

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

ADMINISTRATIVE DECISION

IN THE MATTER OF [REDACTED]
[REDACTED]
DOCKET NO.: 19-410

**GROSS RECEIPTS TAX
ASSESSMENT
ACCT. NO.:** [REDACTED]
**AUDIT PERIOD: APRIL 1, 2017
THROUGH APRIL 30, 2017**

AUDIT NO.: [REDACTED]

[REDACTED]¹

TODD EVANS, ADMINISTRATIVE LAW JUDGE

APPEARANCES

This case is before the Office of Hearings and Appeals upon a written protest received August 16, 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 protest was submitted by [REDACTED], CPA – [REDACTED] [REDACTED] (“Taxpayer’s Representative”). The Department was represented by Lauren Ballard, Attorney at Law, Office of Revenue Legal Counsel (“Department’s Representative”).

At the request of the Taxpayer, this matter was taken under consideration of documents. A briefing schedule was established for the parties by letter dated April 8, 2019. The Department filed its Opening Brief on April 5, 2019. The Taxpayer did not file a Response Brief, but his original protest was accepted into

¹ This amount represents [REDACTED] (tax) and [REDACTED] (interest).

evidence. The record was closed and this matter was submitted for a decision on May 24, 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

The Department's Opening Brief provided some relevant facts and its analysis, providing in pertinent part, as follows²:

On April 6, 2017, [REDACTED] ("Taxpayer") purchased a [REDACTED] cutter from [REDACTED] in [REDACTED], Arkansas. A copy of the invoice is attached as **Exhibit 1**. On the same day, Taxpayer executed a Commercial Farming Sales Tax Exemption ("Exemption"), claiming that he was engaged in the production of "cattle and chickens." A copy of the Exemption is attached as **Exhibit 2**. On July 24, 2018, the Department sent Taxpayer a letter requesting documentation as proof that Taxpayer was entitled to farming exemption (attached as **Exhibit 3**).³

Upon review of the documentation, the Department concluded that Taxpayer had not met his burden of proof showing that he was entitled to the commercial farming exemption for the purchase of the [REDACTED]. On July 24, 2018, the Department issued a Summary of Findings, notifying the Taxpayer that it had assessed [REDACTED] in tax, [REDACTED] in penalty, and [REDACTED] in interest on the purchase of the cutter, for a total of [REDACTED]. A copy of the Summary of Findings is attached as **Exhibit 4**. On July 31, 2018, the Department issued a Notice of Proposed Assessment reflecting those amounts (attached as **Exhibit 5**).

Taxpayer timely protested on or about August 16, 2018 via a power of attorney. In the protest, Taxpayer stated:

The equipment in question was purchased to be used by the S Corporation in the process of farming. [REDACTED] is a shareholder in the S Corporation and the farming profit or loss is passed through to him on his personal return. When discussing this with the second

² Except as noted, all exhibits support the statements for which they are cited.

³ This letter actually states that this transaction did not qualify for the farm machinery and equipment exemption and included the Summary of Findings. The letter did not request documentation from the Taxpayer to establish entitlement to the exemption.

sales tax auditor, he stated that it should not matter if the farm is a Corporation or individually owned. As long as the taxpayer has a Schedule F showing that the income is derived from the business of farming, that should be sufficient. He also stated, "A Corporate farm is just as exempt as an individual farm who files a Schedule F."⁴

A copy of the Protest is attached as **Exhibit 6**. Included with the protest, Taxpayer's representative included a 2017 Schedule F. The Department notes the Schedule F is titled "For Information Purposes Only" and does not indicate the S Corporation.

Within her Opening Brief, the Department's Representative asserted that the items purchased by the Taxpayer represent tangible personal property and, thus, are generally taxable. She further asserted that the Taxpayer has failed to prove entitlement to the farm machinery and equipment exemption. Specifically, she asserted that the Taxpayer has not demonstrated that he is engaged in farming as a commercial business or that the machinery/equipment is directly and exclusively used in farming. She also claimed that the assessment of interest was appropriate under Ark. Code Ann. § 26-18-508 (Repl. 2012).

Within his protest, in addition to the letter from the Taxpayer's Representative, the Taxpayer provided his objection to the assessment, stating as follows, in relevant part: "I own an S corporation that operates the farming business. Equipment was purchased for corporate farm. See attached CPA letter."

After a general discussion of the burdens of proof in tax proceedings, a legal analysis with associated conclusions shall follow.

⁴ This quotation is contained within the Taxpayer's Representative's letter that was attached to the Taxpayer's protest. The Taxpayer's Representative further asserted that the Taxpayer is engaged in commercial farming as a shareholder of an S Corporation that operated a commercial farm. The Schedule F attached to the letter was labeled "For Informational Purposes Only" and did not identify the name of the S Corporation that was engaged within commercial farming.

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).

A. 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/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.

...

- C. The list of exempt items in GR-51(B)(1)(a) is not intended to be exclusive. Other agricultural implements may qualify for this exemption provided they meet the requirements of GR-51(C)(1) and GR-51(C)(2).

1. An implement may not be treated as tax exempt unless it is used "exclusively" in the agricultural production of food or fiber as a business or the agricultural production of grass sod or nursery products as a business.
 - a. An implement will be presumed to be used exclusively in the agricultural production of food, fiber, grass sod, or nursery products as a business if the implement is used on land owned or leased for the purpose of agricultural production of food, fiber, grass sod, or nursery products.
 - b. A person who uses agricultural implements in the production of food, fiber, grass sod, or nursery products primarily for his own consumption is not entitled to this exemption.
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:

- a. Containers or storage facilities;
- b. Implements used in the production or severance of timber (except as exempted by GR-51(F) of this rule), or any motor vehicle of a type subject to registration for use on the highway, or airplanes, or hand tools;
- c. Attachments to and accessories not essential to the operation of the implement itself (except when sold as part of an assembled unit);
- d. Items which are incorporated into real property; and
- e. Repair labor and repair parts.
- 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 supplied.]

...

Additionally, Arkansas Gross Receipts Tax Rule GR-51(E) provides additional guidance relevant to this proceeding, stating as follows:

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.

Example: A fertilizer spreader or seed spreader, or chemical applicator purchased by a farmer would qualify for the farm machinery exemption if used exclusively by a farmer in applying fertilizer, planting seed, or applying agricultural chemicals as part of the agricultural production of food, fiber, grass, sod, or nursery

products as a business. The farm machinery exemption will also be available to a fertilizer dealer, seed company, or other similar business upon the purchase of these same items provided the items are used exclusively and directly by the business in applying fertilizer, planting seed, or applying agricultural chemicals for farmers. [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, the Taxpayer stated within his exemption form that he is engaged in the commercial production of “cattle and chickens.” At this point in the administrative process, the Taxpayer has alleged that he is engaged in commercial farming through his ownership of an S Corporation, but the identifying information for that S Corporation has not been provided. The identity of the S Corporation and the nature of its farming activity is uncertain. The Taxpayer has not demonstrated that he or a company owned by him is engaged in commercial farming. Even assuming the S Corporation is engaged in commercial production of cattle and chickens, it is uncertain how a rotary cutter or mower would be directly utilized in that pursuit. Since the Taxpayer has failed to show that the relevant machinery and equipment fulfills the requirements of the relevant exemption, his exemption claim must be denied. Consequently, the

Taxpayer has not proven entitlement to the farm machinery and equipment exemption by a preponderance of the evidence.

C. 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 of sales tax and interest 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: May 29, 2019

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