

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

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

**GROSS RECEIPTS AND
COMPENSATING USE
TAX ASSESSMENTS
AUDIT NO.:** [REDACTED]
**AUDIT PERIOD: APRIL 1,
2016 THROUGH JULY 31,
2017**

DOCKET NOS.: 22-052

([REDACTED] – Use Tax)¹

**TODD EVANS, ADMINISTRATIVE LAW JUDGE
APPEARANCES**

This case is before the Office of Hearings and Appeals upon a written protest received May 29, 2018, from [REDACTED], on behalf of [REDACTED] the Taxpayer. The Taxpayer protested an assessment of Compensating Use Tax (“use tax”) issued by the Department of Finance and Administration (“Department”). The Department was represented by Taylor Skipper, Attorney at Law, Office of Revenue Legal Counsel (“Department’s Representative”). The Taxpayer was represented by [REDACTED] (“Taxpayer’s Representative”).

At the request of the Taxpayer, this matter was taken under consideration of written documents. A briefing schedule was established for the parties by letter dated July 28, 2021. An opening brief was filed by the Department’s Representative on July 29, 2021. The Taxpayer’s Representative filed a Response Brief on September 7, 2021. The Department’s Representative filed a Reply Brief

¹ This amount represents [REDACTED] (tax) and [REDACTED] (interest). An associated Gross Receipts Tax Assessment was not protested.

on September 30, 2021. The record was closed and this matter was submitted for a decision on October 1, 2021.

ISSUE

Whether the assessments should be sustained? Yes.

FACTS AND CONTENTIONS OF THE PARTIES

A. Opening Brief

Within her Opening Brief, the Department's Representative provided certain information regarding the assessment, stating as follows²:

[REDACTED] ("Taxpayer"), located in [REDACTED], is a [REDACTED] that offers [REDACTED] as well as [REDACTED] to its customers. Taxpayer was incorporated in the State of Arkansas in [REDACTED] and opened for business in [REDACTED].

The Audit

In September of 2017, 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 the period of April 1, 2016 to July 31, 2017 ("Audit Period").³ On July 25, 2017, Megan Summitt, Tax Auditor for the Central Audit District, mailed a letter to Taxpayer scheduling the audit appointment for September 25, 2017.⁴ Ms. Summitt met with Taxpayer's [REDACTED] on September 25, 2017 to review the requested records. At that meeting, [REDACTED] advised that Taxpayer did not have the records available for review. [REDACTED] explained that Taxpayer did not keep invoices or receipts on purchases made by the restaurant due to "lack of space." The meeting ended.

On December 15, 2017, a summons for records was sent to the Taxpayer requesting bank statements and sales receipts for the Audit Period under review.⁵ Taxpayer produced bank statements that reflected transfers between multiple accounts; however, those statements were not in the Taxpayer's name. Ms. Summitt was unable to determine what purchases had been made by the Taxpayer based on the bank statements.

² All exhibits support the positions for which they are cited.

³ The Department's Representative cited Exhibit 1 and noted that the audit could have been extended to earlier periods if the business had opened earlier.

⁴ The Department's Representative cited Exhibit 1.

⁵ The Department's Representative cited Exhibit 2.

Taxpayer also produced a federal tax return for tax year 2016, which included a Form 4562 Depreciation and Amortization Schedule (“Depreciation Schedule”). At the time of the audit, Taxpayer had not filed a tax return for tax year 2017. Per the Depreciation Schedule, Taxpayer claimed depreciation deductions on several pieces of 5-year property and non-residential real property.⁶ These deductions were listed as “Assets Placed in Service During 2016 Tax Year.” As the Depreciation Schedule was the only available record of the purchases made by Taxpayer during the Audit Period, and Taxpayer was not able to produce corresponding invoices to prove whether taxes had been paid at the time of the purchases, Ms. Summitt utilized the Depreciation Schedule to determine the compensating use tax owed for the Audit Period.⁷

Ms. Summitt determined that Taxpayer purchased several items for its business in the total taxable amount of [REDACTED] in the year 2016.⁸ Ms. Summitt calculated the use tax owed for tax year 2016 based on this figure. She then used the monthly average of the 2016 purchases to project purchase amounts for the months of January through July 2017.⁹ Based on these calculations, Ms. Summitt determined that Taxpayer had unreported taxable purchases of [REDACTED] for the Audit Period.¹⁰

The audit resulted in an assessment of sales tax for underreported sales and compensating use tax for taxable purchases. On April 26, 2018, a summary of the Department’s findings was mailed to the Taxpayer.¹¹ The Summary of Findings reflected the audit results as follows:

| Tax Type | Tax | Penalty | Interest | Total |
|-----------------|------------|----------------|-----------------|--------------|
| Gross Receipts | [REDACTED] | [REDACTED] | [REDACTED] | [REDACTED] |
| Compensating | [REDACTED] | [REDACTED] | [REDACTED] | [REDACTED] |

A Notice of Proposed Assessment was sent to Taxpayer on April 26, 2018 in the total amount of [REDACTED].¹²

The Taxpayer disagrees with the use tax assessment and has requested a hearing on documents.¹³ In its Protest, Taxpayer states, in relevant part:

⁶ The Department’s Representative noted that the Auditor listed all deductions from the Depreciation Schedule within Schedule A3.

⁷ The Department’s Representative cited Exhibit 3.

⁸ The Department’s Representative cited Exhibit 3.

⁹ The Department’s Representative cited Exhibit 3.

¹⁰ The Department’s Representative cited Exhibit 3.

¹¹ The Department’s Representative cited Exhibit 4.

¹² The Department’s Representative cited Exhibit 5.

¹³ The Department’s Representative cited Exhibit 6.

- *Schedule A3- Purchases 2016, see attached, has many LeaseHold Improvements, see Highlighted items, that should not be subjected to the Compensating Use Tax figures...*
- *Schedule A2- Projected Purchases for 2017, for each month in the amounts of [REDACTED], are unrealistic and are only based on estimates generated by the Auditor...*
- *The Auditor conducting the Audit, Megan Summitt, generally did not have enough basic Knowledge about the operations of [REDACTED] in general. She constantly keep trying to use Industry averages in coming up with Her numbers for this audit...*

The gist of the Taxpayer's protest is that the 2016 purchases should not have been subjected to the compensating use tax calculations and that the 2017 projected purchases were unrealistic. On September 21, 2018, [REDACTED] for Taxpayer, sent a letter to the Department that included additional documentation in support of the Taxpayer's protest.¹⁴ In the letter, [REDACTED] claimed that the audit was unreasonable because the purchase amounts contained in Schedule A3 were different from the actual purchase amounts. A copy of an invoice from [REDACTED] in [REDACTED] was included for the Department's consideration, which [REDACTED] claims evidences the inaccuracy of the Department's calculations based on Taxpayer's purchase of some of the items listed in Schedule A3. The Taxpayer is incorrect and will be explained more fully below.

Within her Opening Brief, the Department's Representative asserted that the Taxpayer failed to preserve adequate records, warranting the estimated assessment. She averred that the Department utilized a reasonable audit method and the Taxpayer has failed to rebut that assessment. She rejected the Taxpayer's argument that its purchases became property fixtures for the landlord, stating an exemption does not exist for purchases of tangible personal property that are later affixed to real estate. She noted that no tax was listed upon the purchase invoice provided by the Taxpayer nor did the purchase price reflect the amounts contained within the Taxpayer's depreciation schedule. She further stated that

¹⁴ The Department's Representative cited Exhibit 7.

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

B. Response Brief

Within his brief, the Taxpayer's Representative provided the following rendition of the facts¹⁵:

██ ("Taxpayer") will concede that the chronological facts in the Legal Counsel's brief are factually correct. However, the Taxpayer claims that it is not a fact as alleged by the Office of Revenue's Legal Counsel that Ms. Summitt was unable to determine what purchases had been made based on the Taxpayer's bank statements. She missed the Taxpayer produced bank statements and the effective transfers between multiple accounts. She claims those were not in the Taxpayers name although they were for the items for which she is trying to tax.

The Taxpayer disagrees with the use tax assessment and has requested a hearing on the documents. In its Protest, Taxpayer states, in relevant part:

- 1) Schedule A3- Purchases 2016, see attached, has many LeaseHold Improvements, see Highlighted items, that should not be subjected to the Compensating Use Tax figures...
- 2) Schedule A2- Projected Purchases for 2017, for each month in the amounts of ██████████, are unrealistic and are only based on estimates generated by the Auditor.
- 3) The Auditor conducting the Audit, Megan Summitt, generally did not have enough basic Knowledge about the operations of Restaurants in general. She constantly kept trying to use Industry averages in coming up with Her numbers for this audit...

The Taxpayer does argue that the Compensation Use Calculation and the Projected purchases by the Auditor are unrealistic. The Taxpayer claims that the audit was unreasonable because the purchase amounts contained in Schedule A3 were different from the actual purchase amounts. The Taxpayer furnished an invoice from ██████████ which the Taxpayer claims is evidence of the inaccuracy of the Departments calculations based on some of the items listed in Schedule A3.

¹⁵ Initially, the Taxpayer's Representative noted that the Taxpayer was only protesting the assessment of use tax.

The Taxpayer's Representative noted that Arkansas use tax applies to out of state purchases of tangible personal property that are brought into the state and when the taxpayer has ownership of that property. He asserted that a majority of the out of state purchases by the taxpayer that were brought into to Arkansas were later attached to the leasehold and became real estate fixtures that eventually became the property of the lessor. As such, he asserted those purchases are not subject to Arkansas use tax. He characterized his interpretation as expressing the true spirit of the Arkansas use tax law and reaching a fairer result.

C. Reply Brief

The Department's Representative initially dismissed the Taxpayer's assertions that they are currently compliant and unable to pay the assessed amount as being irrelevant to the assessment. She averred that utilization of the Taxpayer's depreciation schedule to complete the assessment was proper in the absence of actual records, warranting an assessment based on the best available evidence. She dismissed the provided bank statements as being incomplete and not providing the Auditor with the Taxpayer's full financial records for its business.

Addressing the newly provided [REDACTED] invoice¹⁶, the Department's Representative asserted that the invoice was not presented during the audit and, thus, could not be utilized by the auditor. She further stated that the invoice could not be considered by this Office as it was not reviewed during

¹⁶ In addition to the information provided by the Department, the invoice further states that the items were purchased from an [REDACTED] company and shipped into Arkansas for the Taxpayer's use.

the audit. She additionally noted that the purchase prices within that invoice demonstrated that, if anything, the assessment is too low. Specifically, she noted that the depreciation schedule included [REDACTED]

[REDACTED] She further noted that the provided invoice predated the audit period, indicating additional purchases prior to the assessed transactions. The audit ran from the date of incorporation. Dismissing the real estate fixture argument, the Department's Representative averred that the purchased items remained items of tangible personal property and no exemption has been established. She further dismissed the assertion that all items were purchased within the state as unproven. Finally, she stated that no "good faith rule" exists preventing the application of Arkansas tax laws.

After a general discussion of the burdens of proof in tax proceedings and a discussion of the applicable law, the parties' argument shall be addressed with a legal analysis and associated conclusions.

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).

Tax Assessments

Arkansas Compensating (Use) Tax, however, generally applies to the privilege of storing, using, distributing, or consuming tangible personal property and taxable services within the State of Arkansas that were purchased outside this state. Ark. Code Ann. § 26-53-106(a) (Supp. 2021). A purchaser is generally

liable for Arkansas Use Tax unless a seller pays the tax on the purchaser's behalf. Ark. Code. Ann. § 26-53-123 (Repl. 2020). Tangible personal property means personal property that may "be seen, weighed, measured, felt, or touched or is in any other manner perceptible to the senses." Ark. Code Ann. § 26-53-102(24)(A) (Repl. 2020).

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). Here, the Taxpayer failed to maintain records of its actual purchases, warranting an estimated assessment based on the best available evidence. 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 Department has demonstrated that the Taxpayer failed to maintain its purchase records, warranting an estimated assessment. As an estimated assessment, the Taxpayer holds the burden of rebutting that assessment.

Initially, the Taxpayer's Representative asserted that the Department should have utilized the bank records to perform the estimated assessment. The Department, however, noted that the bank records were not in the Taxpayer's name and contained multiple unknown transfers between multiple accounts. It was reasonable for the Auditor to not utilize the bank records based on the ambiguity presented within those documents.

The Taxpayer's Representative argued that the depreciated items were later affixed to real property, making the original purchases of the freestanding tangible personal property no longer taxable. No citation to any authority has been provided for this asserted exemption beyond a restatement of the principal that tax laws should be fairly and reasonably construed in line with the spirit of the tax laws. This Office has been unable to discover any such exemption from Arkansas sales or use taxes, and this Office cannot create an exemption not established under Arkansas law. Consequently, this argument is not persuasive.

To the extent that the Taxpayer's Representative is asserting that the assessed items are not tangible personal property, the 2016 assessment amount is based on the Taxpayer's depreciation schedule that included [REDACTED]

[REDACTED] As separate purchases, these items would generally represent items of tangible personal property, not real estate fixtures, at the time of purchase even if

such items may later be incorporated into real estate. Consequently, such items would be taxable as tangible personal property at the time of purchase. However, it should also be noted that this assessment is an estimation, and all the actual purchased items cannot be reviewed as a result of the Taxpayer's failure to fulfill its obligation to maintain actual tax records. If intended, this argument from the Taxpayer's Representative is also not persuasive.

The Taxpayer's Representative further asserted that assessing the depreciated value of purchases created an excessive assessment. It should be noted that the utilization of the depreciation schedule values mean that the assessed amounts were reported to the Department by the Taxpayer, making the allegation of excessive valuation unlikely and, if existing, a direct result of the Taxpayer's actions. Further, an invoice provided by the Taxpayer's Representative indicates that the reported amounts may be lower than the actual purchase prices.

To the extent that the Taxpayer's Representative alleges the utilization of the 2016 depreciation amount to estimate the 2017 purchases was improper, it must again be restated that the Taxpayer bears the burden of refuting the estimated assessment and may not do so with oral testimony standing alone. In the absence of any other purchase records, utilization of the 2016 depreciation schedule purchases was a reasonable approximation of the 2017 purchases. Consequently, this argument is likewise not persuasive.

The Taxpayer bears the burden of refuting the estimated assessment with actual documentation. The only documentation presented, however, is an invoice that, even if it could be properly considered at this time, demonstrates the

assessed depreciation amounts may be lower than actual purchase prices for the assessed items and that items were actually purchased by the Taxpayer from out of state companies for use within Arkansas without payment of any excise taxes. Neither of these findings is beneficial to the Taxpayer's case and appear to contradict some of the assertions of the Taxpayer's Representative.

The Taxpayer has not borne its burden to rebut the reasonableness of the Department's estimated assessment. Consequently, the assessment of tax is sustained.

Interest

Subject to the limitation in Ark. Code Ann. § 26-18-405(d)(1)(C) (Repl. 2020), interest must be assessed upon 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 on the tax balance is sustained after the adjustment required under Ark. Code Ann. § 26-18-405(d)(1)(C) (Repl. 2020).

DECISION AND ORDER

The assessments are sustained after the concessions agreed to by the Department and the adjustment required under Ark. Code Ann. § 26-18-405(d)(1)(C) (Repl. 2020). 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.¹⁷

DATED: October 8, 2021

OFFICE OF HEARINGS & APPEALS



TODD EVANS
ADMINISTRATIVE LAW JUDGE

¹⁷ See *Board of Trustees of Univ. of Arkansas v. Andrews*, 2018 Ark. 12.