

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

**ADMINISTRATIVE DECISION**

**IN THE MATTER OF**

**(ACCT. NO.: ██████████)**

**DOCKET NO.: 21-310**

**INDIVIDUAL INCOME  
TAX ASSESSMENT**

**TAX YEAR 2019  
(\$ ██████████)<sup>1</sup>**

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**RAY HOWARD, ADMINISTRATIVE LAW JUDGE**

**APPEARANCES**

This case is before the Office of Hearings and Appeals upon a written protest dated November 13, 2020, and signed by ██████████, the Taxpayer. The Taxpayer protested the assessment of Individual Income Tax made by the Department of Finance and Administration (“Department”) resulting from an audit conducted by Wade Gambill, Tax Auditor – Individual Income Tax Section, for the Department of Finance and Administration (“Department”). The Audit ID Number is ██████████.

This case was submitted on written documents at the request of the Taxpayer. The Department was represented by Kevin Christian, Attorney at Law, Office of Revenue Legal Counsel. The Taxpayer represented himself. A Briefing Schedule was mailed to the parties on March 8, 2021. The Department’s Opening Brief was filed on March 12, 2021. The Taxpayer’s Response Brief was received on April 15, 2021. The Department’s Reply Brief was filed on April 21, 2021. This matter was submitted for a decision on May 10, 2021.

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<sup>1</sup> The reflected amount includes tax (\$ ██████████), penalty (\$ ██████████), and interest (\$ ██████████ as of October 6, 2020).

## ISSUE

Whether the individual income tax assessment issued by the Department against the Taxpayer should be sustained? Yes.

## FINDINGS OF FACT/ CONTENTIONS OF THE PARTIES

The Department issued a proposed assessment against the Taxpayer for Individual Income Tax for the Tax Year of 2019. The Department's Opening Brief summarized the facts and issues involved in this case and stated, in part:

██████████ ("Taxpayer") filed his 2019 Arkansas individual income tax return, reporting income in the amount of ██████████. See 2019 AR1000F, attached as **Exhibit 1**. The return listed Schedule C losses in the amount of ██████████. The return also listed adjustments on line 22 in the amount of \$ 13,328.00. The adjustments claimed on line 22 are set forth in form AR-OI (listed under--Other Income/Loss and Depreciation Differences" on the return) as "state depreciation." The AR-OI adjustments represent "state depreciation" amounts that were greater than those allowed on the corresponding line of the federal Schedule C. Taxpayer used the claimed Schedule C losses, the adjustments stated in his AR-OI form, and other adjustments to reduce his net taxable income and claimed an overpayment in the amount of \$ ██████████.

On February 5, 2020, Wade Gambill, a tax auditor for the Department, sent Taxpayer an inquiry letter requesting that he substantiate the claimed Schedule C losses. See Individual Income Tax Inquiry Letter, attached as **Exhibit 2**. The letter asked Taxpayer to:

Provide supporting documents and other proof of claim for Federal form Schedule C for 2019. This should include a statement on the business as well as documents supporting income, and expenses claimed to include depreciation schedules and mileage logs if applicable. Failure to clearly organize the material, exclude any requested information or provide proof of payments can result in the disallowance of the expense.

### **Exhibit 2.**

Taxpayer failed to provide documentation supporting entitlement to the deductions. Accordingly, on October 6, 2020, the Department issued a Summary of Findings Letter informing

Taxpayer that because he failed to substantiate the claimed business expenses, the deductions were disallowed and additional income tax was assessed as a result of the disallowance. See Summary of Findings, attached as **Exhibit 3**. A Notice of Proposed Assessment was sent on October 6, 2020, stating that Taxpayer owes a balance of \$[REDACTED] which includes \$[REDACTED] in tax, \$[REDACTED] in penalty amounts, and \$[REDACTED] in interest as of that time. See Notice of Proposed Assessment, attached as **Exhibit 4**. Additional interest continues to accrue.

Taxpayer filed a timely Protest, stating as follows:

I do not feel that the assessment is accurate. I am providing documents to help explain. I just answered the questions when I filed with Turbo Tax.

See Protest Form, attached as **Exhibit 5**.

Taxpayer's Protest also attached various documents including: what appears to be a printout of a financial summary report for a PayPal account; his federal Schedule C; printouts of what appear to be banking activity from two personal checking accounts, one apparently belonging jointly to him and his wife and the other belonging to his wife, for expenses that appear to be, at least substantially, personal in nature; and an apparent list of expenses with no corresponding details.

The documents submitted with Taxpayer's Protest did not substantiate his deductions for business expenses and the Department's assessment should be sustained.

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In the present case, the Tax Auditor requested Taxpayer to provide proof to substantiate the Schedule C expenses stated on his return. The AR-OI adjustments are related to the Schedule C losses because those adjustments represent state depreciation amounts greater than those allowed on the corresponding line of the federal Schedule C. The documents attached to Taxpayer's Protest do not satisfy Taxpayer's burden to demonstrate he is entitled to those deductions. Taxpayer has provided no proof of entitlement for any of the claimed expenses : (1) costs of goods sold; (2) office expenses; (3) supplies; (4) travel; (5) deductible meals; (6) utilities; (7) other expenses; (8) advertising; (9) vehicle expenses; (10) commissions and fees; or (11) depreciation.

To the extent that any of the claimed deductions might be reflected

in the banking activity, it is unclear for what the payments were made or how the proof of payment proves entitlement to the claimed deduction. The documents are not reliable as to prove what exactly was purchased or if something was purchased because they include no receipts, purchase orders, invoices, or proof of payments. There were also numerous items that appeared to be personal expenses that would not be deductible. The documents likewise fail to provide sufficient context or explanation as to allow the Department to determine whether any expenses were for business or personal use.

It is further notable that some of the documents appear to include contradictory information. The financial summary for the [REDACTED] PayPal account indicates sale activity while on the Schedule C Taxpayer reported no gross receipts for the entire year. Additionally, the payments appear to be made from personal checking accounts with some of the payments made from a checking account that appears to be controlled solely by Taxpayer's wife.

Because Taxpayer failed to meet his burden of proof as to demonstrate that he properly claimed business expenses on the 2019 return, the Department's assessment was proper. Interest was properly assessed against the Taxpayer in accordance with Ark. Code Ann. § 26-18-508 (Repl. 2020), and penalty amounts were assessed in accordance with Ark. Code Ann. § 26-18-208 (Repl. 2020). [P. 1 – 5].

The Taxpayer's Response Brief consisted of: (1) a typewritten statement that, "I believe I see my mistake. I did not enter in the amount of what I sold."; and (2) copies of his 2019 Schedule C with handwritten numbers on the lines of "Gross receipts,"<sup>2</sup> "Gross income," and "Net Profit of (loss)."

The Department's Reply Brief addressed the information furnished by the Taxpayer and provided, in pertinent part, as follows:

The images sent by Taxpayer fail to demonstrate that the Department's assessment was somehow improper. The assessment was based on a failure to substantiate business expenses claimed by

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<sup>2</sup> One (1) copy of the Schedule C only had a handwritten number on this line.

Taxpayer on his 2019 Individual Income Tax Return. The images and handwritten notes do not provide sufficient information to substantiate the business expenses Taxpayer claimed on his return, as discussed in the Department's opening Brief. [P. 1].

## **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:

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).

### **Income Tax Assessment**

The State of Arkansas imposes an income tax upon “the entire income of every resident, individual, trust, or estate. The tax shall be levied, collected, and paid annually upon the entire net income as defined and computed in this chapter at the following rates . . .” See Ark. Code Ann. § 26-51-201(a) (Repl. 2020). “Net income” is derived from adjusting gross income by any allowed deductions. See Ark. Code Ann. § 26-51-403 (Repl. 2020).

Tax deductions and credits, like tax exemptions, exist as a matter of legislative grace. See 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 it is entitled to the deduction or credit by bringing herself or himself clearly within the terms and conditions imposed by the statute that contains the deduction or credit. See Weiss v. American Honda Finance Corp., 360 Ark. 208, 200 S.W.3d 381 (2004).

Ark. Code Ann. § 26-51-424 (Repl. 2020) allows a deduction from income for losses incurred in a trade or business. For the purpose of computing net income, the State of Arkansas has adopted Internal Revenue Code § 162 as in effect on January 1, 2019, regarding the deduction of trade and business expenses. See Ark. Code Ann. § 26-51-423(a)(1) (Repl. 2020).

IRC § 162 (adopted by Ark. Code Ann. § 26-51-423(a)(1) (Repl. 2020)) allow deductions for ordinary and necessary expenses incurred in carrying on a trade or business. An expense is “ordinary” if it is “normal, usual, or customary” in a taxpayer’s trade or business. See Deputy v. du Pont, 308 U.S. 488, 495 (1940). An expense is “necessary” if it is “appropriate and helpful” in a taxpayer’s business, but it need not be absolutely essential. Commissioner v. Tellier, 383 U.S. 687, 689 (1966) (citing Welch v. Helvering, 290 U.S. 111, 113 (1933)). No deduction is allowed for personal, living, or family expenses. See IRC § 262(a). Whether an expense is deductible under IRC § 162 is a question of fact to be decided on the basis of all the relevant facts and circumstances. See Cloud v. Commissioner, 97 T.C. 613, 618 (1991). Whenever an expense has substantial business and personal components, allocation of that expense between the business and personal uses is necessary. William L. Heuer, Jr. v. Commissioner, 283 F.2d 865 (C.A. 5, 1960), affirming per curiam 32 T.C. 947 (1959); Clarence J. Sapp, 36 T.C. 852 (1961), affirmed per curiam 309 F.2d 143 (C.A. 5, 1962); Hal E. Roach Studios, 20 B.T.A. 917 (1930).

Ark. Code Ann. § 26-18-506(a) (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.

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”<sup>3</sup> and to “employ proper and reasonable audit methods.”<sup>4</sup> The records produced by the Taxpayer during the audit, which are contained in the case file, were inadequate to prove the accuracy of his return. A review of the records in the case file does not indicate any business purpose for the transactions.

The burden of proving entitlement to a deduction is upon the Taxpayer. A well-founded doubt exists that the Taxpayer was entitled to the deductions for business expenses claimed on his Schedule C, due to the inadequacies of the Taxpayer’s records, so the doubt must be resolved against the application of the deductions. See Ark. Code Ann. § 26-18-313(f)(2) (Repl. 2020).

Due to the inadequacy of the Taxpayer’s records, the Department’s disallowance of the claimed business expenses was justified. Consequently, the Department correctly assessed Arkansas Individual Income Tax against the Taxpayer for the Tax Year of 2019.

### **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. 2020). Penalties were properly assessed against the Taxpayer under Ark. Code Ann. § 26-18-208 (Repl. 2020).

### **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

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<sup>3</sup> See Ark. Code Ann. § 26-18-301(a)(2) (Repl. 2020).

<sup>4</sup> See Ark. Code Ann. § 26-18-305(a)(2)(A) (Repl. 2020).



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](mailto: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.<sup>5</sup>

**OFFICE OF HEARINGS & APPEALS**



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**RAY HOWARD**  
**ADMINISTRATIVE LAW JUDGE**

DATED: May 12, 2021

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<sup>5</sup> See Board of Trustees of Univ. of Arkansas v. Andrews, 2018 Ark. 12.