

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

IN THE MATTER OF

DOCKET NO.: 19-301

AUDIT NO.:

**GROSS RECEIPTS TAX
ASSESSMENT**

ACCT. NO.:

1

**TODD EVANS, ADMINISTRATIVE LAW JUDGE
APPEARANCES**

This case is before the Office of Hearings and Appeals upon a written protest received August 27, 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”). The Department was represented by David Scott, Attorney at Law, Revenue Legal Counsel (“Department’s Representative”).

At the request of the Taxpayer, this matter was taken under consideration of written documents. A briefing letter was established for the parties by letter dated January 11, 2019. The Department filed its Opening Brief on February 6, 2019. The Taxpayer did not file a response, but her protest was received into evidence. The record was closed and the matter was submitted for a decision on April 2, 2019.

ISSUE

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

PARTIES’ PROPOSED FACTS AND ANALYSIS

¹ This amount represents [REDACTED] (tax), [REDACTED] (failure to file penalty) and [REDACTED] (interest).

The Department's Representative's Opening provided certain factual allegation and an analysis, providing in pertinent part, as follows²:

On or about November 30, 2015, [REDACTED], ("Taxpayer") bought a [REDACTED] Tractor, [REDACTED] Loader, [REDACTED] 6 foot Box Blade, [REDACTED] Tiller, and [REDACTED] Brushhog (herein after collectively referred to as "Tractor & Equipment") from [REDACTED] [REDACTED] for [REDACTED]. [Exhibit 1] Taxpayer completed a Commercial Farming Sales Tax Exemption form at the time of purchase and claimed that the Tractor & Equipment would be used exclusively and directly in the production of cattle as a commercial farming business. [Exhibit 2] Because Taxpayer completed a Commercial Farming Sales Tax Exemption form, [REDACTED] did not collect gross receipts ("sales") tax at the time of purchase and the tax remains unpaid.

Rayni McCool, DFA Service Representative, ("Ms. McCool") sent a series of three letters between August 7, 2017 and January 9, 2018 seeking documentation to assist in the determination of whether the exemption was correctly applied. [Exhibit 3] The Taxpayer was asked to provide documents such as Individual Income Tax returns and related schedules verifying farming activities, depreciation schedules for the Tractor & Equipment, or other documentation indicating exclusive and direct use in the commercial business of farming. Taxpayer sent a letter which was received on February 8, 2018. [Exhibit 4] In her letter, Taxpayer stated:

Mr. Breshears,

I just received a letter from your collection section and I am not sure why. We established a business entity in [REDACTED] in [REDACTED] [REDACTED] and continued that until the end of December [REDACTED] when established a new business entity in Arkansas [REDACTED]). We were told we could continue used the old entity but needed to register with Arkansas but decided instead to establish a new entity in Arkansas. We bought a piece of property on [REDACTED] with [REDACTED] acres, established hayfields, [REDACTED] barns and a small house with the planned purpose of growing hay and selling it which we have been doing.

In [REDACTED], we purchased a tractor and implements for the exclusive use on the property. It has never been used anywhere other than the property. We were told by [REDACTED] that given our purpose, we were exempt from paying sales tax on the tractor and implements.

² All footnotes have been omitted; however, the exhibits citations within those footnotes have been inserted at the appropriate locations within the text. All exhibits support the statements for which they are cited.

I am enclosing a copy of our commercial Farming Machinery & Equipment sales tax exemption certification.

I have been working with our accountant and tax preparer concerning all of our business transactions, so they are aware of all of our dealings and have documented such.

As I thought we were in total compliance, I am totally confused as to receiving the collections letter. Please tell me what more I need to do to correct this matter. Thank you.

As of the filing of this brief, Taxpayer has not provided any Individual Income Tax returns or related schedules verifying farming activities, depreciation schedules for the Tractor & Equipment, or other documentation indicating exclusive and direct use in the commercial business of farming. Further, the Taxpayer did not file a schedule F showing her commercial farming business income.

On August 9, 2018, Ms. McCool sent a Summary of Findings letter to the Taxpayer. [Exhibit 5] A Notice of Proposed Assessment was sent to the Taxpayer by Michael Yancey, DFA Division Manager, on August 15, 2018. [Exhibit 6] The Taxpayer timely protested the assessment on August 27, 2018. [Exhibit 7] Taxpayer made the following statement on the Protest form and its attachments:

I bought our [REDACTED] in [REDACTED] as a business with a residential home. I bought the tractor and implements in [REDACTED]. My parent company [REDACTED] was established in [REDACTED]. I have filed state income tax as an Arkansas resident starting in 2016 but moved to Arkansas lived with my parents while my husband worked and lived [REDACTED], until we bought the ranch and moved onto it. We lease our property (pasture) and sell hay. The tractor is used exclusively on the ranch. I do not understand why I am not allowed to exempt farm equipment.

We were advised by our accountant and tax person exemption was allowable. [REDACTED] questions us on use of tractor, said exemption was permissible and did not collect the tax.

Within his Answers to Information Request, the Department's Representative initially stated that it is uncertain whether the Taxpayer is producing and selling hay by herself or if the individual leasing the pasture is

producing and selling the hay utilizing the Taxpayer's property. Assuming the Taxpayer was producing and selling the hay, he asserted that the Taxpayer has not provided documentation or testimony regarding its customers or the customers' use of the purchased hay. He explained that the relevant exemption requires hay to be exclusively fed to livestock which will be sold in processed form at retail. He argued that the exemption cannot be allowed in the absence of that showing. If, for example, the hay was sold to a horse breeder to be fed to horses (a nonfood animal), he asserted that the hay would not be fed to livestock that is sold at retail in a processed form, preventing application of the exemption. Additionally, he questioned whether a loader, box blade, brushhog, or tiller would be exclusively utilized for the production of either cattle or hay by a taxpayer. The Department's Representative concluded his analysis averring that interest was appropriate under Ark. Code Ann. § 26-18-508 (Repl. 2012) and the failure to file penalty was appropriate under Ark. Code Ann. § 26-18-208(1) (Repl. 2012)

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

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.]

Arkansas Gross Receipts Tax Rule GR-51(C)(2) additionally provides 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
- 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.** [Emphasis supplied.]

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, though the Taxpayer initially claimed to be engaged in production of cattle³, it appears that the actual alleged farming activity is hay production. Based on the record, it is currently uncertain whether the Taxpayer or a lessee is engaged in the hay production. Even assuming that she is engaged in hay production for sale, however, it is uncertain how the Taxpayer's customers utilize

³ To the extent that the Taxpayer may still claim to be engaged in that activity, the Taxpayer has presented insufficient evidence that she is engaged in that activity as a commercial business and the relevant farm machinery and equipment are directly and exclusively utilized in that pursuit.

that hay. Specifically, it is unknown whether that hay is exclusively fed to livestock that will be sold at retail in a processed form. Absent that evidence, the relevant exemption cannot be allowed.⁴

The evidence must establish that the machinery or equipment was used directly and exclusively in the production of food or fiber as a commercial business by a preponderance of the evidence. Since the Taxpayer has failed to show that the relevant machinery and equipment fulfills those requirements, her exemption claim must be denied.

C. Failure to File Penalty

With respect to the failure to file penalty, Ark. Code Ann. § 26-18-208(1) (Repl. 2012) provides as follows:

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 percent (35%) in the aggregate . . .

Further, lack of knowledge of publicly available statutes and rules cannot be recognized as a defense to their enforcement. 29 Am. Jur. 2d Evidence 290; see also *Edward v. US*, 334 F.2d 360 (1964) and *Jellico Coal Min. Co. v. Commonwealth*, 96 Ky. 373, 29 S.W. 26 (Ky. App. 1895). The U.S. Supreme Court has explained the reason for this legal principle as follows:

⁴ This decision shall not address remaining contentions by the Department concerning whether the relevant machinery and equipment is used directly and exclusively in the production of hay since those arguments are rendered moot by this conclusion.

The whole course of the jurisprudence, criminal as well as civil, of the common law, points to a different conclusion. It is a common maxim, familiar to all minds, that ignorance of the law will not excuse any person, either civilly or criminally; and it results from the extreme difficulty of ascertaining what is, bonâ fide, the interpretation of the party; and the extreme danger of allowing such excuses to be set up for illegal acts, to the detriment of the public.

Barlow v. US, 32 U.S. 404, 411 (1833). The Arkansas Supreme Court has also provided the maxim that lack of knowledge of the law is no defense applies in equal force “to acts committed or omitted in violation of the criminal or civil laws of the land.” *State v. Simmons*, 1 Ark. 265, 266 (1839). Consequently, the lack of knowledge of the legal requirements cannot be considered in the analysis regarding the alleged errors.

Based on the above analysis, the Taxpayer improperly made an exemption claim and did not report and remit the applicable taxes to the Department. The Taxpayer was responsible for the reporting and remitting sales tax on this transaction due to her exemption claim. Ark. Code Ann. § 26-52-517(b) (Supp. 2017). Further, lack of knowledge of this requirement cannot be recognized as a defense to the assessment of the failure to file penalty. Based on the record, the assessment of the failure to file penalty is sustained.

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 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.⁵

OFFICE OF HEARINGS & APPEALS



TODD EVANS
ADMINISTRATIVE LAW JUDGE

DATED: April 2, 2019

⁵ See *Board of Trustees of Univ. of Arkansas v. Andrews*, 2018 Ark. 12.