Ark. Code Ann. § 26-52-508 (Supp. 2017). A seller, however, may be relieved of this liability if the customer makes an exemption claim. Ark. Code Ann. § 26-52-517(a) (Supp. 2017). At that point, the purchaser will become liable for the sales tax liability if the Department ultimately determines that the purchaser improperly claimed an exemption. Ark. Code Ann. § 26-52-517(e) (Supp. 2017). Here, the Department has demonstrated that the Taxpayer made

an exemption claim at the time of the purchase of the pressure washer.<sup>4</sup> Consequently, the liability for payment of sales tax on the purchase of the pressure washer has shifted to the Taxpayer.

### **C. Farm Equipment and Machinery Exemption**

Ark Code Ann. §26-52-403(b) (Repl. 2014) exempts the sale of certain farm equipment and machinery from sales tax. Pursuant to Ark. Code Ann. § 26-52-105(b) (Repl. 2014), the Director of the Department is directed to promulgate rules for the proper enforcement of the sales tax laws. Arkansas Gross Receipts Tax Rule GR-51 (“GR-51”) addresses the farm machinery and equipment exemption and provides, in pertinent part, as follows:

#### **B. DEFINITIONS.**

1. “Farm equipment and machinery” means the agricultural implements used **exclusively and directly for the agricultural production of food or fiber as a commercial business** or the agricultural production of grass sod or nursery products as a commercial business or the agricultural production of grass sod or nursery products as a commercial business. Farm equipment and machinery does not include implements used in the production and severance of timber, motor vehicles that are subject to registration, airplanes, or hand tools. . . . [Emphasis supplied.]

Further, the governing rule provides further clarity regarding what constitutes direct use, stating as follows:

An implement may not be treated as tax exempt unless it is used "directly" in the agricultural production of food or fiber as a business or the agricultural production of grass sod or nursery products as a business. The term "directly" limits the exemption to the following:

- a. Only those implements used in the actual agricultural production of food, fiber, grass sod, or nursery products to be sold in processed form or otherwise at retail; or

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<sup>4</sup> See Exhibit 2 to the Department’s Answers to Information Request.



- b. Machinery and equipment used in the agricultural production of farm products to be fed to livestock or poultry which is to be sold ultimately in processed form at retail.

Arkansas Gross Receipts Tax Rule GR-51(C)(2).

Additionally, the Department's interpretation of a statute or rule is entitled to deference unless the interpretation is clearly erroneous. The Arkansas Supreme Court has recognized that administrative agencies are often required to interpret statutes and rules. In *Walnut Grove School Distr. No. 6 of Boone County v. County Board of Education*, 204 Ark. 354, 162 S.W.2d 64 (1942), the court's opinion stated, in part:

the administrative construction generally should be clearly wrong before it is overturned. Such a construction, commonly referred to as practical construction, although not controlling, is nevertheless entitled to considerable weight. It is highly persuasive.  
Id. at 359, 162 S.W.2d at 66.

The Department has consistently interpreted Ark. Code Ann. § 26-52-403 (Repl. 2014) and GR-51 in a manner so that the use of machinery or equipment to mow fence rows or to mend fences (or perform other maintenance functions required at a farm) results in machinery or equipment failing to satisfy the "directly" test. The Department's interpretation of Ark. Code Ann. § 26-52-403 (Repl. 2014) and GR-51 regarding the indirect uses of machinery or equipment is not clearly wrong.

A taxpayer claiming a deduction, exemption, or credit bears the burden of proving that it is entitled to the deduction or credit by bringing himself or herself clearly within the terms and conditions imposed by the statute that contains the deduction, exemption, or credit. See *Weiss v. American Honda Finance Corp.*, 360 Ark. 208, 200 S.W.3d 381 (2004).

Even though the use of the pressure washer was beneficial and necessary to the Taxpayer's farming operation, the pressure washer was used in sanitization and, thus, one step removed from the actual agricultural production of hogs. Evidence that only proves a taxpayer uses or operates the machinery or equipment on a farm does not establish entitlement to the tax exemption for farm machinery and equipment. The evidence must establish that the machinery or equipment was used directly and exclusively in the production of food or fiber. Since the Taxpayer has failed to prove direct use of the pressure washer, his exemption claim must be denied.<sup>5</sup>

#### **D. Interest**

Interest must be assessed upon tax deficiencies for the use of the State's tax dollars. See Ark. Code Ann. § 26-18-508 (Repl. 2012). Consequently, the assessment of interest on the tax balance is sustained

#### **DECISION AND ORDER**

The proposed assessment of sales tax and interest 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 decision shall be effective and become the action of the agency.

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<sup>5</sup> Because this conclusion prevents application of the farm machinery and equipment exemption, this decision shall not address the Department's additional argument that the Taxpayer is not raising hogs as a commercial business as it is rendered moot.

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>6</sup>

OFFICE OF HEARINGS & APPEALS

A handwritten signature in blue ink, appearing to read 'T. Evans', is written over a horizontal line. There is a small handwritten number '3' above the signature.

TODD EVANS  
ADMINISTRATIVE LAW JUDGE

DATED: June 1, 2018

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<sup>6</sup> See *Board of Trustees of Univ. of Arkansas v. Andrews*, 2018 Ark. 12.