

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

ADMINISTRATIVE DECISION

IN THE MATTER OF [REDACTED]
[REDACTED]
(ACCT. NO.: [REDACTED])

**GROSS RECEIPTS (SALES) TAX
ASSESSMENT
AUDIT NO. [REDACTED]
LETTER ID: [REDACTED]
AUDIT PERIOD: JAN. 2014
THROUGH DEC. 2019**

DOCKET NO.: 21-336

[REDACTED]¹

TODD EVANS, ADMINISTRATIVE LAW JUDGE

APPEARANCES

This case is before the Office of Hearings and Appeals upon written protest received December 2, 2020, signed by [REDACTED], the Taxpayer. The Taxpayer protested an assessment issued by the Department of Finance and Administration (“Department”).

The hearing in this matter was held on April 22, 2021, at 2:00 p.m. in Little Rock, Arkansas.² The Department was represented by David Scott, Attorney at Law, Office of Revenue Legal Counsel (“Department’s Representative”). Present for the Department was Richard McDonald, Auditor, and Adam Hillis, Audit Supervisor. The Taxpayer was represented by [REDACTED] [REDACTED] (“Taxpayer’s Representative”).³ The Taxpayer also appeared at the administrative hearing.

ISSUE

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

² All parties appeared at the administrative hearing by telephone.

³ [REDACTED] did not present an executed power of attorney. The Taxpayer, however, requested her appearance during the prehearing teleconference and the administrative hearing.

Based on the arguments and evidence presented at this stage in the administrative process, whether the Department's assessment is correct under Arkansas law. Yes.

FACTUAL AND LEGAL CONTENTIONS OF THE PARTIES

1. Prehearing Filings

The Department's Answers to Information Request provided a summary of relevant information, stating as follows in part⁴:

[REDACTED] ("Taxpayer") is engaged in business as a [REDACTED] located in inside the city limits of [REDACTED]. [REDACTED] is listed as the owner/sole-proprietor and has operated the business for [REDACTED].

Tax Auditor Richard McDonald ("Auditor"), for the Department of Finance and Administration (the "Department"), conducted a gross receipts and compensating use tax audit on the books and records of the Taxpayer for tax periods January 1, 2014 - December 31, 2019. On June 24, 2020, the Auditor sent a letter to the Taxpayer requesting Taxpayer to make the following records available during the audit: Tax Reports>Returns, Tax Accruals, Purchase Invoices, Sales Invoices, Bank Statements, Check Registers, Journals/Ledgers, Financial Statements, Credit Card Statements, Cash Register Tapes and/or Summaries, Exemption Certificates, Fixed Asset files/Depreciation Schedules, Chart of Accounts, Organizational Chart, and Building Permits. See Letter as **Exhibit 1**.⁵

The audit began on July 14, 2020 and concluded on October 8, 2020. The requested records were not available at the time of the audit. Taxpayer had failed to maintain proper records, such as sales records, purchase invoices, etc., for the business. The only records available for review were the Taxpayer's bank statements. After a review of the bank statements, the Auditor determined that Taxpayer had underreported by 25% or more. As a result, the audit was extended back an additional three (3) years to period beginning January 1, 2014.

a. Compensating Use Tax

⁴ All exhibits support the positions for which they are cited.

⁵ This document states that the original audit period was January 1, 2017 through December 31, 2019 before it was extended to include prior years.

The Taxpayer purchased supplies for the business from local vendors and was paying sales tax on those items at the point of sale. As a result, no adjustments were made to compensating use tax.

b. Gross Receipts (Sales) Tax

The Taxpayer is registered as an annual filer. With no sales records available for review, the Taxpayer's bank statements were used to determine the amount of sales for the audit period. The Auditor compiled a schedule of the deposits for the audit period. See Schedule A as **Exhibit 2**. Credit was given for the sales tax that had been remitted to the state. The Taxpayer provided Form W-2G's for gambling winnings; however, after a review of those forms, it was determined that Taxpayer had not deposited those winnings into his bank account. Therefore, no credit was given.

At the close of the audit, the Auditor determined a sales tax liability against the Taxpayer in the amount of [REDACTED], including interest of [REDACTED]. No penalty was assessed. The Summary of Findings and Basis for Adjustment was mailed to the Taxpayer on October 8, 2020. See **Exhibit 3**. The Notice of Proposed Assessment was mailed to the Taxpayer on October 8, 2020. See **Exhibit 4**. Taxpayer protested the assessment on November 30, 2020 and requested that a hearing be set by telephone. See Protest attached as **Exhibit 5**.

In his protest the Taxpayer states that he disagrees with the assessment because his customer, [REDACTED] advised him that it was exempt from Arkansas sales tax. The Taxpayer therefore claims that [REDACTED] should be held responsible for a major portion of the sales tax due. However, the Taxpayer did not obtain a certificate of exemption, or the equivalent or information contained in a certificate of exemption, from [REDACTED]

Within his Answers to Information Request, the Department's Representative asserted that the Taxpayer generally performed taxable services and failed to maintain adequate records (resulting in an estimated assessment). He stated that the Taxpayer bore the burden of refuting the estimated assessment. He additionally stated that a seller must obtain sufficient information and maintain adequate records regarding exemption claims by customers under Arkansas Gross Receipts Tax Rule GR-79 but did not do so. He

concluded by averring that the assessment of interest was appropriate under Ark. Code Ann. § 26-18-508 (Repl. 2020).

2. Hearing Testimony

A. Auditor's Testimony

The Auditor provided testimony consistent with the rendition of facts provided within the Department's Answers to Information Request and certified the exhibits attached thereto. The Auditor further testified that he audited for sales tax and use tax compliance simultaneously. The Taxpayer is annual sales tax filer. Schedule A lists the Taxpayer's nonpersonal deposits and reported sales, and calculates net taxable deposits (considered additional taxable sales proceeds by the audit).⁶ The Auditor also calculated the percent of underreporting for each year. Each year had a different total deposit amount. Ultimately, the audit calculated unreported sales of [REDACTED]. The Auditor was unable to independently establish whether a deposit was related to the Taxpayer's personal activities or his business based on the records. The Taxpayer was allowed an

⁶ At this time in the hearing, the Taxpayer's Representative stated that she had not received the Department's Answers to Information Request or the audit paperwork and requested a continuance. The Department's Representative objected to this request as the hearing was already in progress. The Taxpayer was unsure if he received the Department's Answers to Information Request. The Department's Representative stated that he recalled sending the Answers to Information Request to the Taxpayer in the absence of a power of attorney for the Taxpayer's Representative. The Department's Representative noted that his Answers to Information Request had a contemporaneously signed certificate of service attesting to the mailing at the time of filing. Additionally, during the prehearing teleconference on April 8, 2021, the Taxpayer's Representative did not request any documentation from the Department and stated that no prehearing issues needed to be discussed with regards to documentation from the audit or the Department's filings. It was deemed that the Answers to Information Request were sent the Taxpayer based on the contemporaneous Certificate of Service and the Department's Representative's assertion to his memory of that mailing. The mailing of that document directly to the Taxpayer was warranted in the absence of an executed power of attorney. As a mailed document to the Taxpayer, the notice of that filing was sufficient. *See generally* Ark. Code Ann. § 26-18-307 (Repl. 2020). Based on the mailing of the Answers to the Taxpayer and the Taxpayer's Representative's statement that no issues were outstanding during the prehearing teleconference, the Taxpayer's Representative's continuance request was denied.

opportunity to demonstrate that any assessed deposits represented personal financial transaction and not actual sales. The Taxpayer was unable to do so. Though the Taxpayer presented evidence of gambling winnings, those winnings were not deposited into the relevant bank account. He does not know whether the Taxpayer has other bank accounts. The Taxpayer needed to provide documentation to establish if a deposit was related to personal finance and not business sales. The Taxpayer did not provide any evidence that the deposits were unrelated to his business. If some deposits were not related to the Taxpayer's business, he expected that the Taxpayer would let him know.

The Auditor noted that the cleaning of motor vehicles is a taxable service under Arkansas Gross Receipts Tax Rule GR-9.3. The assessment of interest is required on tax deficiencies by statute. The initial audit appointment letter requested evidence of any exemption claims by customers.⁷ As noted by the Taxpayer within his protest, the Auditor also verbally requested any exemption certificates and allowed the Taxpayer time to acquire the certificates during the audit before conclusion of the audit in October 2020. The Taxpayer did not provide written proof of any exemption claims by his customers.⁸ In the absence

⁷ Department's Exhibit 1 (the Audit Appointment Letter dated June 24, 2020) requested copies of the Taxpayer's tax return, tax accruals, purchase invoices, sales invoices, bank statements, check registers, journals or ledgers, financial statements, credit card statements, cash register tapes, **exemption certificates**, depreciations schedules, chart of accounts, organizational chart, and building permits.

⁸ The Taxpayer's Representative requested that the record remain open after the administrative hearing for the submission of additional evidence. The Department's Representative objected to this request stating that any documentation should have already been provided. On March 29, 2021, this Office sent a letter to the parties requesting prehearing submissions, but none were filed by the Taxpayer or his representative. Additionally, no records (except for tax returns and bank statements provided at initiation of the audit) were submitted during the audit or administrative hearing by the Taxpayer or his representative, though requested. Ark. Code Ann. § 26-52-517(g)(2)(A) (Repl. 2020) allows a Taxpayer an additional 120 days from a request by the Department to obtain additional substantiation of a customer's exemption claim. That time

of an exemption claim, the Taxpayer's services were generally taxable. Arkansas Gross Receipts Tax Rule GR-79 allows Taxpayer's ninety (90) days after a sale to acquire exemption certificates from customers.

The Auditor primarily spoke with the Taxpayer's prior representative during the audit (who held himself out as an accounting professional). If a taxpayer appoints a representative, the Auditor stated that such individuals need not have accounting experience to represent a taxpayer. The Taxpayer asked that the Auditor discuss matters with that individual during the initial meeting. The Auditor did not have a power of attorney for that individual with him during the hearing, because he did not anticipate that it would be necessary. The Auditor would have to review his files to see if an executed power of attorney was provided. He does not recall speaking with the Taxpayer after the initial meeting.

B. Audit Supervisor's Testimony

The Audit Supervisor supervised the audit. The assessment was based on estimated sales due the Taxpayer's lack of any sales records. As an estimated assessment, the Taxpayer bore the burden of refuting the assessment. He noted that taxpayers are given ninety (90) days after a sale to obtain a completed exemption certificate from a customer under Ark. Code Ann. § 26-52-517(g)(1) (Repl. 2020).

C. Taxpayer's Testimony

The Taxpayer testified that his business is a [REDACTED]. He remembered meeting with the Auditor at his business, but he only spoke with the Auditor a single time. The Taxpayer had his prior representative give the Auditor

period has expired since the Department made its request on June 24, 2020. Based on these factors the request to allow post hearing submissions was denied.

all available records. The Taxpayer gave his prior representative all sales tax returns and bank statements. He thought [REDACTED] (a customer) remitted its sales taxes directly to the Department. During their only meeting, the Auditor informed the Taxpayer that he would need exemption certificates from the Taxpayer's customers to avoid being assessed on his sales. The Taxpayer kept trying to obtain an exemption certificate from [REDACTED] but was eventually informed by that company that they were not actually exempt from sales taxes within Arkansas. [REDACTED] refused to give and never provided an exemption certificate to the Taxpayer.

D. Hearing Assertions of Taxpayer's Representative

The Taxpayer's Representative stated that she was confused with how the assessment was calculated. She noted that the Taxpayer is not a sophisticated taxpayer. The Taxpayer did perform a taxable service, but he did not know that it was taxable. She acknowledged, however, the lack of knowledge of the law is not a defense to its enforcement. The Taxpayer did not receive good advice from a tax professional. She noted that the Taxpayer did not deduct his supply purchases. The Taxpayer did not know what needed to be submitted during the audit.

E. Hearing Assertions of the Department's Representative

The Department's Representative asserted that the Department provided a prima facie case in support of the assessment. The Taxpayer performed a taxable service within the state. Since the Taxpayer failed to maintain suitable records the assessment was estimated. The Taxpayer was provided with an opportunity to breakout any deposits not related to his business but failed to do so. The

Taxpayer bore the burden of refuting the estimated assessment and failed to do so.

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

CONCLUSIONS OF FACT AND LAW

Burdens 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).

Assessment

Arkansas Gross Receipts (sales) Tax generally applies to all sales of tangible personal property and certain specifically enumerated services, unless an exemption or credit is shown to apply. Ark. Code Ann. § 26-52-301 (Repl. 2020). The cleaning of motor vehicles is a specifically enumerated service. Ark. Code Ann. § 26-52-301(3)(B)(i) (Repl. 2020). Additionally, the sale for resale exemption is not applicable to any supplies used in the performance of taxable cleaning services. Arkansas Gross Receipts Tax Rule GR-9.4(F). The services rendered by the Taxpayer are generally taxable.

Further, it is the duty of every taxpayer to make a return of any tax due under any state tax law and to preserve suitable records to determine the amount due. Ark. Code Ann. § 26-18-506(a) (Repl. 2020). A taxpayer's records may be examined by the Department at any reasonable time, and, when a taxpayer fails to maintain adequate records, the Department may make an estimated assessment based on the information that is available. Ark. Code Ann. § 26-18-506(b) and (d) (Repl. 2020). The burden is on a taxpayer to refute an estimated assessment and self-serving testimony, standing alone, is insufficient to refute an estimated assessment. Ark. Code Ann. § 26-18-506(d) (Repl. 2020); *cf. Leathers v. A. & B. Dirt Mover, Inc.*, 311 Ark. 320, 844 S.W.2d 314 (1992). Specifically, the

Arkansas Supreme Court stated as follows when analyzing an estimated assessment:

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.

Here, the Taxpayer failed to maintain adequate records of his taxable sales, requiring an estimated assessment. Utilization of bank records to otherwise determine taxable sales is a reasonable audit methodology.

Generally, the liability for collection and remittance of sales tax is upon the seller. Ark. Code Ann. § 26-52-508 (Repl. 2020). A seller, however, may be relieved of this liability if a customer makes an exemption claim and the seller obtains certain information from that customer (identifying information of the purchaser and the reason the purchaser is claiming the exemption). Ark. Code Ann. § 26-52-517(a) (Repl. 2020). 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) (Repl. 2020).

If a seller fails to obtain sufficient information from a purchaser making an exemption claim, a safe harbor is present. Ark. Code Ann. § 26-52-517(g)(2)(A) (Repl. 2020). Under that subsection, the seller is granted an additional 120 days from the date of the Department's request for substantiation to prove "by other means that the transaction was not subject to sales or use tax or to obtain in good

faith a fully completed exemption certificate from the purchaser.” *Id.* To obtain an exemption certificate in good faith, the exemption must have been available at the time in the jurisdiction where the transaction is sourced, could be applicable to the item being purchased, and must be reasonable for the purchaser’s business. Ark. Code Ann. § 26-52-517(g)(2)(B) (Repl. 2020).

The Department is authorized to promulgate rules for the enforcement of the Arkansas sales tax. Ark. Code Ann. § 26-52-105(b) (Repl. 2020). Arkansas Gross Receipts Tax Rule GR-79(E) discusses a seller’s relief from liability resulting from exemption claims, stating:

1. The following provisions apply when a purchaser claims an exemption:
 - a. The seller must obtain identifying information of the purchaser and the reason the purchaser is claiming a tax exemption at the time of the purchase;
 - b. A purchaser is not required to provide a signature to claim an exemption from tax unless a paper certificate is used;
 - c. The seller must use the standard form for claiming an exemption electronically;
 - d. The seller is required to obtain the same information for proof of the claimed exemption regardless of the medium in which the transaction occurred; and
 - e. The Department may authorize a system wherein a purchaser that is exempt from the payment of tax is issued an identification number that must be presented to the seller at the time of sale.
2. A seller that follows the exemption requirements is relieved from any tax otherwise applicable if it is determined that the purchaser improperly claimed an exemption. If it is determined that the purchaser improperly claimed an exemption, the purchaser will be liable for the nonpayment of tax, as well as any penalty and interest due on the transaction. This relief from liability does not apply to a seller who does any of the following:
 - a. Fraudulently fails to collect the tax;
 - b. Solicits a purchaser to participate in the unlawful claim of an exemption; or
 - c. Accepts an exemption certificate from a purchaser claiming an entity-based exemption, as defined in Ark. Code Ann. § 26-21-103, if:

- (1) The subject of the transaction sought to be covered by the exemption certificate is actually received by the purchaser at a location operated by the seller; and
 - (2) The multistate certificate of exemption (SSTGB Form F0003) clearly and affirmatively indicates that the claimed exemption is not available in Arkansas.
3. A seller has ninety (90) days from the date of sale to obtain a fully completed exemption certificate or information that is the equivalent of the information required by the exemption certificate. For example, if the seller cannot obtain a fully completed exemption certificate, then the seller has ninety (90) days to obtain the following information:
 - a. Name and address of the seller;
 - b. Name and address of the purchaser;
 - c. Any applicable permit or account numbers;
 - d. The nature of the purchaser's business;
 - e. Identifying information of the transaction (date, invoice, or purchase number); and
 - f. The exemption claimed.
4. If a seller has not obtained an exemption certificate or equivalent information and the Department makes a request for substantiation of the exemption, then the seller has one-hundred twenty (120) days from the date of the request to prove by other means that the transaction was not subject to sales or use tax or to obtain in good faith a fully completed exemption certificate from the purchaser.
5. The seller must maintain proper records of exempt transactions and provide them to the Department when requested.
6. Sellers may obtain indemnification agreements from their customers claiming an exemption.

Here, the only provided evidence of an exemption claim is the Taxpayer's assertion that a purchaser's employee stated that the customer was exempt from Arkansas sales tax. It does not appear that the Taxpayer obtained any detail regarding whether the customer was registered for Arkansas sales tax or what exemption was being claimed. Additionally, the Taxpayer did not possess and has not acquired any written evidence of an exemption claim. It is conceded that the relevant purchaser does not qualify for any exemption claim under Arkansas law.

As noted within *A. & B. Dirt Mover*, a taxpayer may not rebut an estimated assessment solely through self-serving testimony. The Taxpayer has not complied with the requirements of Ark. Code Ann. § 26-52-517(e) (Repl. 2020) and has not rebutted the estimated assessment by a preponderance of the evidence. Consequently, at this stage in the administrative process, the assessment is sustained.

Interest must be assessed upon any tax deficiencies for the use of the State's tax dollars. See Ark. Code Ann. § 26-18-508 (Repl. 2020). Consequently, the assessment of interest is sustained.

DECISION AND ORDER

The assessment is sustained in full. 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 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.⁹

OFFICE OF HEARINGS & APPEALS



TODD EVANS
ADMINISTRATIVE LAW JUDGE

DATED: April 23, 2021

⁹ See *Board of Trustees of Univ. of Arkansas v. Andrews*, 2018 Ark. 12.