

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

ADMINISTRATIVE DECISION

IN THE MATTER OF

ACCT. NO.: [REDACTED]

DOCKET NO.: 19-273

**GROSS RECEIPTS
TAX ASSESSMENT**

AUDIT ID: [REDACTED]

**PERIOD: FEBRUARY 2016
(\$ [REDACTED])¹**

RAY HOWARD, ADMINISTRATIVE LAW JUDGE

APPEARANCES

This case is before the Office of Hearings and Appeals upon a written protest received on July 30, 2018, and signed by [REDACTED], the Taxpayer. The Taxpayer protested an assessment of Gross Receipts Tax (“sales tax”) resulting from an audit conducted by Courtney Frank, DFA Service Representative, on behalf of the Department of Finance and Administration (“Department”).

An administrative hearing was held in Little Rock, Arkansas, on April 29, 2019, at 10:00 a.m. The Department was represented by Leslie Fryxell, Attorney at Law, Office of Revenue Legal Counsel (“Department’s Representative”). Present for the Department were the DFA Service Representative and Matthew Crane – Audit Supervisor. The Taxpayer appeared at the hearing and represented himself. Present for the Taxpayer was [REDACTED] (“Taxpayer’s Witness”).

¹ The reflected amount includes tax (\$ [REDACTED]) and interest (\$ [REDACTED]).

ISSUE

Whether the Department's assessment against the Taxpayer, resulting from disallowance of a claimed exemption, should be sustained? Yes.

FINDINGS OF FACT/CONTENTIONS OF THE PARTIES

The Taxpayer's Protest Form stated that, "I file a Schedule F with the Internal Revenue Service. I sell cattle. Buy round bales of hay & put them out with tractor. Bushhog the pasture. I buy [REDACTED] to feed cows. [P. 1]."

The Department's Answers to Information Request summarized the facts involved in this case and asserted its legal arguments, as follows:

On or about February 26, 2016, the Taxpayer . . . [purchased a tractor, a front double spear, post hole digger, and an auger] from [REDACTED] located at [REDACTED]. The total purchase amount, including a \$ [REDACTED] rebate, was \$ [REDACTED]. No sales tax was paid on the transaction. See sales invoice attached as **Exhibit 1**. It appears that no exemption certificate was executed at the time of the purchase. However, on or about October 14, 2017, a Commercial Farming Machinery & Equipment Sales Tax Exemption Certification form signed by the Taxpayer was obtained. The certification asserted that he was engaged in the production of cattle as a commercial farming business. See copy of Taxpayer's Certification attached as **Exhibit 2**. The fact that the taxpayer signed an exemption certification is significant. In *Carmichael v. Nationwide Life Ins. Co.*, 305 Ark. 549, 552, 810 S.W.2d 39 (1991), the Arkansas Supreme Court stated that "[i]t is well established in Arkansas that one is bound under the law to know of the contents of a paper signed by her and she cannot excuse herself by saying she did not know what it contained."

On June 13, 2018, DFA Service Representative Courtney Frank sent the Taxpayer a letter requesting documentation to support and substantiate his entitlement to claim the sales tax farm exemption. When no response was received a second letter was mailed. See Letters (ID's [REDACTED] and [REDACTED]) attached collectively as **Exhibit 3**. On June 30, Ms. Frank received three sales receipts between the Taxpayer and [REDACTED] and [REDACTED]. See receipts attached as **Exhibit 4**. Because the tractor purchase was in February 2016 and

the receipts were dated 2008, 2012, and 2015, Ms. Frank sought additional documentation that would prove the Taxpayer's entitlement to claim the sales tax exemption. Specifically, Ms. Frank checked Department records to see whether the Taxpayer filed a Schedule F (Profit or Loss from Farming) with his Arkansas income tax returns. However, no Arkansas individual income tax return for tax year 2016 was found. In fact, the Taxpayer has not filed an Arkansas individual income tax return since 2014. Therefore, based on the information available to her, Ms. Frank determined that the Taxpayer did not qualify for the sales tax exemption. The Taxpayer was assessed gross receipts (sales) tax totaling \$ [REDACTED] which includes tax in the sum of \$ [REDACTED], plus interest of \$ [REDACTED]. No penalty was assessed. See Summary of Findings attached as **Exhibit 5** and Notice of Proposed Assessment attached as **Exhibit 6**.

On July 30, 2018, the Department received a timely protest of the assessment and a request for administrative hearing. See Protest attached as **Exhibit 7**.

...

Arkansas Code Annotated 26-52-403 (Repl. 2014) provides a narrow sales tax exemption for farm machinery and equipment "used exclusively and directly in farming." "Farming" is defined as the agricultural production of food or fiber as a business or the agricultural production of grass sod or nursery products as a business. See Ark. Code Ann. 26-52-403(a)(2) (Repl. 2014). Arkansas Gross Receipts Tax Rule GR-51(B)(1) provides that exempt "farm equipment and machinery" is limited to "agricultural implements used **exclusively and directly** for the agricultural production of food or fiber **as a commercial business.**" (Emphasis Supplied).

In order to qualify for the exemption, a purchaser must be engaged in the business of farming for profit as defined in Internal Revenue Code § 183 as adopted by Ark. Code Ann. 26-51-424 (Supp 2017). Arkansas Gross Receipts Tax Rule GR-51(E). In his Certification (**Exhibit 2**), the Taxpayer claims entitlement to the sales tax exemption because he produces cattle as a commercial farming business. Without an Arkansas income tax return, which would include a Schedule F (Profit or Loss from Farming), the Department is unable to verify whether [REDACTED] operated a commercial cattle farming business.

Even if it were determined that the Taxpayer had a commercial farm business for profit, he must also demonstrate that the tractor is used "exclusively and directly for the agricultural production of

food or fiber". (See Arkansas Gross Receipts Tax Rule GR-51(C)(1)(2). The Taxpayer has stated that the tractor is used to "bush hog." As stated on the Certification, a machine owned by a commercial farmer, but also used for any purpose at any time for activities other than commercial farming, does not qualify for the exemption. Bush-hogging, or mowing, is more in the nature of a maintenance or clean up activity. For this reason, the "exclusive" use requirement is not met. Thus, the purchase is disqualified from the exemption.

"Directly" limits the exemption to those implements used in the actual agricultural production of food to be sold in processed form or otherwise at retail or 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). To qualify, use of the tractor must contribute **directly** to the "**production**" of livestock for commercial purposes within the meaning of GR-51. (Emphasis Supplied.) Bush-hogging may be useful to a cattle farmer, but bush-hogging is not "**directly**" related to the actual **production** of cattle. Therefore, the "direct" requirement is not met, and the purchase is disqualified from the exemption.

The Department asserts that the tractor and accessories are tangible personal property and the sale is a taxable transaction. It is the Taxpayer's burden to establish, by a preponderance of the evidence, his entitlement to the exemption. The Department maintains that the Taxpayer has not demonstrated his entitlement to the commercial farming gross receipts (sales) tax exemption on his purchase of the [REDACTED] tractor and accessories. He has not established by a preponderance of the evidence that he is engaged in the business of cattle farming nor that the equipment purchased is used exclusively and directly in the production cattle as a business. [P. 1-4].

The DFA Service Representative authenticated the Department's Exhibits (1 - 7) and presented testimony consistent with the contentions in the Department's Answers to Information Request. The DFA Service Representative also testified that: (1) the Taxpayer purchased a tractor and other implements in February of 2016; (2) she could not confirm that the Taxpayer was entitled to claim the sales tax exemption for farm machinery and equipment; (3) the

Taxpayer sent her documents relating to cattle auctions but the documents did not support the Taxpayer's exemption claim since they were all dated before 2016; (4) she needed a Schedule F from the Taxpayer to show that he was in the commercial business of farming; (5) the Taxpayer did not file an Arkansas Income Tax Return for 2016 so there was no Schedule F for 2016; (6) the last time the Taxpayer filed an Arkansas Income Tax Return was 2014; (7) without an Arkansas Income Tax Return for 2016, she could not verify the Taxpayer's status as a commercial cattle farmer; (8) she does not have a background in cattle farming; (9) she has not been to the Taxpayer's place; (10) she looked at the Taxpayer's Arkansas Income Tax Returns for 2013 and 2014 (farm income was reflected on one [1] of the returns but there was no Schedule F and, on the other return, no farm income was indicated and no Schedule F was attached); (11) most commercial farmers file a Schedule F; (12) the last receipt for a sale of cattle by the Taxpayer was dated January 16, 2015, and she doesn't know if the Taxpayer sold all of his cattle at that time; and (13) based on the available documents, the Taxpayer has not established that he is a commercial cattle farmer.

The Audit Supervisor testified that: (1) he has seen pictures of the Taxpayer's place online and he does not recall seeing any pictures of cows on Google maps;² (2) since the Taxpayer has not filed Arkansas Income Tax Returns after 2014, the Taxpayer is a non-filer; (3) the Department cannot verify the Taxpayer's Federal Income Tax Returns due to a lack of access; (4) the Department cannot determine what the Taxpayer is doing since he has not filed

² The Taxpayer contended that it was obvious that the Audit Supervisor had not seen his place and the Taxpayer's Witness stated that the Taxpayer owns cows.

an Arkansas Income Tax Return; and (5) the Exemption Certificate does not state that the filing of a Schedule F is mandatory but the Department verifies the requirement of “a commercial farming business” with an Arkansas Income Tax Return.

The Taxpayer testified that: (1) he is not required to file Arkansas Income Tax Returns; (2) the Department has documentation that he sold cows on three [3] different occasions; (3) the Department should have sent someone to look at his farm; (4) the Exemption Certificate does not state that he was required to file a Schedule F; (5) he uses the purchased farm implements to feed cows and bury cows; (6) he feeds the cows hay and cotton seed mill; (7) he does not make enough income to be required to file an Arkansas Income Tax Return; (8) Taxpayer Exhibits 1 -4 are photographs of his cows on his land; (9) he files a Schedule F with the federal government; (10) the Department has not done its due diligence to verify if he is a commercial farmer; and (11) the Department has not met its burden of proof to establish that the purchased farm implements are not tax exempt.

Upon cross-examination, the Taxpayer testified that: (1) bushhogging a pasture is necessary for weed control; (2) he has not sold any cattle since 2015; (3) his cows only produced one [1] calf in 2016 and he still has the calf (it has not been sold); (4) he bought a bull last year and he probably has [REDACTED] calves now that he will sell after vaccinations and other pre-conditioning; and (5) feed lot cattle are treated really rough (bordering on inhumane).

The Taxpayer’s Witness testified that: (1) the Taxpayer has cattle and he has had cattle for over [REDACTED] years; (2) he sold a bull to the Taxpayer, two [2]

years ago, and the Taxpayer thought it bred most of his cattle but only one [1] calf was born; (3) the Taxpayer had over [REDACTED] cows in 2016; (4) the Taxpayer purchased hay from him for feeding cattle; (5) Department Exhibit 4 contains documents relating to transactions where the Taxpayer sold cows at auction; (6) a person does not have to be a commercial farmer to sell cows at auction; and (7) the Taxpayer is very caring for animals.

The Department's Representative contended that: (1) the Department does not have unfettered access to anyone's Federal Income Tax Returns; (2) if an Arkansas Income Tax Return is not filed, it is impossible for the Department to verify the information that would have been contained in the return; (3) the copy of the 2016 Federal Income Tax Return/Schedule F furnished to her by the Taxpayer is unsigned so she has no evidence that it has actually been filed and it is inconclusive (it could be evidence of a commercial farm perhaps or it could be evidence of a hobby farm); (4) if the Taxpayer had filed an Arkansas Income Tax Return with a Schedule F, the Department could have reviewed it along with the Exemption Certificate and purchase invoice to make a determination regarding the Taxpayer's eligibility; and (5) the Taxpayer has the burden of proving that he is entitled to the farm machinery exemption.

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).

Tax Assessment

Subject to the applicability of an exemption, deduction, or credit, sales tax is imposed on sales of tangible personal property made by in-state vendors to in-state purchasers. See Ark. Code Ann. § 26-52-101 et seq. (Repl. 2014 & Supp.

2017). Ark. Code Ann. § 26-52-103(30)(A) (Supp. 2017) defines “tangible personal property” as “personal property that can be seen, weighed, measured, felt, or touched or that is in any other manner perceptible to the senses.” The items of machinery and equipment purchased by the Taxpayer were tangible personal property. Consequently, the Department satisfied its burden of proof regarding taxability.

Ark. Code Ann. § 26-52-403(b) (Repl. 2014) exempts the sale of farm equipment and machinery from sales tax. “Farm equipment and machinery” means implements used exclusively and directly in farming. See Ark. Code Ann. § 26-52-403(a)(1)(A) (Repl. 2014). “Farming” means the agricultural production of food or fiber as a business. See Ark. Code Ann. § 26-52-403(a)(2) (Repl. 2014). 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”) provides, in pertinent part, as follows:

B. DEFINITIONS.

1. “Farm equipment and machinery” means 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. . . .

...

E. 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.

Tax deductions, credits, and exemptions exist as a matter of legislative grace. See 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, exemption, or credit bears the burden of proving he or she is entitled to the deduction, exemption, or credit by bringing himself or herself clearly within the terms and conditions imposed by the statute that contains the exemption, deduction, or credit. See Weiss v. American Honda Finance Corp., 360 Ark. 208, 200 S.W.3d 381 (2004). Additionally, Ark. Code Ann. § 26-18-506(a) (Repl. 2012) requires the Taxpayer to keep and preserve suitable records as are necessary to determine the amount of tax due or to prove the accuracy of any return.

In a nutshell, it is the Department's position that: (1) the Taxpayer has the burden of proving entitlement to the sales tax exemption for farm machinery under Ark. Code Ann. § 26-18-313(d) (Supp. 2017) and (2) in the absence of a 2016 Arkansas Income Tax Return and Schedule F, the Department is not able to verify (and the Taxpayer has failed to prove) that he is in the commercial business of cattle farming as required by Ark. Code Ann. § 26-52-403(a)(2) (Repl. 2014) and GR-51. On the other hand, the Taxpayer contended that: (1) he was

not required to file a 2016 Arkansas Income Tax Return and Schedule F; and (2) he is a cattle farmer and has been for years.

While it is not necessary to show a profit on a Schedule F to be a farmer, when combined with lack of records and the fact that the Taxpayer only sold one (1) cow in 2015 through 2016, the evidence gives rise to a well-founded doubt that the Taxpayer was engaged in the commercial business of cattle farming when he purchased the pertinent machinery and equipment on February 26, 2016. Additionally, the absence of a Schedule F indicating the profit or loss from a farming operation (and any documentation depreciating the machinery and equipment purchased on February 26, 2016) raises the possibility that the Taxpayer is a hobby farmer. In accordance with Ark. Code Ann. § 26-18-313(f)(2) (Supp. 2017), the doubt must be resolved against the application of the exemption.

Generally, the liability for collection and remittance of sales tax is upon the seller. A seller, however, may be relieved of this liability if the purchaser makes an exemption claim. See Ark. Code Ann. § 26-52-517(a) (Supp. 2017). If a purchaser makes an exemption claim, the purchaser will become liable for the sales tax liability if the Department ultimately determines that the purchaser improperly claimed an exemption. See Ark. Code Ann. § 26-52-517(e) (Supp. 2017). With respect to the pertinent machinery and equipment purchased by the Taxpayer on February 26, 2016, at this stage of the administrative review, the Taxpayer has failed to prove entitlement to the sales tax exemption for farm

machinery and equipment as a commercial cattle farmer.³ Consequently, the Department correctly assessed sales tax against the Taxpayer.

Subject to the limitation in Ark. Code Ann. § 26-18-405(d)(1)(C) (Supp. 2017), 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). No penalty was assessed against the Taxpayer.

DECISION AND ORDER

Subject to the limitation in Ark. Code Ann. § 26-18-405(d)(1)(C) (Supp. 2017), the proposed 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.

³ In light of this determination, it is not necessary to address the contentions, the arguments, or any testimony concerning whether the items of machinery and equipment purchased by the Taxpayer on February 26, 2016, were used exclusively and directly in the agricultural production of cattle.

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.⁴

OFFICE OF HEARINGS & APPEALS



RAY HOWARD
ADMINISTRATIVE LAW JUDGE

DATED: July 2, 2019

⁴ See Board of Trustees of Univ. of Arkansas v. Andrews, 2018 Ark. 12.