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

ADMINISTRATIVE DECISION

IN THE MATTER OF [redacted] **ACCT. NO.:** [redacted]	**GROSS RECEIPTS AND COMPENSATING USE TAX ASSESSMENTS**
DOCKET NOS.: 19-345	**($[redacted] – Sales Tax)[1]**
19-346	**($[redacted] – Use Tax)[2]**

RAY HOWARD, ADMINISTRATIVE LAW JUDGE

APPEARANCES

This case is before the Office of Hearings and Appeals upon a written protest dated November 16, 2018, and signed by [redacted], on behalf of [redacted] ("Taxpayer"). The Taxpayer protested the assessments of gross receipts tax ("sales tax") and compensating use tax ("use tax") resulting from an audit conducted by Amy Patton, Tax Auditor – Central Audit District of the Office of Field Audit, for the Department of Finance and Administration ("Department"). The audit period was August 1, 2012, through April 30, 2018 (Audit ID: [redacted]).

A telephone was held in Little Rock, Arkansas, on March 1, 2019, at 10:00 a.m. The Department was represented by Lauren Ballard, Attorney at Law, Office of Revenue Legal Counsel ("Department's Representative"). Present for the Department were the Tax Auditor and Robin Moody, Audit Supervisor. [redacted], Power of Attorney [redacted], appeared at the hearing,

[1] The assessed amount includes tax ($[redacted] and interest ($[redacted]).
[2] The use tax assessment was not contested at the hearing.

via telephone, and represented the Taxpayer ("Taxpayer's Representative"). Appearing at the hearing for the Taxpayer, via telephone, were [redacted], Vice President/CFO, and [redacted], Controller ("Taxpayer's Witnesses").

ISSUE

Whether the assessments issued by the Department against the Taxpayer should be sustained? Yes.

FINDINGS OF FACT/CONTENTIONS OF THE PARTIES

A letter attached to the Taxpayer's Protest Form (and also attached to the Taxpayer's Answers to Information Request) set forth the reasons for the Taxpayer's disagreement with the sales tax assessment[3] and stated that, "[t]he taxpayer is protesting the sales tax which has been assessed on withdrawal from stock – packaging and withdrawal from stock – sample sales. [P. 1]."

The Department's Answers to Information Request summarized facts and issues involved in this matter and stated, in pertinent part, as follows:

> [redacted] ("Taxpayer") is a [redacted] that purchases and distributes [redacted]. This business model allows for Taxpayer to purchase from manufacturers in large quantities at a lower cost and then resell these items to [redacted] at a better price.
>
> The Department conducted a routine audit of Taxpayer beginning in May of 2018. In conducting the audit, Department representatives reviewed customer listings, sales downloads, exemption certificates, monthly sales reports fixed asset detail listing (with supporting documents), purchase invoices, and card statements. At the outset of the audit, the Department's representative and Taxpayer agreed to conduct the sales tax audit by representative sample and the compensating use tax audit by actual numbers.

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[3] The Taxpayer conceded the assessment for use tax.

The sample agreement executed by Taxpayer allowed the Department's representative to conduct the sales tax audit using August 2015, June 2016, and November 2017 data. A copy of that agreement is attached as **Exhibit 1**. Additionally, the Taxpayer executed a Waiver of Statute of Limitations form on June 22, 2018. A copy of the waiver is attached as **Exhibit 2**.

After reviewing the records, the Department's representative prepared a schedule of the additional sales and compensating use tax due by Taxpayer. A copy of these schedules is attached as **Exhibit 3**. On September 17, 2018, the Department's representative relayed her findings to Taxpayer in a Summary of Findings (attached as **Exhibit 4**).

. . .

On September 18, 2018, Department's representative mailed Taxpayer a Notice of Proposed Assessment reflecting these figures. A copy of the Notice of Proposed is attached as **Exhibit 5**. On or about November 16, 2018, Taxpayer made a timely protest of the findings. A copy of the protest is attached as **Exhibit 6**. Generally, Taxpayer protested three (3) issues in the audit:

1. The assessment of sales tax on materials used to package and ship the [redacted];
2. The assessment of sales tax on sales of samples; and
3. The application of the 25% underreporting statute of limitation on Taxpayer's sales tax account. [P. 1-2].

The Tax Auditor presented the following testimony regarding the audit: (1) no penalty was assessed against the Taxpayer; (2) the Taxpayer purchases [redacted] [redacted], inventories those items in [redacted], and then distributes those items to [redacted] customers as requested; (3) the only retail sales made by the Taxpayer are to employees but those sales are not the Taxpayer's regular business; (4) the Taxpayer does not manufacture any [redacted] [redacted]; (5) most of the Taxpayer's sales were exempt from tax as interstate sales or sales-for-resale; (6) a sample agreement and a statute of limitations wavier were executed; (7) she began conducting a three [3] year audit

but the audit was extended to six [6] years because the Taxpayer understated sales tax liability by more than 25% for each month;[4] and (8) she prepared the schedules included in Department Exhibit 3.

Subject to the applicability of an exemption, deduction, or a credit, sales tax is imposed on sales of tangible personal property or taxable services made by in-state vendors/sellers to in-state purchasers.[5] Sales tax is also imposed on withdrawals from stock under Arkansas Gross Receipts Tax Rule GR-18(D). 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 arguments presented by the Taxpayer, the arguments presented by the Department, and a legal analysis are set forth below.

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:

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[4] The smallest percentage underreported was during June of 2016 for 55%.

[5] See Ark. Code Ann. § 26-52-101 et seq. (Repl. 2014 & Supp. 2017).

> 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 Assessments[6]

Packaging Materials. The Taxpayer's Protest Letter addressed the taxability of packaging materials and stated, in part:

> The taxpayer's purchases of preparation and packaging materials qualities for exemption under Ark. Code Ann. §26-52-401 as a sale for resale.
>
> The case Heath v. Little Rock Paper Co., 257 Ark. 715, 520 S.W.2d 196 (1975) resulted in the Arkansas Supreme Court determining that "necessary packaging of an assembled or prepared product, such as food wrappers, cups, or containers, can be considered component parts of the finished product and therefore qualify for

[6] See Footnotes 2 and 3.

> the sale for resale exemption even though the cost of such items is not separately billed to customers."
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> The case McCarroll v. Scott Paper Box Co., 195 Ark. 1105, 115 S.W.2d 839 (1938) resulted in a court determination that the boxes used to package baked products for retail sale were exempt because they "became components of the product ultimately sold in packaged from to retail customers."
>
> In the administrative hearing decision [redacted] issued [redacted] by the Arkansas Department of Finance and Administration ("AR DFA"), the State acknowledged that jewelry boxes purchased by a wholesaler and used to package jewelry for sale to retailers did qualify for a resale exemption. The AR DFA noted that "jewelry is expensive and may be susceptible to loss or damage without protective packaging. As a result, the price of a piece of jewelry is not determined without reference to the attributes of delivery."
>
> [redacted] in bulk to various suppliers. Any damage that occurred during shipping would result in significant losses to [redacted]. The price of these [redacted] includes the costs incurred by [redacted] to properly package these goods, and the packaging becomes a part of the product which is sold to the customer. [P. 1-2].

The Department's Answers to Information Request addressed the Taxpayer's exemption claim regarding packaging materials and stated, in pertinent part, as follows:

> *Sale-for-Resale Exemption*
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> Ark. Code Ann. § 26-52-401(12)(A) (Supp. 2017) grants a narrow exemption for sales for resale, stating as follows:
>
> > Gross receipts or gross proceeds derived from sales for resale to persons regularly engaged in the business of reselling the articles purchased, whether within or without the state if the sales within the state are made to persons to whom gross receipts tax permits have been issued as provided in 26-52-202.
>
> If a seller holds a retail permit and purchases goods from its suppliers claiming "sale for resale," but subsequently provides it without charge to customers or third parties (or consumes the goods itself), the value of the merchandise is part of the seller's gross receipts or gross proceeds and the seller must remit tax on the

> purchase price of the goods paid by the seller. Arkansas Gross Receipts Tax Rule GR-18(D).
>
> *Packaging*
>
> In certain instances, packaging may qualify as sale-for-resale, even when it is not separately stated on as a sale. Manufacturers are entitled to certain exemptions for the packaging of manufactured product. *See* Ark. Code Ann. § 26-52-402 (Supp. 2017) *and* Arkansas Gross Receipts Tax Rule GR-55.
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> Moreover, the Department has recognized that "[p]ackaging is not a distinct and identifiable product when it accompanies the retail sale of a product and is incidental or immaterial to the retail sale thereof." The Taxpayer notes the decisions of *Heath v. Little Rock Paper Co.*, 257 Ark. 715, 520, S.W.2d 196 (1975), *McCarr011 v. Scott Paper Box Co.*, 195 Ark. 1105, 115 S.W.2d 839 (1938), and the administrative decision handed down by the Office of Hearings and Appeals in Docket No. ███. Each of these cases involved packaging or materials that were provided to the end consumer as incidental to the sale of the tangible personal property.
>
> In this case, the Taxpayer is not a manufacturer, but a distributor. The packaging materials that were identified and assessed by the auditor were used to ship already packaged materials to retail stores. The material was not integrated into the final product, nor was it incidental to a retail sale of the product. The Taxpayer has failed to identify an exemption to which it would be entitled to claim the shipping materials exempt and has therefore not met its burden of proof. [Footnote omitted, P. 4-5].

With respect to packaging materials, the Tax Auditor testified that: (1) the packaging materials assessed in the audit were items of tangible personal property; (2) during the sample months in the audit, the Taxpayer provided sales-for-resale exemption certificates to ███ vendors for purchases of ███ ███;[7] (3) the packaging materials were used to ship products to the Taxpayer's customers who would ultimately sell the products to the end

[7] See Department Exhibit 2 – Schedule A-3.

users; (4) the assessed packaging materials were not incorporated into products so as to end up on retail shelves (she did not believe any of the packaging materials were sold to the end user); (5) the assessed packaging materials were not things that would end up on retail shelves but they were shipping materials; (6) she is not aware of any sales tax exemption for the purchases of the packaging materials since the Taxpayer did not resell the packaging materials; and (7) the Taxpayer did not remit sales taxes for withdrawals from stock but no penalty was assessed against the Taxpayer.

With respect to packaging materials, the Taxpayer's Witnesses testified that: (1) the packaging materials were necessary to keep the products safe so they would arrive at the locations of customers in good condition; (2) they assumed that the packaging materials were part of the products being sold to our customers; (3) none of the packaging materials are ultimately resold by the Taxpayer's customers; (4) the Taxpayer is a wholesaler not a manufacturer; and (5) the Taxpayer does not charge for the packaging materials as a line-item on its invoices.

The Taxpayer cited Ark. Code Ann. § 26-52-401(12) (Supp. 2017) in support of the contention that the purchases of packaging materials were exempt from tax. Ark. Code Ann. § 26-52-401(12) (Supp. 2017) establishes a sales tax exemption for "sales for resale" and states:

> (A) Gross receipts or gross proceeds derived from sales for resale to persons regularly engaged in the business of reselling the articles purchased, whether within or without the state if the sales within the state are made to persons to whom gross receipts tax permits have been issued as provided in § 26-52-202.

> (B) (i) Goods, wares, merchandise, and property sold for use in manufacturing, compounding, processing, assembling, or preparing for sale can be classified as having been sold for the purposes of resale or the subject matter of resale only in the event the goods, wares, merchandise, or property becomes a recognizable integral part of the manufactured, compounded, processed, assembled, or prepared products.
>
> (ii) The sales of goods, wares, merchandise, and property not conforming to this requirement are classified for the purpose of this act as being "for consumption or use[.]

In Heath v. L. R. Paper Co., 257 Ark. 715, 520 S.W.2d 196 (1975), the Arkansas Supreme Court considered the applicability of the "sales for resale" exemption to supplies purchased by fast food restaurants. The Court stated, in part:

> We are of the opinion, under the evidence in this case, the paper and styrofoam cups used for dispensing coffee, soft drinks and other liquids, and the paper and plastic lids for such cups; the paper bowls and wrappers used in the dispensing of pies and pastries; the paper boats and paper covers used for French fried potatoes; paper wrappers, boxes, and foil wrappers used as containers for sandwiches; the paper and plastic containers for cole slaw, baked beans, etc., and the plastic lids for such containers; and the paper buckets and boxes used for fried chicken are all items exempt under our reasoning in McCarroll v. Scott Paper Box Co.[8] and Hervey v. Southern Wooden Box, supra,[9] but we hold that paper plates; paper and plastic straws and stirrers; plastic tableware and utensils; paper napkins; brown paper sacks and premoistened towelettes are subject to tax under our reasoning in Wiseman v. Ark. Wholesale Grocers' Ass'n. supra."

Id. at 722, 520 S.W.2d at 199 - 200.

In Wiseman v. Ark. Wholesale Grocers' Ass'n., 192 Ark 313, 90 S.W.2d 987 (1936), the Court denied the "sales for resale" exemption for the purchase of wrapping paper, paper bags, and twine used in the retail sale of groceries because

[8] See McCarroll, Comm'r of Rev. v. Scott Paper Box Co., 195 Ark. 1105, 115 S.W.2d 839 (1938).

[9] See Hervey v. Southern Wooden Box, 253 Ark. 290, 486 S.W.2d 65 (1972).

the grocers bought those items for consumption in the course of their business rather than for resale.

In McCarroll, Comm'r of Rev. v. Scott Paper Box Co., 195 Ark. 1105, 115 S.W.2d 839 (1938), a manufacturer purchased paper boxes to be used in the sale of prepackaged cakes, cookies, and other items. The Court held that: (1) the paper boxes became a component of the product which was sold in the box to the jobber, retailer, and ultimately to the consumer; and (2) the cost of the box measured into and became an element in the cost to the final consumer. The Court noted that the paper boxes were distinguishable from the items at issue in Wiseman v. Ark. Wholesale Grocers' Ass'n., supra, because "[i]n the Wiseman case the wrapping paper, bags, and twine were sold for convenience of retailers in manually wrapping or enclosing bulk commodities. The price of a dozen oranges, a peck of potatoes, a roast, and other merchandise customarily found in a retail grocery store, is predetermined either by weight or count, without reference to the attributes of delivery." Id. at 1108 – 1109, 115 S.W.2d at 840.

In Hervey v. Southern Wooden Box, 253 Ark. 290, 486 S.W.2d 65 (1972), the Court held that paper cups sold to the Coca Cola Bottling Company for use in its automatic vending machines were exempt from the tax.

In the instant case, the packaging materials are dissimilar to: (1) jewelry boxes; (2) the boxes and foil wrappers used as containers for sandwiches in Heath v. L. R. Paper Co., supra; (3) the paper boxes used in the sale of prepackaged cakes, cookies, and other items in McCarroll, Comm'r of Rev. v. Scott Paper Box Co., supra; and (4) the paper cups sold for vending machine use in Hervey v. Southern Wooden Box, supra.

Given the facts of this case, the holding of the Arkansas Supreme Court in Dermott Grocery & Commission Co. v. Hardin, 203 Ark. 446, 156 S.W.2d 882 (1941), is persuasive. In Hardin, supra, the appellant argued that paper boxes, paper bags, twine, wrapping paper, and other materials used to deliver merchandise to customers were "resold by the retailer" and became "a component part of the packaged articles and that they merge into and become an element in the cost of the final article sold by the retailer."[10] The Court's opinion in Hardin, supra, stated that: (1) the sole question presented was whether the wrapping paper, paper sacks, etc. were "sales for resale";[11] (2) "[i]n no instance of sale was a specific or separate charge made by the merchant of the commodity, or commodities, so used in wrapping or packaging the merchandise";[12] (3) "[t]he buyer of the merchandise from the retail merchants paid no greater amount for the articles of merchandise, by reason of the commodities used by the merchants in wrapping or packaging the merchandise than would have been paid had the merchandise been delivered to the customer without using such commodities as paper sacks, paper boxes, wrapping paper, etc.";[13] (4) "[b]ut in all cases the retail merchants were engaged in selling merchandise and as an incident to their business, for sanitary purposes, to entice trade, and as a matter of convenience for the customers, used and consumed in their business the commodities mentioned";[14] (5) [n]o contention is made here that the commodities named are

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[10] Id. at 882.
[11] Id. at 882.
[12] Id. at 883.
[13] Id. at 883.
[14] Id. at 883 - 884.

sold for one price and the merchandise for another";[15] and (6) "we think it clear that the commodities named here when sold by appellant to the retail merchants did not become a 'recognizable, integral part of the manufactured, compounded, processed, assembled or prepared products' **but that such commodities were sold to retail merchants for their consumption and use, and as an aid, in carrying on their retail business.** [Emphasis added]." The facts of this case do not support a finding that the Taxpayer was reselling the packaging materials rather than consuming or using the packaging materials in carrying on its business. The Taxpayer failed to prove entitlement to the sale-for-resale exemption on purchases of packaging materials.[16] Consequently, the Department correctly assessed sales tax on the Taxpayer's purchases of the packaging materials.

Samples. The Taxpayer's Protest Letter addressed the taxability of samples and stated, in part:

> The audit selection resulted in $[redacted] of samples which were withdrawn from inventory. This audit selection sample was then extrapolated to a total value of $[redacted]. The taxpayer disagrees with the assessment of sales tax on these items. There are two primary reasons why no sales tax should be assessed on these items:
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> 1. The State has not proven the value of the samples. The Supreme Court of Arkansas in the case Dunhall Pharmaceuticals, Inc. v. State of Arkansas (295 Ark 483, 749 SW2d 666) considered this issue and found in favor of the taxpayer. The court noted that the State had to prove the value of the free samples which were given away before the value of the samples could be subject to taxation. The court said:

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[15] Id. at 884.

[16] Since the Taxpayer is not a manufacturer/processor, the provisions of Arkansas Gross Receipts Tax Rule GR-53(C) are not applicable.

> If the legislature had intended to fix some predetermined value, such as cost of manufacture, to apply to goods, wares, or merchandise withdrawn from stock, it could have easily said so. The legislature knows how to set a predetermined value. For example, complimentary tickets to places of amusement are determined to have a value equal to the sales price of similar tickets.

The Supreme Court also heard an earlier case with Dunhall Pharmaceuticals (288 Ark 16, 702 SW2d 402). The State argued that the samples given away to dentists had value because they had advertising value. The Supreme Court responded by stating "What is the advertising value derived from giving away the samples in question? Surely that value is too nebulous to be measured in dollars and cents when a dentist is free to discard the sample if he prefers another brand."

Samples which are taken by participants at the trade shows have no value because they can be taken by a participant at the tradeshow and discarded.

2. The samples which are not taken by participants at the trade show are returned to inventory at the end of the trade show. The inventory account is increased when the samples are returned to inventory. If these inventory items are subsequently sold, they are sold to retailers. No sales tax is due on these sales due to the fact that [redacted] is making the sale to a retailer, [redacted] obtains re-sale exemption certificates from its customers. [P. 2].

The Department's Answers to Information Request addressed the Taxpayer's contentions regarding samples and stated, in pertinent part, as follows:

> The Taxpayer disagrees with the assessment of tax on the withdrawal of stock of items provided as samples to customers. The Taxpayer's first defense to the assessment of sales tax is that the Department did not establish value of the samples. In support of this argument, the Taxpayer cites to *Dunhall Pharmaceuticals, Inc. v. State of Arkansas*, 295 Ark. 483, 749 S.W.2d 666 (1988) and claims that the Department failed to establish the value of the samples. The Department was able to establish values for the samples in the course of the audit by reviewing purchase orders and the established sales price for certain items.

> The Taxpayer also argues that the samples are returned at the end of the trade show and reintroduced into normal inventory. The Taxpayer indicates that sales tax is collected "if . . . they are subsequently sold." A sample that is returned but not resold would still require remittance of tax on a withdrawal from stock basis. Moreover, no evidence has been presented to show that the items assessed for withdrawal from stock as samples were eventually resold to a customer and sales tax was collected. Taxpayer has failed to meet its burden of proof regarding the application of any exemption to sales tax. [P. 5].

With respect to samples, the Tax Auditor testified that: (1) she located a sample account in the download of sales for the month of November of 2017;[17] (2) the samples were items of tangible personal property and typical of [redacted] that would have been sold by the Taxpayer's customers; (3) the samples were taken to conventions and expos (the samples may or may not have been given away); (4) while she located the withdrawals from stock of the samples, she did not locate any credit transactions in the sample account; (5) she established values for the samples by using the dollar amounts that were logged onto the general ledger account (values assigned on the account by the Taxpayer); (6) she did not identify any sales tax remittance relating to withdrawals from stock; (7) she does not know what happened to samples that were not given away (if a sample that was not given away was returned to inventory, no sales tax would be due); (8) if she had seen any evidence that the sample account contained debit memos to illustrate that withdrawn items were credited back, then she would have included those debits in the audit; and (9) it is possible that the withdrawn items were returned to inventory.

[17] This is one (1) of the three (3) sample months. See Department Exhibit 1.

The Taxpayer's Representative contended that: (1) as outlined in the Taxpayer's Protest Letter, the Arkansas Supreme Court has held that an item given away for advertising has no value when the recipient is free to do whatever he or she wants with the item; and (2) the Taxpayer decided to essentially discard the items given away so the items had no value to the Taxpayer.

With respect to samples, the Taxpayer's Witnesses testified that: (1) the items withdrawn from stock really had no value; (2) it was not worth the effort or money for the Taxpayer to ship the items back and put the items back in stock; (3) in the past, if samples were brought back there would be an inventory adjustment and nothing would be reflected on the samples account (now, credits offset the sample invoices); (4) it would be difficult to go back and determine how much of the items withdrawn went back into inventory; and (5) some samples were returned to inventory but no supporting documentation was furnished to the Tax Auditor.

The Department's Representative contended that: (1) she has addressed the cases outlined in the Taxpayer's Protest Letter and there is no issue regarding value in this case because the Taxpayer's values were used; and (2) the Arkansas Supreme Court recently confirmed the taxability of withdrawals from stock in the case of Walther v. FLIS Enterprises, Inc., 2018 Ark. 64.

Samples of items of tangible personal property given away for free are taxed as withdrawals from stock under Arkansas Gross Receipts Tax Rule GR-18(D). The Taxpayer purchased products tax free as sales-for-resale and later withdrew some of the products and did not resell them and tax must be collected under Ark. Code Ann. § 26-52-322 (Repl. 2014). See Walther v. FLIS

Enterprises, Inc., 2018 Ark. 64, 540 S.W.3d 264. In accordance with Ark. Code Ann. § 26-52-322(b)(2) (Repl. 2014), the proper calculation for the tax is the "value of any goods, wares, merchandise, or tangible personal property withdrawn." In the instant case, the Department calculated the tax based upon the values assigned to the assessed items by the Taxpayer. Consequently, the Department correctly assessed sales tax on the Taxpayer's withdrawals from stock.[18]

Statute of Limitations. With respect to the Department's utilization of a six-year audit period, the Taxpayer's Protest Letter stated that:

> The sales tax has been assessed against the taxpayer back to the year 2012 under Ark. Code Ann. §26-18-306(e) because the taxpayer's tax was understated by 25%. Normally the statute of limitations would allow an assessment for only the three prior years. The taxpayer would like to point out that the 25% understatement rule is grossly unfair to a wholesaler who does not typically owe any sales tax. A wholesaler will practically automatically have a six year statute of limitations due to the fact that there is typically no sales tax due, so any finding of unpaid sales tax will cause a 25% understatement. This should be contrasted with a retailer who would have to incur a gross error in order to understate their sales by 25%. The taxpayer would like to dispute the six year statute as being unfair and discriminatory against a wholesaler. [P. 2].

The Department's Answers to Information Request addressed the Taxpayer's contentions regarding the six-year audit period and stated as follows:

> The Taxpayer's final argument is that it should not have been subject to a six-year audit period. The Taxpayer contends that the application of the statute is unfair to apply to a wholesaler, who does not have many sales that require the collection of sales tax.
>
> This argument is without merit. The Taxpayer underreported by twenty-five percent (25%) and was accordingly subject to the six (6)

[18] It would require speculation to determine the amount of stock returned to Taxpayer's inventory in the absence of supporting documentation so the Department's assessment has not been refuted. See Ark. Code Ann. § 26-18-506 (Repl. 2012).

> year statute of limitations. The statute does not provide relief to those who are not ordinarily engaged in a collection activity. [P. 5].

Ark. Code Ann. § 26-18-306(e) (Supp. 2017) provides that the Department may assess tax due for a six-year period if a taxpayer understates a tax due by twenty-five percent (25%) or more. There is no factual dispute that the Taxpayer exceeded the threshold of twenty-five percent (25%) underreported for sales tax. As a discretionary function of the Director's office, the action of the Director will only be set aside should there be an abuse of that discretion. Kale v. Arkansas State Medical Board, 367 Ark. 151 (2006). Discretionary actions must be sustained unless those actions are shown to be arbitrary and capricious. Leathers v. Jacuzzi, Inc., 326 Ark. 857, 935 S.W. 2d 252 (1996). The evidence in this case does not support a finding that the Department's utilization of a six-year audit period was arbitrary or capricious.

The Taxpayer's Representative requested equitable relief based upon fairness. This Office has no equitable power to grant the Taxpayer equitable relief based upon fairness. An administrative tribunal can only operate within the powers granted to it by the legislature. There is considerable doubt whether the Arkansas General Assembly may even constitutionally grant equitable powers to an administrative agency, since the granting of equity is purely a judicial power. Provenzano v. Long, 64 Nev. 412, 183 P.2d 639 (1947); Mich. Mut. Liability Co. v. Baker, 295 Mich. 237, 294 N.W. 168 (1940), Ford v. Barcus, 261 Iowa 616, 155 N.W.2d 507 (1968) (citing Doyle v. Dugan, 229 Iowa 724, 295 N.W. 128 (1940)). Ark. Code Ann. § 26-18-405 (Supp. 2017) clearly indicates the decision of a hearing officer is limited to the application of the law to a proposed

assessment or refund denial and does not grant authority for decisions based in equity, even assuming that such a power could be constitutionally granted and exercised by this tribunal.

Interest and Penalties. Interest was properly assessed upon the tax deficiencies for the use of the State's tax dollars. See Ark. Code Ann. § 26-18-508 (Repl. 2012). No penalties were assessed against the Taxpayer.

DECISION AND ORDER

The assessments are 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.

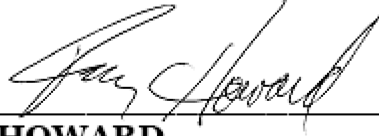
Pursuant to Ark. Code Ann. § 26-18-405 (Supp. 2017), unless the Taxpayer requests in writing within twenty (20) days of the mailing of this decision that the Commissioner of Revenues revise the decision of the Administrative Law Judge, this Administrative Decision shall be effective and become the action 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.

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.[19]

OFFICE OF HEARINGS & APPEALS



RAY HOWARD
ADMINISTRATIVE LAW JUDGE

DATED: April 10, 2019

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[19] See Board of Trustees of Univ. of Arkansas v. Andrews, 2018 Ark. 12.