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

ADMINISTRATIVE DECISION

IN THE MATTER OF [redacted] **ACCT. NO.:** [redacted]	**GROSS RECEIPTS TAX ASSESSMENT AUDIT ID:** [redacted]
DOCKET NO.: 19-378	**PERIOD: 01/01/15 - 12/31/17 ($[redacted])[1]**

RAY HOWARD, ADMINISTRATIVE LAW JUDGE

APPEARANCES

This case is before the Office of Hearings and Appeals upon a written protest dated January 3, 2019, signed by [redacted] ("Taxpayer's Representative"),[2] Attorney at Law, on behalf of [redacted], the Taxpayer. The Taxpayer protested an assessment of Gross Receipts (sales) Tax resulting from an audit conducted by [redacted], Original Tax Auditor, on behalf of the Department of Finance and Administration ("Department").

An administrative hearing was held in Arkadelphia, Arkansas, on June 6, 2019, at 10:00 a.m. The Department was represented by Lisa Ables, Attorney at Law, Office of Revenue Legal Counsel. Present for the Department were Dakota Cowart - Tax Auditor[3] and Vanessa Smith – Audit Supervisor. The Taxpayer's Representative appeared at the hearing and represented the Taxpayer.

[1] The reflected amount included tax ($[redacted]) and interest ($[redacted]).
[2] The case file contains a properly executed Power of Attorney.
[3] The Original Tax Auditor did not appear at the hearing.

ISSUE

Whether the Department's assessment against the Taxpayer 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 basis for the Taxpayer's disagreement with the assessment as reflected by the handwritten statements on the Protest Form) and stated, as follows:

> [redacted] ("Taxpayer") is an electrical contractor that specializes in both residential and commercial repairs. Taxpayer provides local electrical contract work as well as common repairs and maintenance of machinery and appliances. Taxpayer is located inside the city limits of [redacted], AR in [redacted].
>
> The Department conducted a routine audit of Taxpayer, beginning in April of 2018. The Department looked at periods from January 2015 to the end of December 2017. The Department reviewed relevant documentation, including sales invoices for the audit period. Taxpayer was a non-filer for all periods, claiming that he did not believe any of his work was taxable.
>
> Having reviewed the work performed by Taxpayer, the Department noted several unreported taxable sales. A copy of those sales was compiled into a schedule and is attached as **Exhibit 1**. The Department also conducted an audit of use tax, however, it did not find any unreported taxable purchases.
>
> On October 31, 2018, the Department sent a Summary of Findings to the Taxpayer reflecting its assessment of [redacted] in additional taxable sales and [redacted] in interest, for a total of [redacted]. A copy of the Summary of Findings is attached as **Exhibit 2**. The Department did not assess penalty on the assessment. On November 8, 2018, the Department issued a Notice of Proposed Assessment, which is attached as Exhibit 3.
>
> On January 4, 2019, the Department received the Taxpayer's timely protest of the assessment, which is attached as **Exhibit 4**. In it, the Taxpayer states:

> GR-21(1) GR-21(2)
>
> A generator becomes part of the real estate after installation.
> A generator is not an electrical appliance.
>
> . . .
>
> A generator is an electrical device that converts mechanical energy into electrical energy, typically through a motor. Initial installation, alteration, addition, cleaning, refinishing, replacement, and repair of these devices is taxable. As noted in the *Otis Elevator* case, it is immaterial if the generator is affixed to real property. [P. 1-3].

The Audit Supervisor testified that: (1) the Taxpayer is an electrical contractor and performed repairs to electrical devices and machinery at both residential and commercial buildings; (2) she supervised the performance of the Taxpayer's audit; (3) sales invoices and purchased invoices were reviewed in the audit; (4) schedules were prepared which listed repair work and generator installations; (5) the Taxpayer was a non-filer during the audit period so sales tax was assessed on taxable services; (6) no use tax was assessed against the Taxpayer since tax was paid on purchases; (7) a generator is a machine that produces electricity; (8) it is her understanding that none of the assessed invoices involved new construction jobs and the Taxpayer has not provided her with anything to demonstrate that new construction jobs were picked up in the audit; and (9) she has personal knowledge of most of the job locations covered by the assessment and those were not new construction jobs.

Upon cross examination, the Audit Supervisor testified that: (1) when she compares the last working notes to the final report, it reflects that all of the Taxpayer's jobs involving new construction were removed from the audit (not assessed); (2) a new installation of a generator in an existing building was not

removed from the audit; (3) the installation of a generator would involve wiring but the generator would be removable; and (4) a generator is a machine not a part of real property.

The Taxpayer's Representative contended that: (1) the applicable sales tax laws, such as GR-21, lack clarity; (2) if the Taxpayer is liable for sales tax, the application of liability should be prospective not retroactive; and (3) the sales tax laws are confusing.

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 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.[4] As a general rule, sales tax applies to the entire gross receipts from sales of tangible personal property and certain specifically enumerated services within the State of Arkansas. See Ark. Code Ann. § 26-52-301 et seq. (Repl. 2014 & Supp. 2017).

The repair and replacement of electrical devices or machinery, and the initial installation of electrical devices or machinery in an existing building, are taxable services. See Arkansas Gross Receipts Tax Rules GR-9 and GR-9.17. The controlling legal authority supports the Department's position that a generator is a machine. In Heath v. Research-Cottrell, Inc., 258 Ark. 813, 529 S.W.2d 336 (1975), the Arkansas Supreme Court construed the term "machine" broadly, to include the cooling tower for the Arkansas Nuclear 1 Unit at Russellville, Arkansas, and the court stated, as follows:

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

> In Blankenship v. W.E. Cox & Sons, 204 Ark. 427, 162 S.W.2d 918 (1942), we relied upon the Webster International Dictionary, definition of the word "machine" as being "any device consisting of two or more resistant, relatively constrained parts, which, by a certain pre-determined intermotion, may serve to transmit and modify force and motion so as to produce some given effect or to do some desired kind of work ... " We additionally pointed out that "a crowbar abutting against a fulcrum" and "a pair of pliers in use" would fall within any "strict definition" of the word "machine." Later in Ben Pearson, Inc. v. The John Rust Co., 223 Ark. 697, 168 S.W.2d 893 (1954), we incorporated the definition found in Blankenship, supra, and added an extract from Coming v. Burden, 56 U.S. (15 How.) 252, 14 L.Ed. 683, to the effect that "the term machine includes every mechanical device or combination of mechanical powers and devices to perform some function and produce a certain effect or result." (Emphasis supplied.) In the case at bar, even though the principle involved in recirculating the water for cooling purposes lacks the complexity customarily associated with a machine, there is still present the dynamics of elevating (by mechanical pumps) the heated water some 447 feet and the subsequent interaction of this heated water with asbestos baffles to aid in dissipating the heat as the water descends. This interaction comports with the Blankenship and Ben Pearson, supra, definitions of a machine in that the internal components of the cooling tower comprise "two or more resistant, relatively constrained parts" which "produce some given effect or do some desired kind of work."

Id. at 818 – 819, 529 S.W.2d at 338 – 339.

The Taxpayer's argument that an installed generator becomes part of a structure (so the transaction is not taxable) is not persuasive. The Arkansas Supreme Court has explained that taxable services performed on machinery remain taxable regardless of whether those components are affixed to real estate. In Arkansas Department of Finance & Administration v. Otis Elevator, 271 Ark. 442, 609 S.W.2d 41 (1980), the Arkansas Supreme Court considered the issue of "whether the fact that the elevators are attached to structures on real property

removes [a taxpayer's] service and maintenance proceeds from the ambit of the Gross Receipts Tax Law"[5] and stated, in pertinent part:

> Both sides agree that, as a general rule, a tax cannot be imposed except by express words indicating that purpose, and any ambiguity or doubt must be resolved in favor of the taxpayer. Wiseman v. Arkansas Utilities Company, 191 Ark. 854, 88 S.W.2d 81 (1935). Appellee contends that it was the intent of the General Assembly in enacting the Gross Receipts Tax Law that it apply solely to the sale of, or service to, tangible personal property, as well as certain enumerated types of intangible property. The Chancellor agreed with this interpretation of the law and overturned the assessment, ruling that there was no showing that the tax was expressly imposed upon the proceeds from services to real property.
>
> We must disagree. It is true that sales of tangible personal property are subjected to the tax in subsection (a) of 84-1903, but the subsection applicable here also imposes the tax on the sale of the services therein enumerated. It is clear that 84-1903(c)(3) expressly imposes the tax upon service to motors, electrical devices, and machinery of all kinds, all of which describe in various ways an elevator and its components. Appellee concedes that the proceeds from these services would be taxable were it not for the fact that elevators are affixed to structures upon real property. This argument must fail. We find it significant that the General Assembly in its enumeration of services to be taxed by this subsection included the addition, replacement or repair of tin and sheetmetal, which obviously are primarily utilized in the construction of buildings and other structures upon real property. We think the intent of the General Assembly was made sufficiently clear by their reference to "machinery of all kinds" and that they intended the tax to apply to service to all machinery whether or not it was affixed to realty.

Id. at 443 -444, 609 S.W.2d at 42.

With respect to invoices or jobs not already removed from the audit by the Department, the evidence presented does not preponderate in favor of a finding that the Taxpayer proved entitlement to the tax exemption for installation services (of generators) performed in a newly constructed or substantially

[5] Id. at 443, 609 S.W.2d 42.

modified building under Arkansas Gross Receipts Tax Rule GR-9.17(C)(2) or GR-21(B)(2).

With respect to a taxable service, the entire gross receipts derived from the performance of the taxable service is subject to tax (including the transfer of title or possession of any materials or supplies used or consumed in performing the taxable service and without deduction for "labor or service cost"). See Ark. Code Ann. § 26-52-103(13)(A) (Supp. 2017).

The liability for collecting and reporting sales tax on the sale of a taxable service is upon the seller of the service unless the purchaser claims an exemption.[6] See Arkansas Gross Receipts Tax Rule GR-79(C). While it is extremely unfortunate that (prior to the Department's audit) the Taxpayer was unaware the installation of a generator in existing building was taxable, including the associated labor charges, the argument (that the assessment should be prospective only) is not persuasive.[7] Lack of actual or constructive knowledge of a tax levy is inadequate to avoid imposition of the tax. Every person is presumed to know the law and lack of knowledge is not an excuse for failure to comply with the mandates of the law. See Duchac v. City of Hot Springs, 67 Ark. App. 98, 107, 992 S.W.2d 174, 180 (1999). Based upon the facts of this case, the Department correctly assessed sales taxes against the Taxpayer.

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.

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[6] The Taxpayer was not collecting sales tax during the audit period so there was no evidence introduced to establish that any of the Taxpayer's customers claimed an exemption.

[7] Taxpayers can obtain binding legal opinions from the Department regarding tax issues under Arkansas Gross Receipts Tax Rule GR-75.

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.

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.[8]

OFFICE OF HEARINGS & APPEALS

RAY HOWARD
ADMINISTRATIVE LAW JUDGE

DATED: June 20, 2019

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