

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

IN THE MATTER OF [REDACTED]
[REDACTED]
DOCKET NO.: 19-203

**GROSS RECEIPTS TAX
ASSESSMENT
ACCT. NO.:** [REDACTED]
**AUDIT PERIOD: AUG. 1, 2015
THROUGH SEPT. 30, 2015**

AUDIT NO.: [REDACTED]

[REDACTED]¹

**TODD EVANS, ADMINISTRATIVE LAW JUDGE
APPEARANCES**

This case is before the Office of Hearings and Appeals upon a written protest received July 6, 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 April 3, 2019, at 10:00 a.m. in Little Rock, Arkansas. The Department was represented by Amanda Land, Attorney at Law, Office of Revenue Legal Counsel (“Department’s Representative”). Also present for the Department was Warren Townsend (“Auditor”) and David Wilson (“Audit Supervisor”). The Department’s Representative and her witnesses appeared at the hearing by telephone. 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.

¹ This amount represents [REDACTED] (tax) and [REDACTED] (interest).

PARTIES' PROPOSED FACTS AND ANALYSIS

Prehearing Filings

The Department's Answers to Information Request provided some relevant factual allegations, providing in pertinent part, as follows²:

On August 11, 2015, [REDACTED] ("Taxpayer") purchased: (1) [REDACTED] for [REDACTED]; (2) [REDACTED] for [REDACTED]; (3) [REDACTED] for [REDACTED]; and (4) [REDACTED] for [REDACTED] from [REDACTED]. The total for all four items was [REDACTED]. On September 1, 2015, Taxpayer purchased [REDACTED] for [REDACTED] from [REDACTED]. See Invoices, attached collectively as **Exhibit 1**. Simultaneous with each of the purchases, Taxpayer submitted a Commercial Farming Sales Tax Exemption form claiming that Taxpayer is engaged in the production of cattle and that the machinery/equipment purchased would be used exclusively and directly in the commercial production of cattle. See **Exhibit 1**. Because Taxpayer submitted a Commercial Farming Sales Tax Exemption form for the equipment, [REDACTED] did not collect sales tax on the invoices.

On April 19, 2018, the Department sent Taxpayer a letter advising that the purchase was being reviewed by the Department to ensure that the farm exemption was properly claimed. See **Exhibit 2**. The letter also stated that the Department needed documentation that would assist in determining whether the exemption was correctly applied. The letter included examples of acceptable documentation, including individual income tax returns, depreciation schedules for machinery/equipment, or other documentation indicating direct or exclusive farm use or the machinery/equipment. The letter provided Taxpayer two (2) weeks to provide the documentation. See **Exhibit 2**. In response, Taxpayer called the Department, stating he was a [REDACTED]. He stated that he was not in the production of food or fiber as a commercial business. See Auditor's Comments, **Exhibit 3**. Accordingly, the Department disallowed the Commercial Farming Sales Tax Exemption and issued its Summary of Findings on May 4, 2018. A copy of the Summary or Findings is attached as **Exhibit 4**. Per the Summary or Findings, the Department assessed [REDACTED] in tax, \$0.00 in penalty, and [REDACTED] in interest for a total assessment of [REDACTED]. On May 15, 2018, the Department issued a Notice of Proposed Assessment. A copy of the Notice of Proposed

² All exhibits support the statements for which they are cited.

Assessment is attached as **Exhibit 5**. On July 6, 2018, the Taxpayer timely filed a Protest of the Notice of Proposed Assessment. A copy of the Protest is attached as **Exhibit 6**.

Within her Answers to Information Request, the Department's Representative asserted that the items purchased by the Taxpayer represent tangible personal property and, thus, are generally taxable. She further asserted that the Taxpayer has failed to prove entitlement to the farm machinery and equipment exemption. Specifically, she asserted that the Taxpayer has not demonstrated that he is engaged in farming as a commercial business or that the machinery or equipment is directly and exclusively used in farming.

Within his protest, the Taxpayer provided his objection to the assessment, stating as follows, in relevant part: "I have a tax number under [REDACTED]³ [REDACTED] dated back in the [REDACTED]. I have [REDACTED] and became [REDACTED]. Not able to take care of them gave to son. I live in [REDACTED] now, don't owe any taxes. Thanks God bless you"

Hearing Testimony

A. Taxpayer's Testimony

The Taxpayer asserted that, if he had his tax identification number on file with the Department, he would not have been assessed. He spoke with individuals employed by the Department and stated his tax identification number was under the name [REDACTED]. He obtained that number during the [REDACTED] and stated that the requirement of commercial production of food or fiber

³ Prior to the administrative hearing, the Taxpayer provided a letter from the IRS dated November 19, 2018, that confirmed that he had been issued an employer identification number under the name of [REDACTED]. In addition to that filing, the Taxpayer provided a copy of the restrictive covenants for his property in [REDACTED], Arkansas. That document demonstrates that the lots within [REDACTED].

did not apply to farms at that time. He testified that he was told by someone at the time of receipt of the tax identification number that he was then exempt on his purchases of feed, cattle, and whatever other items utilized on the farm. He did have [REDACTED] of cattle on his Arkansas property at the time of purchase. He bought the cattle to eventually sell. He kept the cattle on that property until his [REDACTED] that he could not have [REDACTED] [REDACTED], which he provided for the record before the administrative hearing. At the time of that notification (about a year ago), he transferred the cows to [REDACTED]. He still owns those cows, but they are no longer located in Arkansas. The relevant machinery and equipment were used on the farm to move hay, mow pasture, and install and maintain fencing. He has been [REDACTED]. He asserted that he is not required to sell cows every year to qualify as a commercial farmer and many people own cattle for tax purposes only. He is [REDACTED] and does not receive any profit from his farm. He concluded his testimony by noting that a [REDACTED] can be used for many farm activities like transporting hay and feed. If he did anything illegal, he asserted that it was not intentional.

B. Auditor's Testimony

The Auditor testified that his duties involve the enforcement of state tax laws administered by the Department (including determining the appropriateness of farm machinery and equipment exemption claims made by taxpayers) and the assistance of Taxpayers. His testimony verified the accuracy of the rendition of facts provided within the Department's Representative's Answers to Information Request. He also noted that the farming exemption certificate is

important as it relieves a seller of the obligation of collecting and remitting sale tax on farm machinery and equipment purchases. He spoke with the Taxpayer during the audit. At that time, the Taxpayer informed him that the Taxpayer was a [REDACTED], not engaged in the production of food or fiber as a commercial business, an owner of acreage, an owner of chickens (using the eggs for personal consumption or as gifts to a local neighbor), an owner of a garden for personal consumption, and an owner of [REDACTED]. The Taxpayer did not provide supporting documentation for his assertions. The Auditor ultimately concluded that the Taxpayer was not commercially producing food or fiber for sale. The Department denied the Taxpayer's exemption claim and assessed the Taxpayer for the deficiency. He has reviewed the Taxpayer's income tax returns for the 2015 and 2017 tax years.⁴ During those years, the Taxpayer did not file a Schedule F or otherwise report farm income. He concluded stating that it is not clear how the [REDACTED] are utilized to produce and bail hay because those items are typically used for general mowing purposes.

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:

⁴ No state income tax return was filed for the 2016 tax year.

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).

C. Sales Tax Assessment

1. Sales Tax

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 machinery or equipment purchased by the Taxpayer 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 relevant machinery and equipment. Consequently, the liability for payment of sales tax on the purchase of the machinery and equipment has shifted to the Taxpayer.

2. 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.]

Additionally, Arkansas Gross Receipts Tax Rule GR-51(E) provides additional guidance relevant to this proceeding, stating as follows:

ENGAGED IN THE BUSINESS OF FARMING. A purchaser of farm machinery and equipment shall be considered to be engaged in the business of farming for purposes of the exemption if the purchaser meets the requirements in GR-51(E)(1) or GR-51(E)(2).

1. The purchaser is engaged in the agricultural production of food, fiber, grass sod, or nursery products **as a business for profit** as defined in Internal Revenue Code § 183 as adopted by Ark. Code Ann. § 26-51-424; or
2. a. The purchaser provides services to farmers directly related to the production of food, fiber, grass sod, or nursery products;
b. The items of farm machinery and equipment are used exclusively and directly to provide those services; and
c. The items of farm machinery and equipment would have otherwise qualified for the farm machinery exemption if purchased and used exclusively and directly by the farmer for the same activity.

Example: A fertilizer spreader or seed spreader, or chemical applicator purchased by a farmer would qualify for the farm machinery exemption if used exclusively by a farmer in applying fertilizer, planting seed, or applying agricultural chemicals as part of the agricultural production of food, fiber, grass, sod, or nursery products as a business. The farm machinery exemption will also be available to a fertilizer dealer, seed company, or other similar business upon the purchase of these same items provided the items are used exclusively and directly by the business in applying fertilizer, planting seed, or applying agricultural chemicals for farmers. [Emphasis supplied.]

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.

Tax deductions and credits, like tax exemptions, exist as a matter of legislative grace. *Cook, Commissioner of Revenue v. Walters Dry Good Company*, 212 Ark. 485, 206 S.W.2d 742 (1947); and *Kansas City Southern Ry. Co. v. Pledger*, 301 Ark. 564, 785 S.W.2d 462 (1990). A taxpayer claiming a deduction or credit bears the burden of proving that he or she 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 or credit. *Weiss v. American Honda Finance Corp.*, 360 Ark. 208, 200 S.W.3d 381 (2004).

Here, the Taxpayer has testified that he is [REDACTED] and never produced a profit from his farming operation. Additionally, the Auditor testified that the Taxpayer's income tax returns during and after the relevant purchases have not shown any income from the Taxpayer's farming operation. If it was assumed but not decided that the Taxpayer was engaged in a farming activity, the exemption claim still must be denied as the Taxpayer has not shown that he is engaged in the farming activity as a for-profit commercial business.⁵

The evidence must establish that the machinery or equipment was used directly and exclusively in the production of food or fiber as a commercial

⁵ Because this conclusion prevents application of the exemption, the Department's remaining arguments for denying the exemption claim shall not be addressed since they are rendered moot.

business by a preponderance of the evidence. Since the Taxpayer has failed to show that the relevant machinery and equipment fulfills those requirements, his exemption claim must be denied.

C. 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.

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.⁶

OFFICE OF HEARINGS & APPEALS

A handwritten signature in blue ink, appearing to read 'T.E.', is written over a horizontal line.

TODD EVANS
ADMINISTRATIVE LAW JUDGE

DATED: April 5, 2019

⁶ See *Board of Trustees of Univ. of Arkansas v. Andrews*, 2018 Ark. 12.