
DOVER DIXON HORNE PLLC
TAX ADVISORY

Michael O. Parker
425 West Capitol Ave, Ste 3700

Little Rock, AR 72201

October 20, 2009
(501) 375-9151

**TWO ARKANSAS COURT DECISIONS
EXTEND TAXPAYER RIGHTS**

Two important court decisions in recent weeks have extended the rights and remedies of taxpayers in Arkansas. The first decision involves property taxes, and the rights of taxpayers to obtain refunds for taxes paid as a result of listing errors on commercial personal property tax reports. The second decision addresses the burden of proof in state tax cases, and recognizes that for many years Arkansas courts have misapplied an important legal principle. Both decisions are notable for their positive impact on the rights of taxpayers in our state.

Avaya, Inc. v. Janet Troutman Ward, et al., Pulaski County Circuit No. 2007-009799 (June 22, 2009).¹ Arkansas law allows manufacturers to exclude raw materials, work in process and finished goods inventories destined for shipment out of state from inventories subject to personal property tax.² Manufacturers claim this exclusion by attaching a Manufacturers' Inventory Report to their Commercial Personal Property Assessment Form filed with their local county assessor by May 31 each year. The exclusion is calculated based on the percentage of goods shipped out of state in the previous year. Other businesses may be able to claim an export or "in transit" exclusion as well, although the rules are not as clear.

Unfortunately, the export exclusion is overlooked by many manufacturers. Some of the more obvious reasons for this reporting error include: (a) the fact that the exclusion is not mentioned on the official Commercial Personal Property Assessment Form published by the Arkansas Assessment Coordination Department or any instructions that accompany the Form, and (b) county assessors often fail to provide copies of the official Manufacturers' Inventory Report when mailing the Assessment Forms to manufacturers each year. So, manufacturers must be aware of the exclusion as a matter of general knowledge or past experience in order to claim the exclusion. Manufacturers with tax compliance offices outside the state are particularly prone to overlooking the exclusion.

Voluntary Payment Principle. As a general rule, taxes paid to a governmental entity cannot be recovered unless a right to refunds has been created by statute. This is referred to as

the “voluntary payment principle.” The Arkansas Tax Procedure Act has long contained a procedure for claiming refunds of most state taxes paid “through error of fact, computation or mistake of law.”³ But no similar right exists for most overpayments of local property taxes made as a result of errors on reporting forms.⁴ For this reason, property taxes that are paid voluntarily each year have not been subject to refund if errors are discovered later. Furthermore, there is no provision for paying property taxes “under protest” in the event a taxpayer is still questioning a tax bill when the due date arrives.

The Property Taxpayer Bill of Rights. In 1999 the Arkansas legislature adopted “The Property Taxpayer Bill of Rights.”⁵ The Bill as originally introduced was strongly opposed by county assessors, and was ultimately “watered down” substantially from its original form before it was adopted as Act 572 of 1999. However, one important change survived to clarify that certain types of “actual and obvious errors” would be subject to refund for up to three (3) years from the date the taxes were paid. These include “extension errors, erroneous property descriptions, classifications, or listings.”⁶

Avaya, Inc. In 2002, 2003 and 2004, Avaya’s tax consultants failed to claim the export exclusion and included Avaya’s inventories destined for shipment outside the state in the listings of inventories subject to assessment. This resulted in overpayments of property taxes on inventories in excess of \$1.2 Million for the three year period. In 2005, Avaya filed amended Reports and requested refunds of the overpayments. County officials refused to make the refunds and claimed that refunds are only available under the 1999 Act if the assessor makes an error; not if a taxpayer makes a mistake on its Commercial Personal Property Assessment Form. The County Court agreed with the County tax officials and Avaya appealed to Pulaski County Circuit Court where a trial was held in January, 2009. On June 22, 2009 an Order was entered granting Avaya a refund for two of the three years in issue, but denying the refund for the oldest year because of incomplete shipping records.

Pulaski County elected not to appeal the decision and issued a refund check to Avaya in October, 2009.

Conclusion. Although the Pulaski Circuit Court decision was not appealed to the Arkansas Supreme Court and does not become statewide precedent, we anticipate the Arkansas Assessment Coordination Department will take the Circuit Court’s interpretation of law into account in the guidance it provides to other county officials across the state. Under this interpretation, taxpayers who make listing errors in their Commercial Personal Property Assessment Forms and are overbilled taxes as a result are entitled to claim refunds for up to three years after the taxes are paid. It makes no difference if the error is made by the taxpayer or by the assessor. All that is required is that the refund is based on an extension error, erroneous property description, classification or listing.

Caution. The procedures that must be followed in claiming refunds are precise and must be followed to the letter. Also, refunds are not available to resolve disputes over valuation. Valuation issues can only be addressed by County Boards of Equalization in the assessment years, well before tax bills are issued or paid. The refund procedure established in The Property Taxpayer Bill of Rights is limited in scope but is well suited for listing errors, such as a failure to claim the export exclusion as in Avaya's case.

Richard Weiss, Director v. Bryce Co., LLC. 2009 Ark. 412 (September 17, 2009). *Bryce Co., LLC* is the first case to address a new law passed by the Arkansas General Assembly in 2009 to clarify the burden of proof in tax cases.

Background. When a taxpayer claims an exemption from tax, it is well accepted that the taxpayer has the burden of clearly establishing his right to the exemption. On the other hand, when the state levies a tax, it has the burden of clearly establishing that the tax applies to a particular person, class of property, or transaction. This is referred to as the *rule of strict construction* of tax statutes.

Unfortunately, the rule of strict construction and other legal principles involving proof of facts have not been carefully distinguished in tax opinions issued by the Arkansas Supreme Court over a number of years. As a result, the Court has stated on numerous occasions that a taxpayer has the "burden of proving" his right to an exemption "beyond a reasonable doubt" and "to doubt is to deny an exemption." On this basis, this Arkansas tax attorney among others has often advised clients that it is more difficult for taxpayers to successfully claim tax exemptions in Arkansas than in many other states.

Legislative Action. During the 2009 Regular Session of the Arkansas General Assembly, the Joint Tax Committee of the Arkansas State Chamber of Commerce and Associated Industries of Arkansas advocated a bill sponsored by Sen. Larry Teague to clarify the rule of strict construction and the burden of proof in tax cases as a matter of law.⁷ Among other things, the proposed bill provided that the standard of proof in tax cases is "clear and convincing evidence," which is a much more common standard in civil cases than "beyond a reasonable doubt." The bill also made the point that Arkansas taxpayers have been at a disadvantage when claiming an exemption, deduction or credit compared to taxpayers in other states, and the bill was intended to address this inequity. An underlying purpose of the bill was to encourage the Arkansas Supreme Court to take a closer look at the rules of construction and burden of proof in tax cases and clarify the rules that properly apply. After extended jousting with the Department of Finance and Administration, an amended version of the bill was adopted as Act 755 of 2009.⁸

Bryce Co. LLC Decision. Under Arkansas law, machinery and equipment "used directly" in producing articles of commerce and packaging materials are exempt from sales and use tax. Equipment is defined to include materials that have some degree of complexity and continuing utility. The issue in *Bryce Co. LLC* was whether "sticky back" tape used to attach a printing plate

to a printing press to produce packaging materials is exempt from tax. The trial court found that the tape meets the definition of equipment and is exempt from tax, and the Arkansas Supreme Court agreed. But most exciting to tax attorneys is the fact that the Supreme Court recognized that its prior opinions have misapplied “beyond a reasonable doubt.” The Court observed “*our later cases have apparently applied this principle more broadly than was originally intended,*” and went on to recognize that Act 755 has now clarified the burden of proof and established a “new standard of review.” The purpose behind Act 755 of 2009 has been achieved.

Conclusion. For many years, taxpayers forced to take their exemption claims through administrative appeal or to the courts have endured a mantra from revenue department attorneys that they must prove their right to the exemption “beyond a reasonable doubt.” Act 755 and the *Bryce Co. LLC* opinion should cause the Revenue Department to moderate this approach. The new Act and the *Bryce Co. LLC* decision will make it much easier for lower courts to distinguish between rules of construction and burden of proof and not hold taxpayers to unreasonable standards. The State Chamber of Commerce, Associated Industries of Arkansas, the Arkansas Legislature and the Court are all to be commended for addressing such a long-standing issue in a very constructive way.

¹Dover Dixon Horne PLLC represented Avaya, Inc. as co-counsel in this litigation.

²Ark. Code Ann. §26-26-1102, *Omega Tube and Conduit Corp. v. Maples*, 312 Ark. 489, 850 S.W.2d 317, Supp. Op. 313 Ark. 499 (1993).

³Ark. Code Ann. §26-18-507.

⁴See cases cited at Ark. Code Ann. §26-35-901.

⁵Arkansas Act No. 572, 1999 Regular Session.

⁶Ark. Code Ann. §26-28-111(c).

⁷Michael O. Parker serves as special tax counsel for ASCC/AIA and drafted the original bill.

⁸See Ark. Code Ann. §26-18-313 (Supp. 2009).

Mike Parker is co-author of the American Bar Association's annual Sales and Use Tax Desk Book, and the Council on State Taxation's (COST's) Audit Session Notebooks, is a frequent speaker on state and local tax issues, and is listed in Beset Lawyers in America - Tax. Mr. Parker is an ex-officio member of the Board of Directors of the Arkansas State Chamber of Commerce/Associated Industries of Arkansas and serves as special tax counsel for the organizations.

Any U.S. federal tax advice contained in this communication is not intended to be used and cannot be used for the purpose of (i) avoiding penalties under the Internal Revenue Code or (ii) promoting, marketing or recommending to another party any tax-related matter.

Dover Dixon Horne PLLC is a member of MERITAS Law Firms Worldwide: www.meritas.org.

