

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

ADMINISTRATIVE DECISION

IN THE MATTER OF [REDACTED]
[REDACTED]
DOCKET NO.: 20-125

**GROSS RECEIPTS TAX
ASSESSMENT
ACCT. NO.:** [REDACTED]
**AUDIT PERIOD: FEB. 1, 2016
THROUGH FEB. 29, 2016**

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 dated July 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”).

A hearing was held in this matter on September 20, 2019, at 1:00 p.m. in Little Rock, Arkansas. The Department was represented by Nina Carter, Attorney at Law, Office of Revenue Legal Counsel (“Department’s Representative”). Also present for the Department was David Wilson, Audit Supervisor. The Taxpayer appeared at the hearing by telephone and was represented by [REDACTED], Attorney at Law (“Taxpayer’s Representative”).²

¹ This amount represents [REDACTED] (tax), [REDACTED] (failure to file penalty), and [REDACTED] (interest).

² Earlier in this matter, the Taxpayer was represented by [REDACTED], Attorney at Law. During the hearing, the Taxpayer stated on the record that he wanted the Taxpayer’s Representative to represent him during the proceeding.

ISSUE

Whether the Taxpayer purchased the relevant farm machinery and equipment. Yes.

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

Prehearing Filings

Within her Answers to Information Request, the Department's Representative provided a summary of the relevant facts providing, in pertinent part, as follows:

On February 10, 2016, [REDACTED] ("Taxpayer") purchased the following pieces of equipment from [REDACTED]:

- a. A used [REDACTED] [REDACTED] with [REDACTED] for [REDACTED];
- b. A used [REDACTED] with [REDACTED] for [REDACTED]; and
- c. A used [REDACTED] [REDACTED] with [REDACTED] for [REDACTED].

The total taxable purchases equaled [REDACTED]. See Retail Purchase Order attached as **Exhibit 1**.³ Taxpayer completed a "Commercial Farming Machinery & Equipment Sales Tax Exemption Certification" certifying that he was engaged in the production of vegetables as a commercial farming business and that the machinery/equipment purchased would be used exclusively and directly in the commercial production of food or fiber. See copy of Taxpayer's Certification attached as **Exhibit 2**.

On May 24, 2018, the Department sent an inquiry letter, and a copy of Arkansas Gross Receipts Tax Rules GR-51, to Taxpayer requesting proof to demonstrate that the equipment purchased was used for allowable purposes. Specifically, the Department requested documentation of the

³ This document states that the Taxpayer purchased the listed machinery from the seller on February 10, 2016, for [REDACTED] to be paid in four installment payments.

commercial farming venture, including “Individual Income tax returns and related schedules verifying farming activities, depreciation schedules for this machinery/equipment, or other documentation indicating direct or exclusive farm use of this machinery/equipment.” A copy of the letter is attached as **Exhibit 3**.

Taxpayer did not respond to the letter. Taxpayer did not provide any evidence to demonstrate that the machinery/equipment were used *exclusively* or *directly* in the *production of food or fiber as a commercial business*. Taxpayer did not provide any income tax returns or schedules evidencing that he was involved in the commercial production of food or fiber.

Lacking the sufficient documentation, the Department disallowed the Commercial Farming Sales Tax Exemption and issued its Summary of Findings on July 5, 2018. Copies of the cover letter and Summary of Findings sent to the Taxpayer are attached as **Exhibits 4 and 5** respectively. The Department then issued a Notice of Proposed Assessment to Taxpayer on July 6, 2018, in the amount of [REDACTED]. The assessment consists of tax in the amount of [REDACTED], a penalty of [REDACTED], and interest in the amount of [REDACTED]. See Notice of Proposed Assessment, attached as **Exhibit 6**.

...

Within her Answers to Information, 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 and penalty was appropriate under Ark. Code Ann. §§ 26-18-508 (Repl. 2012) and 26-18-208(1) (Repl. 2012), respectively. She acknowledged that any interest that has accrued between the date of the Taxpayer’s protest and the issuance of the final assessment should be waived under Ark. Code Ann. § 26-18-405(d)(1)(C) (Supp. 2017).

Within his protest, the Taxpayer detailed his disagreement with the assessment, asserting the following:

This tractor was purchased for farm use during the year worked on pond, brush hog, etc. The tractor was repossessed because of my illness. I have since got on [REDACTED] and can not work because of [REDACTED]. Thus this protest!

Within his Answers to Information Request, the Taxpayer provided his objection to the assessment, stating the following in relevant part:

I bought this tractor without down payment and never paid any money for the tractor. At that time I was ill ultimately resulting in my current condition with congestive heart failure and heart disease. I have [REDACTED] I now am [REDACTED]. The tractor was repossessed and no payment made. I contend no sale was made or consummated for a lack of consideration. No consideration, no sale, no tax due, basic contract law. Plus any exempt under state tax laws involving agriculture (brush hogging, etc.).

Hearing Testimony

A. Audit Supervisor's Testimony

The Audit Supervisor provided testimony consistent with the rendition of facts provided within the Department's Answers to Information Request. He further stated that the code provision for the farm machinery and equipment is Ark. Code Ann. § 26-52-403 and Arkansas Gross Receipts Tax Rule GR-51. He also testified that the requirements of the farm machinery and equipment exemption are stated upon the exemption claim form. As part of the assessment, the Department attempted to review the Taxpayer's income tax filings, but no returns were filed by the Taxpayer for 2015 or 2016. He averred that utilization of the machinery and equipment for brush hogging or building a pond (as listed in the Taxpayer's protest) is not directly associated with the commercial production

of food or fiber. He noted that no documentation has been provided to prove that the Taxpayer is engaged in commercial vegetable farming. The Audit Supervisor reviewed the Taxpayer's real property tax records prior to the hearing and declared that the Taxpayer only owned [REDACTED] Arkansas.

B. Taxpayer's Testimony

The Taxpayer testified that he currently resides at [REDACTED] in [REDACTED] Arkansas. He acknowledged that he attempted to purchase farm machinery and equipment in February 2016 for [REDACTED]. He intended to utilize that machinery and equipment on land that he owned [REDACTED], Arkansas. That land was plowed with the machinery and equipment and [REDACTED] acres were planted with [REDACTED] in 2016. Unfortunately, the [REDACTED] and destroyed that crop. He was attempting to attain [REDACTED] at the time of the February 2016 purchase. He [REDACTED] [REDACTED]. He did not remit any payments towards the February 2016 purchase. Eventually, the machinery and equipment were repossessed by the seller. He believes that the sale was never completed due to his lack of payment. He is now [REDACTED] and had to stop working at the farm property. He [REDACTED], which represents his total income. During cross examination, he acknowledged that he financed his February 2016 purchase with the seller and was required to remit annual installments. He reasserted, however, that no payment was ever made towards the purchase. The machinery and equipment were repossessed after one year. He also loaned out the machinery and equipment to [REDACTED]

who utilized the machinery and equipment to build a pond and brush hog their properties.

C. Hearing Assertions of Taxpayer's Representative

The Taxpayer's Representative argued that the Taxpayer met the requirements of the farm machinery and equipment exemption because he utilized the purchased items in agricultural production. Additionally, he argued that no consideration was provided for the transaction, and, thus, no taxable sale occurred.

D. Hearing Assertions of Department's Representative

The Department's Representative argued that the machinery and equipment were not directly and exclusively used in commercial farming. Specifically, she noted that brush hogging and construction of a pond represented indirect, nonexclusive uses. She further asserted that sales tax accrued on the date of the Taxpayer's purchase (which utilized financing) and that repossession was not a defense to the tax liability.

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

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).

B. 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). A sale is defined as a “transfer of either title or possession” for a valuable consideration. Ark. Code Ann. § 26-52-103(26) (Supp. 2017). “Consideration” is not defined in Chapter 52 of Title 26 to the Arkansas Code. Black’s Law Dictionary 324 (8th Ed. 2004) defines “consideration” as “something (such as an act, a forbearance, or a return promise) bargained for and received by a promisor from a promisee; that which motivates a person to do something, esp. to engage in a legal act”

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. While the Taxpayer asserted that no consideration was remitted towards the purchase, the record demonstrates the Taxpayer received possession and ownership of the machinery and equipment in exchange for his promise to remit annual payments to the seller. The Taxpayer’s promise to remit payments qualifies as consideration, and it is evident that a sale of the machinery and equipment occurred.

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 or

equipment. Consequently, the liability for payment of sales tax on the purchase of the machinery or 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) (Supp. 2017), the Department is directed to promulgate rules for the proper enforcement of the sales tax laws. Arkansas Gross Receipts Tax Rule 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.]

...

The Department has consistently interpreted Ark. Code Ann. § 26-52-403(b) (Repl. 2014) and GR-51 in a manner so that the use of machinery or equipment to mow fence rows (or perform other maintenance functions required at a farm) results in machinery or equipment failing to satisfy the "directly" test. Evidence that only proves a taxpayer uses or operates machinery or equipment on a farm does not establish entitlement to the tax exemption for farm machinery and equipment. The evidence must establish that the machinery or equipment

was used directly for the production of food or fiber. The Department's interpretation of Ark. Code Ann. § 26-52-403(b) (Repl. 2014) and GR-51 regarding the indirect uses of machinery or equipment is not clearly wrong.

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).

Even assuming (but not deciding) that the Taxpayer was engaged in the farming of ██████████ as a commercial business and that the machinery and equipment was used in that pursuit, the Taxpayer has explained that the machinery and equipment was also utilized by family members to build a pond and brush hog their properties. Such activities would not represent direct use of the machinery and equipment in the commercial production of food or fiber. It is also evident that the machinery and equipment was not exclusively utilized in the production of food or fiber. Consequently, the Department correctly denied the Taxpayer's claim of entitlement to the farm machinery and equipment exemption on the purchase.⁴

The assessment of tax is sustained.

C. Failure to File Penalty

With respect to the failure to file penalty, Ark. Code Ann. § 26-18-208(1) (Repl. 2012) provides as follows:

In the case of a taxpayer's failure to file any return required by any state tax law on or before the date prescribed determined with regard to any extension of time for filing the return, unless it is shown that the failure is due to reasonable cause and not to willful neglect, there shall be added to the amount required to be shown as tax on the return five percent (5%) of the amount of the tax if the failure is not more than one (1) month, with an additional five percent (5%) for each additional month or fraction of a month during which the failure continues, not to exceed thirty-five percent (35%) in the aggregate . . .

⁴ The remaining arguments raised by the Department's Representative as reasons for denying the Taxpayer's exemption claim shall not be addressed as they are rendered moot.

Based on the above analysis, the Taxpayer improperly made an exemption claim and did not report and remit the applicable taxes to the Department. The Taxpayer was responsible for the reporting and remitting sales tax on this transaction due to his exemption claim. Ark. Code Ann. § 26-52-517(b) (Supp. 2017). Based on the record, the assessment of the failure to file penalty is sustained.

C. Interest

Subject to the limitation in Ark. Code Ann. § 26-18-405(d)(1)(C) (Supp. 2017), 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 after the adjustment required under Ark. Code Ann. § 26-18-405(d)(1)(C) (Supp. 2017).

DECISION AND ORDER

The proposed assessment of sales tax, penalty, and interest is sustained in part. 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

A handwritten signature in blue ink, appearing to read "T. Evans", is written over a horizontal line. There is a small handwritten mark above the signature.

TODD EVANS
ADMINISTRATIVE LAW JUDGE

DATED: September 23, 2019

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