

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

IN THE MATTER OF

(ACCT. NO.: [REDACTED])

**COMPENSATING USE &
SPECIAL EXCISE TAX
ASSESSMENTS
AUDIT NO.: [REDACTED]**

**DOCKET NOS.: 17-492
17-493**

**USE TAX ([REDACTED])¹
SPEC. EX. TAX ([REDACTED])²**

**TODD EVANS, ADMINISTRATIVE LAW JUDGE
APPEARANCES**

This case is before the Office of Hearings and Appeals upon written protest dated August 30, 2016, signed by [REDACTED] on behalf of [REDACTED] the Taxpayer. The Taxpayer protested an assessment issued by the Department of Finance and Administration ("Department"). The Audit Period is January 1, 2012, through December 31, 2014.

A hearing was held in this matter on July 19, 2017, at 1:00 p.m. in Little Rock, Arkansas. The Department was represented by John Theis, Attorney at Law, Office of Revenue Legal Counsel ("Department's Representative"). Also present for the Department was Paula Osborn, Tax Auditor, ("Auditor"), Billy Hunter, Tax Auditor, and Melissa Guin, Audit Supervisor ("Audit Supervisor"). [REDACTED] ("Taxpayer's Representative") appeared at the hearing by telephone and represented the Taxpayer. No additional individuals appeared at the administrative hearing on behalf of the Taxpayer.

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

² This balance represents [REDACTED] (tax) and [REDACTED] (interest).

The record remained open after the hearing for the submission of post-hearing filings. The Department filed its initial post-hearing brief on July 27, 2017. The Taxpayer filed its post-hearing Response Brief on September 19, 2017. The Department filed its final reply brief on September 25, 2017. The record was closed and submitted for a decision on Friday, September 26, 2017.

ISSUE

Whether the Department's Assessments in this matter are correct under Arkansas law. Yes.

FINDINGS OF FACT/CONTENTIONS OF THE PARTIES

In his first post hearing brief, the Department's Representative provided a brief summary of this matter, stating as follows:

██████████ (Taxpayer) is a corporation operating as a furniture and electronics rent-to-own company. Taxpayer operates retail outlets throughout the ██████████, including ██████████. Auditors for the Arkansas Department of Finance and Administration (DFA) recently audited Taxpayer for both sales tax and use tax compliance. These audits resulted in a use tax assessment of ██████████. This amount has been paid by Taxpayer and it is DFA's understanding that the use tax assessment is not protested by Taxpayer.

DFA also reviewed Taxpayer's compliance with Arkansas sales tax law as well as for other excise taxes levied by the State of Arkansas. This review resulted in an assessment of short-term rental tax in the total amount of ██████████. This assessment consists of tax in the amount of ██████████ and interest of ██████████. A notice of proposed assessment was issued to Taxpayer by DFA for **failure to properly collect and remit 1% short-term rental tax on leases having a rental term of less than 30 days.**

Taxpayer routinely executes documents identified as a "██████████" with its customers calling for standard rental periods of weekly, semi-monthly or monthly. Taxpayer collected and remitted sales tax on all rentals of tangible personal property during the audit period but **failed to collect and remit 1% short-term rental tax on its rentals for periods of less than 30 days.** Copies of Taxpayer's

standard [REDACTED] were included with the Answers to Information Request filed with the Office of Hearings and Appeals by both Taxpayer and DFA.

The terms of the [REDACTED] provide that Taxpayer's customer may select an initial rental term of weekly, semi-monthly, or monthly. The agreement also provides that the customer is not obligated to renew the agreement beyond the initial rental term. If the customer chooses to renew the agreement beyond the initial term, the customer may do so by making an advance payment on a weekly, semi-monthly or monthly basis. The customer may terminate the [REDACTED] at any time without penalty by surrendering or returning the rented property and paying any unpaid rents for those periods for which rent is due when the property was returned.

During the administrative hearing, the Tax Auditor testified that she performed this audit. She performed an audit of the Taxpayer's sale tax, use tax, and special excise tax reporting. The use tax portion of the assessment was not protested by the Taxpayer and was not discussed further during her testimony. Based on the [REDACTED] she explained that the Taxpayer had weekly, semimonthly, and monthly payment agreements. The audit was completed based on sample months. The Taxpayer explained that it would be difficult to provide a copy of each agreement signed by its customers. The Taxpayer, however, ultimately provided a download containing (among other information) a listing of the lease term for each customer that was deemed acceptable by the Department. The Department removed any agreements containing a month-to-month payment term as long-term leases. The remaining agreements (based on weekly and semimonthly payments) were deemed to be subject to short-term rental tax, which was not collected by the Taxpayer.

The Auditor asserted that short-term rental tax (ET-5) applies to leases of tangible personal property for less than thirty (30) days. The blank [REDACTED] [REDACTED] (revised March 4, 2014)³ was provided by the Taxpayer during the assessment. The terms of that agreement show that the transaction is a rental that may be terminated at any time. Further, the customer is not obligated to renew the agreement beyond the chosen rental term (either weekly, semimonthly, or monthly). Additionally, the agreement provides that the Taxpayer retains ownership of the property. She explained that many of the weekly and semimonthly agreements continued for periods beyond thirty (30) days. She explained that the Department interprets Arkansas law to require taxation of these transactions as a series of short-term leases. Even if the customer ultimately took ownership by completing a contract, it would not affect her decision. It is uncertain which, if any, customers opted for an early purchase option based on the provided records. However, she explained that those rental proceeds would still be taxable.

During the administrative hearing, the Taxpayer's Representative began his argument noting that the Department bears the burden of proving that a transaction is taxable. [REDACTED] are governed by Arkansas law under the [REDACTED] Act (Title 4, Chapter 92), which set forth the definition of a [REDACTED]. He asserted that definition fits the Taxpayer's transactions. He stated that the Taxpayer's transactions are not true leases but hybrid contingent sales. He acknowledged, however, the transactions are not installment or financed sales. Since it is not a true lease, he asserted that

³ See Department's Exhibit 1.

the Department's simplistic view of calling it a lease is incorrect. He stated that customers intend to ultimately purchase the item when entering into a contract.

Additionally, the Taxpayer's Representative testified that the duration of the agreements is substantially longer than thirty (30) days, making the transactions long-term and not short-term leases. Further, under Ark. Code Ann. § 26-52-103(15)(B)(ii) (Repl. 2014), that statute explains that a lease does not include transactions where the transfer of possession or control requires transfer of title after completion of required payments and payment of an option price that does not exceed \$100 or one percent (1%) of the cost of the total required payments. He argued that it cannot be a short-term rental if it is not a lease or rental in the first place. He acknowledged that the customers' agreements are terminable at the end of each rental period. He explained that, typically, customers will only end an agreement due to financial hardship but can reinstate that agreement later if they meet certain requirements. Though a customer may select a monthly payment option, a customer may choose to pay either weekly, semimonthly, or monthly at their discretion without entering a new agreement. Customers do not get a prorated refund of their rental payments if a customer returns an item early.

The Department's Representative asserted that the Taxpayer's assessed transactions should be treated as short-term rentals because the transactions have a short-term duration and are terminable at will by the customer. He argued that the transactions do not become long-term leases simply because the leases are renewed multiple times.

After a general discussion of the burdens of proof in tax proceedings, the relevant legal issue shall be addressed.

CONCLUSIONS OF LAW

Standard of Proof

Ark. Code Ann. § 26-18-313(c) (Supp. 2015) 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) (Supp. 2015). 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. 2015). 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. 2015).

Legal Analysis

Subject to the applicability of an exemption, deduction, or credit, Arkansas Compensating (use) Tax is imposed on sales of tangible personal property and taxable services made by vendors/sellers from outside the State of Arkansas to in-state purchasers for storage, use, or consumption in the State of Arkansas. See Ark. Code Ann. § 26-53-101 et seq. (Repl. 2014 & Supp. 2015). Ark. Code Ann. § 26-53-102(16)(A) (Repl. 2014) defines tangible personal property to mean “personal property that may be seen, weighed, measured, felt, or touched or is in any other manner perceptible to the senses.” Here, it appears that the Taxpayer conceded the use tax portion of this assessment; however, this portion of the assessment shall be discussed in case it remains at issue. A review of the Use Tax Schedule (Schedule B) shows that the assessed transactions involve purchases of office supplies, computers, printers, window graphics, molding, and carpet installation. Such items generally represent tangible personal property and are subject to use tax. Additionally, installation of flooring is a taxable service. Ark. Code Ann. §§ 26-52-301(3)(B)(i) (Repl. 2014) and 26-53-106 (Repl. 2014). Since these transactions are generally taxable and no exemption claim was made by the Taxpayer, the assessment of use tax is sustained.

Regarding the assessment of short-term rental tax, an additional tax of one percent (1%) is imposed on short-term rentals of tangible personal property. Ark. Code Ann. § 26-63-301(b) (Repl. 2008). Short-term rentals are defined as “a

rental or lease of tangible personal property for a period of less than thirty (30) days, except rentals or leases of motor vehicles, trailers, or farm machinery and equipment.” *Id.* at (a)(2). A “lease” is defined as follows:

- (A)(i) “Lease” or “rental” means any transfer of possession or control of tangible personal property for a fixed or indeterminate term for consideration.
- (ii) A lease or rental may include future options to purchase or extend.
- (B) “Lease” or “rental” does not include:
 - (i) A transfer of possession or control of tangible personal property under a security agreement or deferred payment plan that requires the transfer of title upon completion of the required payments;
 - (ii) A transfer of possession or control of tangible personal property under an agreement that requires the transfer of title upon completion of required payments and payment of an option price that does not exceed the greater of one hundred dollars (\$100) or one percent (1%) of the total required payments⁴; or
 - (iii)(a) Providing tangible personal property along with an operator for a fixed or indeterminate period of time.
 - (b) A condition of this exclusion in this subdivision (5)(B)(iii) is that the operator is necessary for the equipment to perform as designed.
 - (c) For the purpose of this subdivision (5)(B)(iii), an operator must do more than maintain, inspect, or set up the tangible personal property.

Ark. Code Ann. § 26-63-102(5) (Repl. 2008).

Additionally, the above definition of lease must be exclusively utilized for imposition of this tax regardless of whether any other federal, state, or local law would otherwise characterize this transaction as a lease. *Id.* at (5)(D).

The Arkansas Supreme Court has explained the necessary construction to be given to a statute, stating as follows:

⁴ During the administrative hearing, the Taxpayer’s Representative argued that this exception should apply to its transactions. In his initial post-hearing brief, the Department’s Representative noted that the Taxpayer had neither a series of “required payments” nor an option price at the conclusion of the agreement. The Taxpayer’s Representative did not raise this argument within his post-hearing filing and it is assumed that it was dropped by the Taxpayer. If this argument is still being asserted, the Department’s Representative’s analysis is persuasive and this exclusion does not apply to the Taxpayer’s transactions.

Reviewing issues of statutory interpretation, this court first construes a statute just as it reads, giving the words their ordinary and usually accepted meaning in common language. *Wal-Mart Stores, Inc. v. D.A.N. Joint Venture III, L.P.*, 374 Ark.489, 288 S.W.3d 627 (2008). **When the language of a statute is plain and unambiguous, conveying a clear and definite meaning, the court does not resort to the rules of statutory construction.** *Id.* [Emphasis supplied.] *City of Jacksonville v. City of Sherwood*, 375 Ark. 107, 114, 289 S.W.3d 90, 94-95 (2008).

The Taxpayer's Representative's objections to the Department's assessment were summarized in his post-hearing Response Brief as follows:

1. Taxpayer's [REDACTED] is not a true lease for sales tax purposes and should instead be treated as a retail sale agreement.
2. Taxpayer's [REDACTED] are not short-term rentals.

Regarding the Taxpayer's first argument, the Taxpayer's Representative argued that its agreements contain certain extraordinary customer rights (such as lifetime reinstatement and an eventual transfer of ownership) that are atypical of standard leases. Additionally, he noted that the taxpayer was deemed to be involved in a [REDACTED] franchise-tax purposes. He also noted that a prior Administrative Decision ([REDACTED]) stated that the Department has interpreted ET-5(D)⁵ to mean "leases with rental charges for a period of less than thirty (30) days, terminable at will by either party, are a series of renewed short-term leases regardless of the duration of the rentals." He utilized this statement to note that the Taxpayer's agreements are only terminable at will by the customer and, thus, its agreements do not qualify as short-term leases.

In his post hearing Reply Brief, the Department's Representative argued that [REDACTED] are deemed to be a "true lease" and not a credit

⁵ This subsection of the applicable regulation explains that, if a customer makes lease payments for periods of less than thirty (30) days, the transaction shall be deemed a short-term lease unless a taxpayer provides adequate documentation to the contrary.

or installment sale under Arkansas law, citing Ark. Code Ann. § 4-92-104 (Repl. 2011). Further, the Department's Representative also noted that the taxpayer's agreements fit the definition of a lease for purposes of the short-term rental tax under Ark. Code Ann. § 26-63-102(5) (Repl. 2008). He completed his analysis with several citations to court cases that held similar agreements should be treated as leases in various other contexts.

Initially, what qualifies as a lease for purposes of short-term rental tax is explicitly defined at Ark. Code Ann. § 26-63-102(5) (Repl. 2008), which governs that determination for this proceeding. Consequently, the parties' arguments regarding what constitutes a lease under case law in other contexts or other statutory regimes is not relevant and not persuasive. The governing statutory definition shall be utilized for determining the application of the short-term rental tax for this decision.

Though the Taxpayer's Representative cited [REDACTED] for the principle that leases must be terminable at will by either party to qualify as short-term rentals for purposes of Ark. Code Ann. § 26-63-301(b) (Repl. 2008), that decision analyzed a lease that was terminable by either party, did not address proper taxation of a lease that is only terminable at will by a single party, and was not issued to the Taxpayer. Consequently, that decision is not applicable to the matter at hand. Further, that requirement does not exist in the governing statute or regulations. Consequently, this argument is not persuasive.

Regarding the Taxpayer's second argument, the Taxpayer argued that the length of time that a customer retains possession of the items should control the determination of the intended term of the lease rather than the payment

frequency. He asserted that only [REDACTED] of the Taxpayer's transactions involve rentals of items that are returned in thirty (30) days or less.

In his post-hearing Reply Brief, the Department's Representative asserted that the term of a lease is "the period for which a customer is entitled to keep the property before the customer must either return the property or renew the agreement" ⁶ He further argued that utilizing the Taxpayer's Representative's interpretation of the law would lead to an absurd result ⁷ where the Taxpayer would have to wait until a transaction concluded to see if the item was returned within thirty (30) days before knowing if short-term rental tax applied. He noted that this approach would place the Taxpayer at the disadvantage of not being able to collect short-term rental tax from its customers during the agreement, requiring the Taxpayer to bear the tax with its own funds. He asserted that utilizing the agreements' delineated payment terms avoids this concern and creates clarity regarding the application of the tax at the creation of the transaction.

At this point in the analysis, a review of certain terms of the Taxpayer's typical agreement with its customers ⁸ is necessary before a legal conclusion regarding the applicability of the short-term rental tax can be reached. The relevant provisions from the agreement are repeated below:

⁶ See the top of page 3.

⁷ The Department's Representative correctly noted that statutory constructions which create absurd consequences are disfavored, citing *Williams v. Little Rock School District*, 347 Ark. 637, 66 S.W.3d 590 (2002).

⁸ A sample agreement was provided to the Auditor during the assessment. That document was attached as Exhibit 1 to the Department's Answers to Information Request which shall be utilized for purposes of this analysis. Though this agreement was revised on September 23, 2015, a review of the revised terms showed that the relevant provisions were not materially altered in that revision.

[REDACTED]

Here, the agreement repeatedly states that the Taxpayer retains ownership of the property during the transaction, allowing the customers to only have possession. Additionally, the agreement explains that each payment only entitles

a customer to possession of the property for the “rental term.” Additionally, each additional payment is referred to as a “renewal” of the lease. These provisions demonstrate that, in exchange for certain payments, a customer receives a transfer of possession of the Taxpayer’s items for a certain period of time, the rental term. Consequently, the transaction represents a lease for purposes of the short-term rental tax.

Further, the lease provides that, at the end of each Rental Term, a customer must either pay what is due for an additional rental term (described as a renewal) or return the item. The customer also has no obligation to continue making payments under the agreement or to ultimately complete the agreement and take ownership of an item. Based on the evidence presented, the Rental Term does represent the lease period for this agreement. It is of no moment that a customer may choose to renew the agreement for additional rental terms. A series of renewals do not alter the underlying agreement whereby the customer is only liable for each advance rental payment, may only possess the item for that rental term, and may cancel the transaction at the end of that rental term. Each advance rental payment only represents the lease of that item for that particular rental term and does not represent a payment for an installment sale. Further, the Department’s Representative’s argument that the Taxpayer’s approach (calculating the lease period based on the total length of a transaction with all renewals) leads to an absurd result is persuasive and further supports this conclusion.

The assessment of short-term rental tax is sustained on the weekly and semimonthly [REDACTED] because both represent leases of

tangible personal property for terms of less than thirty (30) days under Ark. Code Ann. § 26-63-301(b) (Repl. 2008).

Interest was properly assessed for use of the state's tax dollars. Ark. Code Ann. § 26-18-508 (Repl. 2012).

DECISION AND ORDER

The 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 (Supp. 2015), 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 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.

The Taxpayer may seek relief from the final decision of the Administrative Law Judge or the Commissioner of Revenues on a final assessment by following the procedure set forth in Ark. Code Ann. § 26-18-406 (Supp. 2015).

OFFICE OF HEARINGS & APPEALS


TODD EVANS
ADMINISTRATIVE LAW JUDGE

DATED: October 10, 2017