

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

ADMINISTRATIVE DECISION

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

**WITHHOLDING
TAX ASSESSMENT**

DOCKET NO.: 22-207

PERIOD: 01/01/15-12/31/17
[REDACTED]¹

**RAY HOWARD, ADMINISTRATIVE LAW JUDGE
APPEARANCES**

This case is before the Office of Hearings and Appeals upon a written protest dated April 10, 2020, and signed by [REDACTED], President, on behalf of [REDACTED] the Taxpayer. The Taxpayer protested an assessment of withholding tax resulting from an audit conducted by Stacie Kitchens (“Tax Auditor”) and Dakota Cowart (“Auditor DC”)² – Southern Audit District of the Office of Field Audit, for the Department of Finance and Administration (“Department”). The Audit ID Number is [REDACTED].

A telephone hearing³ was held in Little Rock, Arkansas, on January 11, 2020, at 11:00 a.m. The Department was represented by Taylor Skipper, Attorney at Law, Office of Revenue Legal Counsel (“Department’s Representative”). The Tax Auditor and Vanessa Smith (“Audit Supervisor”) appeared at the hearing for the Department. The Taxpayer was represented by [REDACTED], Attorney at Law, [REDACTED] (“Taxpayer’s

¹ The assessed amount includes tax ([REDACTED]) and interest ([REDACTED]).

² He no longer works for the Department.

³ All participants appeared via telephone.

Representative”). Present for the Taxpayer was [REDACTED] (“Taxpayer’s Witness”).

ISSUE

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

FINDINGS OF FACT/CONTENTIONS OF THE PARTIES

In his Opening Statement, the Taxpayer’s Representative contended that: (1) there are three [3] calculation methodology problems with the assessment; (2) the first problem, and most significant, is the audit was based upon an annual number of work hours [REDACTED]; (3) the Taxpayer has provided documentation, and will provide testimony, to establish that none of the employees worked a simple [REDACTED] hours per year (in the sample group of employees that were used to put on a spreadsheet, it was indicated that all of them had worked [REDACTED] hours in 2015 and one of them worked almost [REDACTED] hours); (4) the problem lies in that, if you take the number of hours that were worked in Arkansas and use [REDACTED] as the denominator (for the total number of hours worked in a year), the result will be skewed (when the actual hours worked exceeded [REDACTED]); (5) the second point, is that [REDACTED] was a [REDACTED] [REDACTED] and not an hourly employee (so there is no justification for apportioning his income based on the number of hours worked in Arkansas); (6) in the audit, 100% of [REDACTED] time was attributed to Arkansas in 2015 even though he worked less than 6 months in Arkansas; (7) the third point, involves the method of determining the number of hours worked in Arkansas (his best guess is that there was confusion about the number of hours worked per day

as evidenced by schedules which show that [REDACTED] worked 22 – 23 hours on some days); (8) the unknown employee designation in March of 2015 reflects that for one day the Taxpayer was assessed for 23 hours or maybe 46 hours; (9) there are some significant deficiencies on how the Department calculated the number of hours; (10) the most important point is that the Taxpayer had all of the documents the Department needed (which have been provided); and (11) it is a basic argument over the facts and calculations,⁴ there are no real legal arguments here.

The Department's Answers to Information Request summarized the facts and issues involved in this case and stated, in part:

[REDACTED]. ("Taxpayer") is a [REDACTED] based out of [REDACTED] with a customer base in [REDACTED]. On April 9, 2018, the Department of Finance and Administration (the "Department") sent Taxpayer a letter to confirm an appointment for an audit of Taxpayer's withholding tax and corporate income tax account for the period of June 1, 2015 to May 31, 2018. The Auditors engaged in multiple sit-down meetings with Taxpayer at the [REDACTED] location. The Auditors determined that Taxpayer only withheld Arkansas income tax on its Arkansas based employees. Taxpayer did not withhold Arkansas income tax on its out of state employees who worked in Arkansas, as it based income tax withholdings on the location where the employee was based. Taxpayer did not keep clear records of wages earned by each employee within the state.

To estimate the wages earned in Arkansas during the audit period by employees who are based outside of Arkansas, the Auditors utilized sales invoices for Taxpayer's job sites in Arkansas. Each sales invoice contained handwritten lists of the employees who worked at each job site and hours billed to the customer. Taxpayer used these lists to determine pay for the employees who worked at each job site. The Auditors compiled a list of the employees who were listed for each job and allocated the billed number of hours to

⁴ He stated that 2015 was picked because the issues are the same for every year in the audit period and there was no need bringing everything to the table for every employee for every year.

each employee as hours worked by that employee at that job.[Footnote 2 provided as follows, “See Schedule 2015/C as Exhibit 2, Schedule 2016/C as Exhibit 3, and Schedule 2017/C as Exhibit 4. If the Auditors were unable to determine an employee’s name, the employee was listed as “Unknown” and assumed to be based outside of Arkansas.”] The Auditors then totaled the number of hours worked in Arkansas each year for each employee and divided that total by the amount of full-time hours within a year. The resulting percentage was then applied to the gross wages for that employee to determine an estimate of the wages earned in Arkansas for each employee. Withholding wage tax owed was then assessed based on the estimate of wages earned in Arkansas.

On February 11, 2020, the Department issued a Summary of Findings to Taxpayer reflecting withholding wage tax liability of [REDACTED] and interest in the amount of [REDACTED]. No penalty was assessed due to there being no evidence of negligence or intentional disregard. On February 12, 2020, the Department erroneously issued a Notice of Proposed Assessment to the Taxpayer in the amount of [REDACTED]. [Footnote 6 provided as follows, “See Notice of Proposed Assessment and Basis for Adjustment as Exhibit 9. The Notice reflected a zero balance due to an error by Taxpayer’s payroll provider filing an incomplete withholding return. The zero balance was reversed after the discovery of the error.”] The Basis for Adjustment attached to the Notice of Proposed Assessment detailed withholding wage tax owed in the amount of [REDACTED]. Taxpayer disagrees with the Department’s assessment and filed a Protest requesting a telephone hearing. In its Protest, Taxpayer states:

This withholding wage tax audit was performed as part of a sales tax audit which has been withdrawn by the state of Arkansas. As the attached assessment shows a zero balance due, we are under the assumption that this portion has been withdrawn as well.

...

Withholding Wage Tax

The Arkansas Income Tax Withholding Act of 1965, Ark. Code Ann. § 26-51-901 *et seq.* (Repl. 2020), requires every employer making payments of wages to employees to deduct and withhold from the employees' wages an amount determined from withholding tables promulgated by the Secretary and furnished to the employer. Ark. Code Ann. § 26-51-905 (Repl. 2020). The employer must file an annual withholding return and remit the full amount required to be deducted and withheld from the wages of the employees if the

amount is less than one thousand dollars (\$1,000) per year and must file a monthly withholding return if the amount is one thousand dollars (\$1,000) or more per year. Ark. Code Ann. § 26-51-908(a) (Repl. 2020). Except in very narrow circumstances, an employer who fails to withhold or pay the required withholding wage tax is personally and individually liable for the unpaid tax. *Id.* at § 26-51-908(e) (Repl. 2020).

Taxpayer's Duty to Preserve Records

It is the duty of taxpayers to maintain adequate records reflecting their business activities, taxable transactions, and the accuracy of their reported and paid taxes.

Interest

Interest is required to be assessed upon tax deficiencies for the use of the State's tax dollars. See Ark. Code Ann. § 26-18-508 (Repl. 2020). Pursuant to Ark. Code Ann. § 26-18-508 (Repl. 2020), interest at the rate of ten percent (10%) per annum will continue to accrue until the tax is paid in full.

DISCUSSION

Taxpayer is required under the Arkansas Income Tax Withholding Act of 1965 to deduct and withhold from its employee's wages proper withholding tax for wages earned in Arkansas. Taxpayer erroneously believed that withholding tax was determined based on the employee's home location and failed to withhold tax for employees based outside of Arkansas who worked in Arkansas. The Department reviewed the Taxpayer's available documents and determined that Taxpayer did not keep clear records of the wages earned by its employees at Arkansas job sites. Because Taxpayer lacked suitable records necessary to determine the amount of tax due, the Department estimated the tax owed from the records that were available. The Department's assessment is based on the Taxpayer's own records of employees who worked in the state of Arkansas. Per Taxpayer, these records were used to determine pay for employees who worked on each job, and therefore, were the best documentation available to determine withholding tax owed.

Taxpayer has the burden of refuting the estimated assessment by offering sufficient evidence to prove that the Department's method was unreasonable. Taxpayer has failed to meet this burden. In its protest, Taxpayer claims the withholding wage tax assessed has been withdrawn. This is incorrect. As evidenced by the Basis of Adjustment and Summary of Findings, the zero balance of the

Notice of Proposed Assessment was in error. Taxpayer has not provided evidence to warrant a withdrawal of the assessment and withholding wage tax is owed.

Because Taxpayer failed to maintain adequate records, the Department estimated and assessed tax owed based on the documentation available. Taxpayer has not provided evidence to refute the Department's assessment. The assessment of interest is proper as the tax was not timely paid.

CONCLUSION

For the reasons set forth above, the Department's assessment of withholding wage tax and interest should be sustained in full. The Department reserves the right to supplement these answers upon receipt of additional information from the Taxpayers regarding the basis of the protest, and further reserves the right to refer to any other relevant laws during these proceedings. [Footnotes 1, 3, 4, 5, 7, and 8 omitted, P. 1 – 5.]

The Tax Auditor authenticated the Department's Exhibits 1 – 10 and testified that: (1) the Taxpayer provides [REDACTED]; (2) the Taxpayer is [REDACTED] [REDACTED] and provided services in Arkansas; (3) Arkansas withholding tax was assessed against the Taxpayer; (4) to her knowledge, the documents provided for review during the audit included sales invoices (with backup details showing the hours for employees), annual wages for all employees, and state withholding returns; (5) at the time of the audit, the Taxpayer was not properly withholding taxes because it was not withholding taxes for out-of-state employees (based on addresses) working in Arkansas; (6) the Taxpayer did not keep clear records of wages earned in Arkansas by out-of-state employees; (7) due to a lack records, the Department estimated the withholding tax owed by the Taxpayer by using its billing records; (8) Department Exhibit 2 reflects the raw hours calculation (shows employees, their base, regular and overtime hours worked in Arkansas, the standard hours per

year was used because that is all that was available at the time); (9) a percentage of Arkansas wages was determined; (10) [REDACTED]⁵ dated March 20, 2015, shows 12 regular hours for [REDACTED] which is reflected on page 25 of Department Exhibit 2; (11) [REDACTED] also shows 5 workers and 20 hours of overtime so 4 hours of overtime is reflected for [REDACTED] on page 25 of Department Exhibit 2; (12) Department Exhibit 5⁶ is the Apportioned Arkansas Wages Calculation for 2015 (gross wages were provided by the Taxpayer and the applied percentage came from the raw data calculation schedule to determine Arkansas annual wages then the standard deduction and personal exemption were allowed to calculate net taxable income which was divided out for a biweekly withholding adjustment); (13) the Department used [REDACTED] hours per year for the calculations and the Taxpayer did not provide any documentation to show that the employees may have worked more [REDACTED] hours; (14) [REDACTED] shows 5 workers, only 2 are listed and 1 signed, so 2 were unaccounted for (those 2 were included as “unknown”);⁷ (15) to date, to her knowledge, the Taxpayer has not provided any information regarding the identity of the unknown employees; (16) the Notice of Proposed Assessment ([REDACTED] balance) was not correct when it was issued; (17) with respect to the Taxpayer’s Answers to Information that was filed this morning, she has reviewed it the best she could and the Taxpayer has not provided any information regarding whether [REDACTED]

⁵ See Taxpayer’s Answers to Information Request – P. 43.

⁶ Department Exhibits 6 and 7 are the same type calculations for 2016 and 2017, respectively.

⁷ At a later point, the Taxpayer’s Representative contended that a former RLC Attorney, David Scott, indicated that the auditors told him that the unknown workers were labeled as such because they could not read the handwriting of the individual employees listed on the invoices. When asked about the legibility of the signatures on [REDACTED], the Taxpayer Auditor stated that she does not see any signatures that she can not make out (she could not read the one at the bottom but was able to figure out who it was).

██████████ is a salaried employee; and (18) as of right now, the Taxpayer has not provided any information or documentation that would change the Department's assessment.

Upon cross-examination, the Tax Auditor testified that: (1) it is correct that she said she does not believe anything is available to show that employees may have worked more than ██████ hours; (2) she went and helped Auditor DC one [1] week during the audit and gathered information; (3) she is not sure that she met Taxpayer's Witness; (4) she was not involved in writing up or helping compile the audit (Auditor DC was responsible for finalization of the audit); (5) Auditor DC told her that no additional information was provided; (6) she does not know if the final work papers were provided to the Taxpayer (for review) before the Notice of Proposed Assessment was sent out (but that is normal practice); (7) she has never known of Auditor DC to issue a Notice of Proposed Assessment before sending the final work papers to a taxpayer for review but she can not say that it was done; (8) page 25 of Taxpayer Exhibit 1, the third line for ████████████████████ shows 11.5 regular hours and on the same day it shows 11.5 overtime hours for a total of twenty-three [23] hours (in response to the question, "does that make any sense to you?" she stated, "I can't say that, no."); (9) there are other days where Taxpayer Exhibit 1 shows that ████████████████████ worked a total of twenty-one [21] hours (in response to the question, "he is not going to work two [2] days, back-to-back, twenty-one [21] hours total, is he?" she stated, "I wouldn't think so but . . . I have not reviewed these in detail so I do not know."); (10) about a month ago, she was brought in to handle this audit defense; (11) this data (Taxpayer Exhibit 1) was not provided until this morning; (12) she did not

get involved with asking the Taxpayer for information (she did not ask for documents that were not provided); (13) Auditor DC said that he had a hard time getting information;⁸ (14) on March 22, 2015 (Taxpayer Exhibit 1 – P. 31), 2 different unknown employees were credited for working a total of 46 hours; (15) she totaled together all of the unknown employees to arrive at the gross wages for the category “Unknown” employee (For 2015, See Taxpayer Exhibit 3); (16) the category “Unknown” employee was for all of the workers the Taxpayer did not have a name for; and (17) to her knowledge, the total hours in column D (See Taxpayer Exhibit 2) was not provided to Auditor DC or Auditor AS.⁹

The Audit Supervisor testified that: (1) with respect to Taxpayer Exhibit 2¹⁰ and the audit procedure, she believes¹¹ that Auditor DC sent his calculations

⁸ At this point, the Audit Supervisor stated that: (1) she was the supervisor of the two [2] main auditors who worked on this audit (Auditor DC and Anna Springer (“Auditor AS”)); (2) she knows what went on with this audit (she was kept in the loop); (3) the Department did not get anything from the Taxpayer to indicate how many hours the employees worked during a year; (4) the auditors requested a lot of information from the Taxpayer; (5) from what she understands, ██████████ was a salaried employee so forty [40] hours a week was used for him (nothing else was provided for him); (6) salaried employees don’t get overtime; (7) the auditors were just trying to get the hours split out for ██████████; (8) she thinks ██████████ was over the crews that worked in Arkansas; and (9) there was a lack of communication between the auditors and representatives of the Taxpayer towards the end of the audit. The Taxpayer’s Representative responded and stated that: (1) most of the audit protest is a failure to communicate; (2) the representatives of the Taxpayer did not know what information to provide and apparently the auditors did not know what questions to ask; and (3) the failure to communicate was provided with the evidence this morning.

⁹ At this point, the Taxpayer’s Witness stated that the Taxpayer had this information for all employees but it was not requested from her.

¹⁰ The Taxpayer’s Representative stated that: (1) this exhibit reflects a sample of four [4] employees in 2015; (2) the Taxpayer went through, without even discussing the total number of hours which is erroneous, and just used the hours calculated in the audit (Column C); (3) the numbers reflected in Column C are incorrect, but even using those number of hours worked in Arkansas, when it is taken into consideration the total hours worked as shown on Column D, it really skews the numbers in the audit; (4) the first employee listed on this exhibit worked ██████████ total hours in 2015 not ██████████; (5) the second employee listed on this exhibit worked ██████████ hours in 2015; (6) all of the information reflected on this exhibit was available and could have been provided had the Taxpayer known that was an issue when the audit was going on; and (7) the Taxpayer could have at least identified that issue when the audit was completed if the Taxpayer had been given the opportunity to review the audit prior to the proposed assessment.

¹¹ At this point, the Taxpayer’s Representative stated that believing is just speculating. The Audit Supervisor responded that she could look it up if she were at her office but she was not.

to the Taxpayer's Witness; (2) she has never seen the records that are attached to the Taxpayer's Answers to Information Request before today; (3) she knows for positive that Auditor AS requested by email the additional information from the Taxpayer and never received it (she made that request on July 9, 2019); and (4) the records were requested but not received.

Upon cross-examination, the Audit Supervisor testified that: (1) as a supervisor, she reviews audits before they go out; (2) the Taxpayer was sent the calculations, and at that time, they were not communicating with the auditors; (3) on page 25 of Taxpayer Exhibit 1, the more than 20 hours per day attributed to the salaried employee, [REDACTED], was based on the information the auditors were given to work with, so they used it; (4) on page 25 of Taxpayer Exhibit 1 (with respect to an hourly employee), [REDACTED] was indicated to 21 hours per day on several days, we don't know, he could have been on call, he could have been out there, he could have been on call 24 hours a day, they may have been paying him, and he may have worked 22 hours, we don't know (unless the Taxpayer would explain that to us); (5) there was not more than 24 hours attributed to [REDACTED] (they may have been paying him to travel); (6) she had been told, by Auditor DC and Auditor AS, that [REDACTED] was a salaried employee; (7) she does not understand why the auditors apportioned the hours for [REDACTED] (for work in Arkansas) because they did not have to do that for him at all; (8) the auditors gave [REDACTED] 100% to Arkansas and the reason is because he was over all of the jobs in Arkansas; (9) we did not have any way of knowing that [REDACTED] did not spend all of his time in Arkansas (we assumed that since he was over the jobs in Arkansas that he had to be in

Arkansas on those jobs); (10) when we were doing the audit, we did not have any information from the Taxpayer to know that he was not in Arkansas when he was working;¹² (11) from what she understands, the auditors were finally given the total wages for the employees who worked in Arkansas and there was a group of them that were not listed so that group was put under “Unknown” (the total for 2015, on Taxpayer Exhibit 3, is the total from those workers); (12) the auditors used all of the information that they were provided and completed the audit the best they could with what they had from the Taxpayer; (13) she did not request additional information from the Taxpayer; (14) she did not gather documents or review documents [REDACTED] but the auditors discussed their findings with her; and (15) she was not involved with requesting documents from the Taxpayer.

Upon re-direct examination, the Audit Supervisor testified that: (1) the hours attributed to employees (on Taxpayer Exhibit 1 or Department Exhibit 2), which sometimes total close to 24 hours in a day, were calculated based solely on the Taxpayer’s documents (the documents were used to bill customers and determine pay for employees); and (2) the Taxpayer had a location [REDACTED] [REDACTED] and Arkansas based employees (they had Arkansas addresses) and the Taxpayer withheld Arkansas income tax from their wages (this was verified by the auditors).

Upon re-cross-examination, the Audit Supervisor testified that: (1) the auditors calculated the assessment using the records that were provided (detail

¹² At this point, the Taxpayer’s Representative stated that: (1) when you go through this listing which the Department got from the Taxpayer, and you look at [REDACTED], you can see from the entries that he was not in Arkansas the full time; and (2) he was only there less than 6 months. The Audit Supervisor responded and said: (1) those were the hours that were shown; and (2) she doesn’t know, she can’t answer that.

sheets behind invoices that were used to bill the Taxpayer's customers); (2) the auditors also used the yearly wages that were paid to the employees; (3) information was requested from the Taxpayer and the auditors used what was provided; (4) the Department did not perform a sample audit but used the records provided by the Taxpayer (the Taxpayer's Representative argued that the auditors used those records to project that the employees worked a total of [REDACTED] hours); and (5) Auditor AS requested the records reflecting the total annual hours worked but the Taxpayer did not provide those records (the Taxpayer's Representative argued that the Department has not established that it ever requested any records that were not provided by the Taxpayer).

At this point during the hearing, to address the controversy regarding records requested and/or provided, the Taxpayer's Witness testified that: (1) she was involved with the Arkansas withholding tax audit¹³ and worked with the auditors when they were [REDACTED] to gather information; (2) the auditors never made a request for documents, when they were [REDACTED], that she did not provide; (3) nobody at the Department requested additional information from her that she did not have or that she did not provide; (4) the Taxpayer complied with every request for documentation made by the auditors; (5) she easily had accessible the total number of hours that each employee worked for each of the years in the audit period (in response to that statement, the Tax Auditor and Audit Supervisor stated that they have not seen that information); (6) once the audit was completed, she was not given an opportunity to review it or discuss issues before the issuance of the Proposed Assessment; and (7) if the auditors had

¹³ She was also involved with the sales tax audit which has now been resolved.

asked for the total number of hours worked annually for each of the employees, she would have provided it to them.

Upon cross-examination, the Taxpayer's Witness testified that: (1) [REDACTED] is the Taxpayer's President and she works with him on a daily basis; (2) she does not recall a request from the Department to the Taxpayer's Representative and [REDACTED] (dated October 8, 2021) that requested any documents pertaining to this matter that the Taxpayer wanted the Department to review; and (3) to her knowledge, no supplemental records were given to the Department after the audit was completed because the Taxpayer as not asked for anything.

Upon re-direct examination, the Taxpayer's Witness testified that: (1) when she reviewed the 2015 Arkansas "raw hours" calculation (Taxpayer Exhibit 1 and Department Exhibit 2), there were no instances when the Taxpayer paid an employee (salaried or hourly) for 21+ hours per day; (2) the Taxpayer has never paid an employee for a 21+ hour day (the employees are paid for hours worked); (3) the schedule (Taxpayer Exhibit 1 and Department Exhibit 2) is obviously misstated and unreliable based on the numbers provided for regular hours and overtime hours; (4) it is her best guess and belief that some overtime hours had already been included in the regular hours column (for example, on page 25 of Taxpayer Exhibit 1 and Department Exhibit 2, for Employee LS, the regular hours were [REDACTED] and overtime hours were [REDACTED]); (5) the total number of hours for Employee LS [REDACTED] are significantly overstated;¹⁴ (6) she calculated examples of the overstated Arkansas Wages (as reflected on Taxpayer Exhibit 2) based

¹⁴ At this point, the Taxpayer's Representative contended that it would be more accurate reflection would be to use the regular hours and not the "already included" overtime hours.

upon gross salary and the number of hours worked in Arkansas and did not even include overtime hours; and (7) no employees worked just 40 hours week.

The Taxpayer's Answers to Information Request stated, in pertinent part, as follows:

██ is located in ██████████ and performed numerous jobs in Arkansas during the audit period. The ██████████ employees included in the audit did not work fulltime in Arkansas so their wages earned had to be apportioned to Arkansas based upon the amount of time worked in Arkansas to determine the amount of Arkansas withholding tax due. The audit methodology used to calculate the Arkansas wages was flawed which resulted in an overstated amount of employee wages earned in Arkansas.

The first audit calculation error is based upon the premise that ██████████ employees work only ██████████ hours per year, which is reflected on audit Schedule C in the column titled "Standard Full Time hours per Year". The attached PDF named 2015 Arkansas Withholding Audit Raw Hours Calc reflects this audit assumption, which applies to all years of the audit. Attached is an EXCEL spreadsheet named 2015 Arkansas Audit Correction Examples, which we prepared to exemplify how erroneous the audit assumption of ██████████ hours worked annually. Four employees were used for the example to establish that the audit calculation of the employees percentage of time worked in Arkansas is significantly skewed and overestimated. Each of these hourly employees worked in excess of ██████████ hours in 2015, so the percentage of time worked in Arkansas is significantly lower than the audit estimate. Additionally, ██████████ is a salaried employee, so the hours worked in Arkansas is irrelevant in determining the percentage of ██████████ salary which was earned in Arkansas. The audit asserts that 100 percent of ██████████ wages should be apportioned to Arkansas based upon the hours he worked in 2015, even though ██████████ worked in Arkansas less than 6 months in Arkansas in 2015. ██████████ has all of the records necessary to determine for each employee the total hours worked annually and the total hours worked in Arkansas annually, and these records were available for the auditor's review.

Audit Schedule C "Raw Hours Calculation" clearly reflect a fundamental error in the number of hours worked. Several examples are highlighted in yellow on the PDF named "2015 Arkansas Withholding Audit Raw Hours Calc". The most glaring example is on PDF page 29 of the 2015 Arkansas Withholding Audit

Raw Hours Calc, which indicates that [REDACTED] worked [REDACTED] on October 11, 2015. There are also numerous other audit errors indicating that [REDACTED] worked [REDACTED] per day in 2015. This is not possible and clearly establishes an error in the audit calculation method. [REDACTED] records do not support this audit determination. The best guess is that the audit counted the overtime both the in "Regular Hours" and the "Overtime Hours" which resulted in duplication. [REDACTED] records can easily rectify this confusion.

The final audit error is based upon the audit's creation of the "Unknown Employee". [REDACTED] records clearly identify each of its employees working every job. No one has ever explained the audit "Unknown Employee". Audit Schedule C PDF 2015 Arkansas Withholding Audit Raw Hours Calc lists the Unknown Employee on pages 29 - 31. On pages 29 - 30 the Unknown Employees is shown to have worked on the [REDACTED], which is [REDACTED], on March 20, 21, 22, and 23 of 2015. It is noteworthy that this audit schedule indicated the Unknown Employee worked 23 or maybe 46 hours on March 22, 2015. Attached is a copy of the [REDACTED] [REDACTED] with backup for worked performed on March 20, 21, 22, and 23 of 2015. One can only wonder what the audit basis for the Unknown Employee is.

Accordingly, the audit should be adjusted to correct the percentage of employee wages earned in Arkansas to more accurately reflect the amount of Arkansas withholding tax due. [P. 2 - 3.]

The Taxpayer's Representative contended that: (1) this is an estimated assessment based on the Department's determination that they did not have all of the information they needed and they have to establish that; (2) the Department's Answers to Information Request stated that they did not have the documents needed; (3) the Taxpayer's counter to that is, yes we did, and we could have easily produced it, if we understood what the Department wanted to see; (4) in order for the Department to do an estimated assessment and project the figures, rather than use the Taxpayer's records, the Department has to establish that Taxpayer's record were not available or not made available; (5) since the records were available, and the Department did not ask for them or look at them, the

assessment should be set aside; (6) the Taxpayer would be willing for the Department to come back in and look at the actual figures and documents because possibly some withholding tax is due but the proposed assessment is a gross overstatement of any liability based on a premise which is baseless because the Department can not establish that the Taxpayer does not have the records; (7) Taxpayer Exhibit 2 is the perfect explanation that the Taxpayer does have the records, had the records, and could have made them available;¹⁵ (8) the Taxpayer's Witness never denied any request for records; (9) initially, the Department was contending that the problem with the unknown employees was an illegibility issue, and now today, the Department is contending that it is a numbers issue;¹⁶ (10) it should be determined that there was no basis for an estimated assessment or projection because the Department incorrectly concluded that the Taxpayer had inadequate records; (11) we are here today to show an example of the records we have got and that were available (12) the estimated assessment should be set aside as baseless; (13) there is information (and documents) relevant to the calculation of this assessment that has not been looked at or considered by the Department;¹⁷ (14) the auditors got copies of all of the invoices in order to draft the audit work papers so they had everything that he

¹⁵ The Tax Auditor stated that she has never seen the records the Taxpayer is relying on to refute the estimated assessment.

¹⁶ At this point, the Department's Representative stated that it can be both. The Tax Auditor stated that: (1) she recalled that, when she was there, several backup documents could not be read at all; (2) nothing was provided for the list of additional employees; and (3) it could have been both reasons.

¹⁷ With respect to the contention concerning the additional documents, the Department's Representative stated that: (1) she gave the Taxpayer's Representative a deadline back in October to produce those documents for the auditors to review and until today the documents were not received by the Department; and (2) the Taxpayer has been given ample opportunity to provide documents to support its position (the Department did not receive them and is moving forward).

has provided this morning;¹⁸ (15) there is no justification for an estimated (projected) audit; (16) neither the Tax Auditor nor the Audit Supervisor were directly involved with the audit progress (the most established is that the Tax Auditor went down ██████ to gather information, brought it back to Arkansas, and Auditor DC and Auditor AS took over); (17) if the Taxpayer had been given the opportunity to review the audit before issuance of the Proposed Assessment, it could have been pointed out that the ██████ hours per year worked is inaccurate and unreliable (and the unknown employees could have been identified); (18) he just found out today that the auditors knew ██████████ was a salaried employee, who only worked 5 months in Arkansas the whole year, yet the Department attributed 100% of his salary to Arkansas (and that was an erroneous assumption); and (19) the Taxpayer is requesting that it be determined that there was no justification for an estimated audit (Taxpayer did not refuse to provide pertinent records).

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.

¹⁸ In response to that contention, the Tax Auditor stated that she had never seen the excel spreadsheet that was produced by the Taxpayer until this morning. The Taxpayer's Representative said that the spreadsheet is not a document but just his work product (he put it together from the documents the tax auditors had to review).

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).

Withholding Tax Assessment

In the instant case, it was not disputed that: (1) wages paid to out-of-state residents for work performed in Arkansas are subject to Arkansas withholding taxes; and (2) the Taxpayer had jobs in Arkansas and employees (hourly and

salaried) working in Arkansas during the audit period. See Ark. Code Ann. § 26-51-901 et seq. (Repl. 2020 & Supp. 2021).

The Department contended that the “Taxpayer only withheld Arkansas income tax on its Arkansas based employees.”¹⁹ The Taxpayer’s Representative contended that the Taxpayer had hourly employees [REDACTED], who worked in Arkansas part of the year, and the Taxpayer withheld and paid Arkansas income tax on their wages. In response, the Department’s Representative stated that the burden is on the Taxpayer to provide documentation to support that contention.

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”²⁰ and to “employ proper and reasonable audit methods.”²¹ 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.

¹⁹ See Department’s Answers to Information Request – P. 1.

²⁰ See Ark. Code Ann. § 26-18-301(a)(2) (Repl. 2020).

²¹ See Ark. Code Ann. § 26-18-305(a)(2)(A) (Repl. 2020).

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 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.

The alternative audit methodology proposed by the Taxpayer, and the Taxpayer's arguments regarding the excessiveness of the assessment, are insufficient to preponderate in favor of a finding the Taxpayer has refuted the Department's assessment. A review of the audit substantiates that the estimated assessment was made utilizing the best information available to the Department. The law requires that sufficient credible evidence be offered by the Taxpayer to establish that the audit results are in error. The Taxpayer has failed to meet its burden of proof and failed to refute the reasonableness of the Department's assessment of withholding tax by a preponderance of the evidence. Ark. Code Ann. § 26-18-506(d) (Repl. 2020) and the A & B Dirt Movers case simply requires a reasonable estimation methodology, not a perfect one. Utilization of the Taxpayer's invoices was a reasonable methodology in the absence of records reflecting the total hours worked by the Taxpayer's employees in Arkansas.

The Taxpayer's Representative made several arguments regarding records that were available but not requested by the Department and also contended that (based on the availability of those unreviewed records) "the audit should be

adjusted to correct the percentage of employee wages earned in Arkansas to more accurately reflect the amount of Arkansas withholding tax due.” See Taxpayer’s Answers to Information Request – P. 3. Those issues really involve audit disputes more so than legal controversies. Similar cases in the past have focused on the authority vested in the Office of Hearings and Appeals. In a Revision Decision issued in May of 2019, the Commissioner of Revenues delineated the authority of the Office of Hearings and Appeals and held that:

The duties of a hearing officer appointed by the Department are limited to reviewing written protests and making written findings as to the applicability of a proposed assessment or denial of a claim for refund. Accordingly, it is outside the scope of the duties of the hearing officer to provide taxpayers with guidance concerning the existence of programs to request a waiver of interest or penalties.

Given the parameter of duties outlined above, it would be outside the scope of the duties of a hearing officer to determine the weight or relevance of documents not reviewed during an audit or to order a re-audit of a matter submitted for consideration based on disputes regarding the production of documents. Consequently, the Department correctly assessed withholding tax against the Taxpayer.

Interest

Subject to the limitation in Ark. Code Ann. § 26-18-405(d)(1)(C) (Repl. 2020), 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).

DECISION AND ORDER

Subject to the limitation in Ark. Code Ann. § 26-18-405(d)(1)(C) (Repl. 2020), the proposed assessment is sustained. The file is to be returned to the

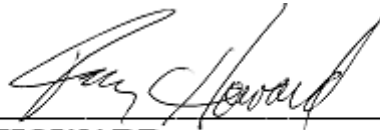
appropriate section of the Department for further proceedings in accordance with this Administrative Decision and applicable law.

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.²²

OFFICE OF HEARINGS & APPEALS



RAY HOWARD
ADMINISTRATIVE LAW JUDGE

DATED: May 5, 2022

²² See Board of Trustees of Univ. of Arkansas v. Andrews, 2018 Ark. 12.