

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

ADMINISTRATIVE DECISION

IN THE MATTER OF

ACCT. NO.: [REDACTED]

DOCKET NO.: 19-342

**GROSS RECEIPTS
TAX ASSESSMENT**

AUDIT ID: [REDACTED]

PERIOD: 09/21/15-09/30/15
(\$ [REDACTED])¹

RAY HOWARD, ADMINISTRATIVE LAW JUDGE

APPEARANCES

This case is before the Office of Hearings and Appeals upon a written protest dated October 25, 2018, signed by [REDACTED], the Taxpayer. The Taxpayer protested an assessment of Gross Receipts (sales) Tax resulting from an audit conducted by Rayni McCool, DFA Service Representative, on behalf of the Department of Finance and Administration (“Department”). The Letter ID Number is [REDACTED].

A telephone hearing was held in Little Rock, Arkansas, on March 5, 2019, at 10:00 a.m. The Department was represented by Lisa Ables, Attorney at Law, Office of Revenue Legal Counsel. The DFA Service Representative and Patti Gilliland, Audit Supervisor, appeared at the hearing for the Department, via telephone. The Taxpayer appeared at the hearing, via telephone, and represented himself.

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 Department's Answers to Information Request summarized the facts and issues involved in this case (including the Taxpayer's handwritten reasons for disagreement with the assessment)² and stated, as follows:

On September 21, 2015, [REDACTED] ("Taxpayer") purchased a [REDACTED] [REDACTED] (Hereafter "Ranger"), from [REDACTED] in [REDACTED], Arkansas for \$ [REDACTED]. See **Exhibit 1**. At the time of the purchase, Taxpayer claimed entitlement to the farm exemption. See Commercial Farming Sales Tax Exemption Certificate attached as **Exhibit 2**.

On August 14, 2018, The Department sent a letter to the Taxpayer requesting additional proof that Taxpayer appropriately claimed the commercial farming exemption for the Ranger purchased in 2015. Specifically, the Department requested documentation of Taxpayer's commercial farming venture, including "individual income tax returns and related schedules verifying farming activities, depreciation schedules for this machinery/equipment, or other documentation indicating direct or exclusive farm use of this machinery/equipment." See letter is attached as **Exhibit 3**.

The Taxpayer responded by letter dated August 21, 2018 and enclosed his Schedule F for period 2015. He stated that his family has owned the farm for more than [REDACTED] and that he has [REDACTED]. See letter attached as **Exhibit 4** and Schedule F attached as **Exhibit 5**.

A review of the 2015 Schedule F provided by the Taxpayer reflects Taxpayer's principal crop or activity as "Horses." A further review of the Department's records reflect that Taxpayer has reported no income for tax periods 2013 through 2017. No additional evidence to demonstrate that the Ranger was used

² See Taxpayer Protest Form – P. 1.

exclusively or directly in the production of food or fiber as a commercial business was provided.

Lacking the sufficient documentation, the Department disallowed the commercial farming sales tax exemption and assessed \$ [REDACTED] in tax, and \$ [REDACTED] in interest for a total of \$ [REDACTED], against the Taxpayer. A Summary of Findings and Explanation of Adjustment (See **Exhibit 6**) and Notice of Proposed Assessment (See **Exhibit 7**) were sent to the Taxpayer on September 10, 2018. Thereafter, on October 25, 2018, Taxpayer filed a timely protest of the assessment. Taxpayer gave the following reasons for his disagreement with the assessment (See **Exhibit 8**):

The farm operation in question has been cultivated for hay for many years as the attached affidavit states. I would be happy to conduct a site visit to verify same if one of your staff would like to do so. Please see attached documents. I am willing to conduct phone interview or attend a hearing if preferred.

Included with the Taxpayer's protest were two letters. The letter dated October 3, 2018 was signed by [REDACTED] (See **Exhibit 9**), and states, in relevant part, as follows:

Please let this letter confirm that I, [REDACTED], for the past several years, including and prior to the calendar year 2015, have cultivated hay off the farms owned by [REDACTED], of which [REDACTED] is a partner. I have continued to cut hay off the [REDACTED] farms each year since this time as well. I have done so under the direction of [REDACTED] and [REDACTED], who I know to be owners of the farms in question. Please let this letter serve as my sworn affidavit as to such.

The letter dated October 5, 2018 was signed by [REDACTED] (See **Exhibit 10**), and states, in relevant part, as follows:

As requested please find the attached affidavit from [REDACTED] who has cut hay off of [REDACTED] farms, [REDACTED], for many years. If necessary, I would welcome a visit to said farm properties to evidence the hay operation that exists or any other information you might find helpful in resolving the sales tax question at hand.

...

. . . In support of his claim for the sales tax exemption on the purchase of the Ranger as farm machinery and equipment, the Taxpayer states that his family has owned a farm for more than [REDACTED]. The Taxpayer states that he has [REDACTED]. The Taxpayer provided Schedule F for the [REDACTED], which reflects that the “principal crop activity” of the farm is “Horses.” In further support, the Taxpayer provided a letter from [REDACTED], Partner of the [REDACTED], which states that he has enclosed, with his letter, an affidavit from [REDACTED] affirming that he [REDACTED] “cultivated (cut) hay from off the Taxpayer’s family farm in (as well as before and after) 2015.

Even assuming the foregoing facts and evidence as true, the Taxpayer has not demonstrated that the Ranger was (1) used **exclusively** and **directly** in the (2) **commercial production of food or fiber**. [P. 1-5].

The DFA Service Representative presented testimony consistent with the contentions in the Department’s Answers to Information Request³ and she authenticated the Department’s Exhibits (1 – 10).

The Taxpayer presented testimony consistent with the contentions in Department Exhibits 4, 5, 8, 9, and 10. The Taxpayer also testified that: (1) he is a [REDACTED] partner in the [REDACTED] farm;⁴ (2) income from the hay is not every year because there is trading out done with bushhogging and other things; (3) some years hay is cultivated on the farm; (4) hay production is a by-product of owning rural land; (5) the Taxpayer does not own cattle; (6) the hay produced is fed to the Taxpayer’s horses or the cattle of the person who cuts the hay (and buys the hay); (7) the Ranger is not used to cut the hay (it does not cultivate hay); and (8) hay is loaded on the Ranger and transported from barn to barn or to trailers.

³ She also stated that a trade-in allowance/credit was not allowed on the purchase of the Ranger.

⁴ He also stated that he does not receive a K-1.

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 Ranger purchased by the Taxpayer was an item of tangible personal property. Consequently, the Department satisfied its burden of proof regarding taxability.

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). 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 him and he cannot excuse himself by saying he did not know what it contained. [Citation omitted].” When the Taxpayer signed the exemption

certification relating to the Ranger and the production of hay, any liability for the tax (and interest) in this case was transferred to him.

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. . . .

...

[C.] 2. **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.**

3. Implements which are not exempt include, but are not limited to, the following:

...

f. **Examples of non-exempt items include** (i) a machine owned by a commercial farmer but also used at a location other than the farming property (such as a duck club or deer camp); (ii) **a machine owned by a commercial farmer but also used for any purpose at any time for activities other than commercial farming, even while located at the commercial farm (such as** pleasure riding, **household activities,** residential yard work, gardening, hunting, and fishing); and (iii) a machine purchased by a commercial farmer who also uses the machine to produce food or fiber primarily for his own consumption. [Emphasis added].

The Taxpayer claimed the sales tax exemption for farm equipment and machinery on the purchase of the Ranger. The Department has consistently interpreted Ark. Code Ann. § 26-52-403(b) (Repl. 2014) and GR-51 in a manner so that the use of machinery or equipment to mow fence rows (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(b) (Repl. 2014) and GR-51 regarding the indirect uses of machinery or equipment is not clearly wrong. Even though the use of the Ranger was beneficial to the Taxpayer’s farming operation, the use of the Ranger was one step removed from the actual agricultural production of food or fiber. The Ranger was not used to cultivate hay (the hay was actually cut by a third party) but was used to transport hay to various locations on the Taxpayer’s horse farm.

Evidence that only proves a taxpayer uses or operates 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 for the production of food or fiber.⁵ The Taxpayer failed to prove that the Ranger was used directly in the agricultural production of food or fiber. The Department correctly assessed sales tax against the Taxpayer on the purchase of the Ranger.

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).⁶

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 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.

⁵ For the purpose of this analysis, the Ranger was considered as being used exclusively at the Taxpayer's farm.

⁶ No penalty was assessed against the Taxpayer.

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.⁷

OFFICE OF HEARINGS & APPEALS



RAY HOWARD
ADMINISTRATIVE LAW JUDGE

DATED: April 4, 2019

⁷ See Board of Trustees of Univ. of Arkansas v. Andrews, 2018 Ark. 12.