

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

ADMINISTRATIVE DECISION

IN THE MATTER OF

ACCT. NO.: [REDACTED]

**GROSS RECEIPTS AND
COMPENSATING USE
TAX ASSESSMENTS**

**DOCKET NOS.: 21-135
21-136**

**(\$ [REDACTED] – Sales Tax)¹
(\$ [REDACTED] – Use Tax)²**

RAY HOWARD, ADMINISTRATIVE LAW JUDGE

APPEARANCES

This case is before the Office of Hearings and Appeals upon a written protest submitted on June 26, 2020, and signed by [REDACTED], Owner, on behalf of [REDACTED] the Taxpayer. The Taxpayer protested the assessments of gross receipts tax (“sales tax”) and compensating use tax (“use tax”) resulting from an audit conducted by [REDACTED], Tax Auditor,³ from the Southwest Audit District⁴ of the Office of Field Audit, for the Department of Finance and Administration (“Department”). The audit period was from November 1, 2015, through January 31, 2020 (Audit ID: [REDACTED]).

An administrative hearing was held in Hot Springs, Arkansas, on January 28, 2021.⁵ The Department was represented by David Scott, Attorney at Law, Office of Revenue Legal Counsel (“Department’s Representative”). Present for

¹ The assessed amount includes tax (\$ [REDACTED]), penalty (\$ [REDACTED]), and interest (\$ [REDACTED]).

² The assessed amount includes tax (\$ [REDACTED]) and interest ([REDACTED]). The use tax assessment was not contested by the Taxpayer at the hearing.

³ The Tax Auditor is no longer an employee of the Department.

⁴ This district is now a part of the Southern Audit District.

⁵ The hearing was conducted virtually from the hearing room in Little Rock, Arkansas.

the Department were Paula Osborn, Audit Supervisor, and Melissa Guin, Audit District Manager (collectively, “Department’s Witnesses”). The Owner appeared at the hearing and represented the Taxpayer.

The record remained open after the hearing for the Owner to submit additional records to the audit staff. On April 14, 2021, the Department’s Representative submitted an email stating that, “[t]he Department requests that the Office of Hearings and Appeals issue the final decision in this matter subject to the post-hearing concessions as reflected in the revised summary of findings (attached) and in accord with the evidence and testimony presented at the hearing.”

ISSUE

Whether the assessments issued by the Department against the Taxpayer should be sustained? Subject to the concessions made by the Department, yes.⁶

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 assessments⁷ as reflected in the handwritten portion of the Protest Form submitted by the Owner) and stated, in part:

██████████ . . . [hereinafter “[Taxpayer]” is a ██████████ business located in ██████████. [Taxpayer] is a sole proprietorship owned and operated by ██████████. [Taxpayer] creates and sells ██████████ using a ██████████.

On February 20, 2020, a gross receipts and compensating use tax audit was conducted on the books and records of [Taxpayer]’s

⁶ See Footnote 2.

⁷ See Footnote 2.

business for tax period November 1, 2018 through January 31 , 2020. During conduct of the audit, it was determined that [Taxpayer] had underreported by 25% or greater. Therefore, the audit was extended back an additional three (3) years to November 1, 2015. It was further determined that [Taxpayer] had failed to maintain adequate records for the periods under review. Therefore, the auditor used available information in calculation of the tax due.

[Taxpayer] has had a [REDACTED] since January 2018; however, those records were not provided. [Taxpayer] provided [REDACTED] credit card transaction statements for January 1, 2019 through December 31, 2019. [Taxpayer] uses QuickBooks ("QB") and several invoices were manually input into the QB system. The QB reports were reviewed for a few months in 2019. [Taxpayer] provided invoices for 22 transactions, 8 of which reflected that tax had been charged. The tax should have been collected on all 22 transactions. Handwritten taxable invoices were reviewed for the month of December 2016. However, based on the pre-stamped invoices numbers, the invoices were only partially complete. Bank statements were reviewed for January 1, 2017 through January 31, 2020. Credit card statements were requested, but [Taxpayer] advised that it did not have access to these statements because "the card did not belong to him." At the conclusion of the audit, an estimated assessment was made against [Taxpayer] in the following amount:

[Table omitted. See Footnotes 1 and 2 for the amounts.]

See Total Taxable Sales Spreadsheet and Basis for Adjustment Schedule (Schedule A-2) and Basis for Adjustment - Taxable Sales (Schedule A) as **Exhibit 1**. See Total (Over)/Under Reported Taxable Spreadsheet (Schedule A-1) as **Exhibit 2**. See 25% Under Reported Taxable Sales Spreadsheet (Schedule A-8) as **Exhibit 3**. See Detailed Taxable Consumer Use Spreadsheet (Schedule B-2) as **Exhibit 4**. Schedules A-3 - A-7 attached as **Exhibit 4A**. Schedules B & B-1 attached as **Exhibit 4B**.

A Summary of Findings reflecting the above adjustments was sent to [Taxpayer] on April 24, 2020 (**Exhibit 5**), and Notice of Proposed Assessment was sent on April 28, 2020 (**Exhibit 6**). [Taxpayer] timely protested the adjustment on June 26, 2020. See **Exhibit 7**. In its protest, [Taxpayer] claims as follows:

After reviewing the documents provided, we can show some discrepancies on the amounts for the proposed assessment. We are reporting all sales including taxes collected. Amounts shown on assessment do not reflect

deposits made. We are also paying tax on purchases made for supplies.

This argument on the part of [Taxpayer] is unclear. No additional information or documentation was provided with the Taxpayer's protest.

...

Gross Receipts Tax

Regarding the gross receipts tax adjustments, because it was determined that [Taxpayer] had failed to provide sufficient documentation, the auditor based the assessment on a combination of [Taxpayer]'s bank deposits, [REDACTED] statements, and Taxpayer's 2016 Schedule C income reported. The bank statements were for the period January 1, 2017 through January 31, 2020 and were used to calculate [Taxpayer]'s taxable sales for that time period. See **Exhibit 4A**. Between December 22, 2018 through January 15, 2019, no deposits were made to either bank account, even though the business was in operation. The [REDACTED] deposits were not deposited into either account for the months of January 2019 through March of 2019; however, a statement was provided for that time period. See **Exhibit 4A**. The 2019 [REDACTED] transaction report was used for January 1, 2019 through December 31, 2019 and a projection for November 1, 2015 through December 31, 2015 was used for [REDACTED] based on the twelve (12) months reviewed. The [REDACTED] and [REDACTED] bank statements were used for taxable deposits (sales) for the time period provided of January 1, 2017 through January 31, 2020. A projection of taxable bank deposits was used for November 1, 2015 through December 31, 2015. Schedule C income was used for taxable sales for January 1, 2016 through December 31, 2016. The audit resulted in an adjustment for State (0015), [REDACTED]

The auditor further noted that a June 2017 invoice from one of [Taxpayer]'s customers noted "tax exempt for taxable sales." However, based upon a telephone call to [Taxpayer], the auditor was advised that [Taxpayer] did not have an exemption certificate for that customer on file. Therefore, the auditor determined that [Taxpayer] bore the burden of the tax itself.

A ten (10%) penalty was applied to the gross receipts tax assessment because the auditor determined that there was evidence of negligence or intentional disregard in failing to pay the tax. [Taxpayer] had been reporting on similar items and there had been no change in the law.

...

[Taxpayer] failed to maintain adequate records for the period under review. Further, [Taxpayer] failed to provide any information to prove that the methodology used by the auditor was unreasonable. The statements made by [Taxpayer]--that " *[a]fter reviewing the documents provided, we can show some discrepancies on the amounts for the proposed assessment. We are reporting all sales including taxes collected. Amounts shown on assessment do not reflect deposits made. We are also paying tax on purchases made for supplies*"--are self-serving and not relevant to the analysis herein. See Ark. Code Ann. § 26-18-506(d) (Repl. 2020), which provides that the burden is on a taxpayer to refute an estimated assessment and self-serving testimony, standing alone, is insufficient to refute an estimated assessment. *Leathers v. A. & B. Dirt Movers, Inc.*, 311 Ark. 320, 844 S.W.2d 314 (1992). [Taxpayer] was also a non-filer for compensating use tax and therefore underreported by 25% or greater.

For the reasons set forth above and because the Taxpayer has failed to meet his burden of proof relative to the tax-exempt status of the sales at issue in this protest, the Department's assessment of sales tax, penalty, and interest should be sustained in full. [P. 1 – 6].

The Department's Witnesses presented testimony consistent with the contentions in the Department's Answers to Information Request and, regarding the sales tax assessment, testified that: (1) due to a lack of records, the Department issued an estimated assessment; (2) Schedule A-2 (Department Exhibit 1) is the schedule prepared to calculate the Taxpayer's taxable sales from November of 2015 through January of 2020 ("audit period"); (3) taxable sales were calculated using actual bank deposits as reflected on the Taxpayer's bank statements,⁸ Schedules A-4, A-5, and A-6, (non-taxable deposits, as determined by the Tax Auditor, are listed on the Schedules and were deducted for the calculation); (4) for the months of November and December of 2015, there were

⁸ [REDACTED] (January of 2017 through December of 2018) and [REDACTED] (January of 2019 through January of 2020).

no banks statements,⁹ so taxable deposits/sales were projected by averaging actual bank deposits;¹⁰ (5) since there were no bank statements for 2016,¹¹ Schedule C income from the Taxpayer's income tax return was used to determine the monthly amount of taxable sales; (6) total taxable sales also included deposits and transactions from a credit card processing system for the months in 2019¹² (at this point, the Department conceded the amounts projected to November and December of 2015);¹³ (7) the Taxpayer was given credit for reported taxable sales (See Department Exhibit 2); (8) if the Taxpayer produces bank statements for 2016, the Department will make any warranted adjustments; (9) the credit card system deposits are not separately stated on the bank records in 2019¹⁴ so the credit card system deposits were listed on a different schedule;¹⁵ (10) the statements from a different bank, used by the Taxpayer prior to 2019, differentiated between check deposits and credit card system deposits; (11) a credit card transaction report was used to determine the taxable sales; (12) there had to be another bank account because there is a check from [REDACTED]¹⁶ on a different account at the [REDACTED]; (13) the credit card sales report used by the Tax Auditor shows more sales than what was going into the Taxpayer's account at [REDACTED]; (14) the Taxpayer should pay tax on gross receipts

⁹ At this point, the Owner stated that he was not asked for these bank statements since the original audit period was from 2017 - 2020.

¹⁰ See Schedule A-4.

¹¹ See Footnote 9.

¹² See Schedule A-3.

¹³ The Department also conceded a duplicate [REDACTED] deposit in January of 2018 in the amount of \$ [REDACTED] and an [REDACTED] deposit for \$ [REDACTED] in August of 2018.

¹⁴ The Department's Witnesses stated that the bank statements indicate that all deposits were checking deposits.

¹⁵ At this point, the Owner stated that the Taxpayer only had one [1] business account for the credit card system deposits to go into.

¹⁶ The Owner said this was his mother so she obviously would have a different account.

without any allowance for the fees charged by the credit card system; and (15) the deposits for January of 2020 needs to be adjusted by removing a deposit of \$ [REDACTED].¹⁷

With respect to the assessment of sales tax, the Owner testified that: (1) he does not have bank statements for 2016 at this time; (2) he is not sure how the Tax Auditor arrived at the numbers for monthly taxable sales in 2016;¹⁸ (3) the total amount of gross receipts reflected on the Taxpayer's 2016 Schedule C was inflated but an amended return has not been filed; (4) he will provide bank statements for 2016 at a later date; (5) he does not know where some of the Tax Auditor's numbers came from and there are discrepancies; and (6) he thinks the controversy with the credit card system deposits will be resolved by the parties.

CONCLUSIONS OF LAW

Standard of Proof

Ark. Code Ann. § 26-18-313(c) (Repl. 2020) 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:

¹⁷ The Department conceded a deposit of [REDACTED] which related to the purchase of a trailer.

¹⁸ At this point, the Department's Witnesses stated that the total amount of gross receipts on the Taxpayer's 2016 Schedule C was divided by 12.

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) (Repl. 2020).

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) (Repl. 2020).

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) (Repl. 2020).

Assessments

Subject to the applicability of an exemption, a deduction, or a credit, use tax is imposed on sales of tangible personal property or taxable services made by out-of-state vendors/sellers to in-state purchasers for storage, use, or consumption in this state,¹⁹ and sales tax is imposed on sales of tangible personal

¹⁹ See Ark. Code Ann. § 26-53-101 et seq. (Repl. 2020) and see also Footnote 2.

property or taxable services made by in-state vendors/sellers to in-state purchasers.²⁰

In this case, the Taxpayer made taxable sales of tangible personal property. 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) (Repl. 2020). The Taxpayer did not produce any documentation to establish that any purchasers of taxable tangible personal property made exemption claims.

The Department has statutory authority to “[a]udit and properly determine and compute the state tax payable by any taxpayer subject to taxation under any state law”²¹ and to “employ proper and reasonable audit methods.”²² Ark. Code Ann. § 26-18-506 (Repl. 2020) requires the Taxpayer to maintain suitable records and states:

(a) It is the duty of every taxpayer required to make a return of any tax due under any state tax law to keep and preserve suitable records as are necessary to determine the amount of tax due or to prove the accuracy of any return.

...

(d) When a taxpayer fails to preserve and maintain the records required by any state tax law, the director may, in his or her discretion, make **an estimated assessment** based upon information available to him or her as to the amount of tax due by the taxpayer. **The burden of proof of refuting this estimated assessment is upon the taxpayer.** [Emphasis added].

In the absence of suitable records, the Taxpayer has the burden of refuting the Department’s estimated assessment. See Jones v. Ragland, 293 Ark. 320, 737 S.W.2d 641 (1987); Leathers v. A. & B. Dirt Movers, Inc., 311 Ark. 320, 844

²⁰ See Ark. Code Ann. § 26-52-101 et seq. (Repl. 2020).

²¹ See Ark. Code Ann. § 26-18-301(a)(2) (Repl. 2020).

²² See Ark. Code Ann. § 26-18-305(a)(2)(A) (Repl. 2020).

S.W.2d 314 (1992); Weiss v. Best Enterprises, Inc., 323 Ark. 712, 917 S.W.2d 543 (1996). The law requires that sufficient credible evidence be offered by the Taxpayer to establish that the audit results are unreasonable. In Leathers v. A & B Dirt Movers, Inc., 311 Ark. 320, 844 S.W.2d 314 (1992), the Arkansas Supreme Court discussed the absence of appropriate documentation in the context of an estimated assessment, and stated:

In short, we find Mr. Nabholz's testimony insufficient, standing alone, to meet the taxpayer's statutory burden in refuting the reasonableness of the assessment. To hold otherwise would be to permit a taxpayer to maintain scant records and after an unsatisfactory tax audit, avoid taxation by merely verbalizing his transactions unsupported by appropriate documentation made at the time of the transactions or by testimony from other parties to the transactions.

Id. at 330, 844 S.W.2d at 319.

It is undisputed that the Taxpayer made taxable sales of tangible personal property during the audit period. The Taxpayer failed to maintain sufficient records to determine the amount of tax due. Due to the lack of records, the Department's issuance of an estimated assessment using the amount of gross receipts from the Taxpayer's bank records and income tax records was a reasonable audit method.

The Taxpayer failed to establish that the audit methodology or calculations used by the Tax Auditor were unreasonable. The Taxpayer failed to present sufficient evidence to meet the burden of refuting the estimated assessment of sales tax. See Jones v. Ragland, supra; Leathers v. A. & B. Dirt Movers, Inc., supra; Weiss v. Best Enterprises, Inc., supra. Consequently, the evidence

presented supports a finding that the Department correctly assessed sales tax against the Taxpayer.

Statute of Limitations

Ark. Code Ann. § 26-18-306(e) (Repl. 2020) 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 evidence to refute the Department's proof that the Taxpayer exceeded the threshold of twenty-five percent (25%) underreported for sales tax. As a discretionary function of the Secretary's office, the action of the Secretary 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.

Interest and Penalty

Interest was properly assessed on the tax deficiency for the use of the State's tax dollars. See Ark. Code Ann. § 26-18-508 (Repl. 2020). The Taxpayer failed to maintain adequate business records and significant underreporting of tax liability was established. Consequently, a negligence penalty was properly assessed against the Taxpayer under Ark. Code Ann. § 26-18-208(4)(A) (Repl. 2020).

DECISION AND ORDER

Subject to the concessions made by the Department, the proposed assessments are sustained. The file is to be returned to the appropriate section of

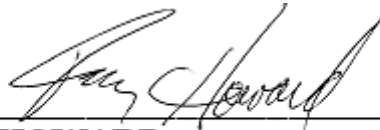
the Department for further proceedings in accordance with this Administrative Decision and applicable law.

Pursuant to Ark. Code Ann. § 26-18-405 (Repl. 2020), 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 (Repl. 2020) 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.²³

OFFICE OF HEARINGS & APPEALS



RAY HOWARD
ADMINISTRATIVE LAW JUDGE

DATED: April 29, 2021

²³ See Board of Trustees of Univ. of Arkansas v. Andrews, 2018 Ark. 12.