

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

ADMINISTRATIVE DECISION

IN THE MATTER OF [REDACTED]

ACCT. NO.: [REDACTED]

DOCKET NO.: 18-368

**REFUND CLAIM
DISALLOWANCE**

AUDIT NO.: [REDACTED]

07/01/15 – 07/31/15

(\$ [REDACTED])

RAY HOWARD, ADMINISTRATIVE LAW JUDGE

APPEARANCES

This case is before the Office of Hearings and Appeals upon a written protest dated March 17, 2017, signed by [REDACTED], on behalf of [REDACTED], the Taxpayer. The Taxpayer protested the denial of a refund claim resulting from an audit conducted by the Department of Finance and Administration (“Department”).

The Taxpayer requested that the matter be considered upon written documents submitted with the protest. A briefing schedule was mailed to the representatives of the parties on April 24, 2018. On June 4, 2018, the Taxpayer requested a revised briefing schedule. The Department was represented by Michelle Baker, Attorney at Law, Office of Revenue Legal Counsel. The Taxpayer was represented by and through its protest (and an attached letter). The Taxpayer did not file an Opening Brief. The Department’s Response Brief was

filed on July 16, 2018. The Taxpayer did not file a Reply Brief. This matter was submitted for a decision on August 6, 2018.

FINDINGS OF FACT/CONTENTIONS OF THE PARTIES

The Taxpayer operates a manufacturing facility in Arkansas. The letter attached to the Taxpayer's Protest Form stated that the Taxpayer "purchased equipment from [REDACTED] to move Work-in-Process material that was started in another [REDACTED] production facility and shipped to the Arkansas production site for further processing." The Taxpayer remitted tax to the Department on the purchase of the equipment (which included a [REDACTED] truck, a battery, and a charger)¹ and subsequently requested a tax refund.²

The Department's Response Brief set forth a summary of the facts involved in the case and legal contentions, including italicized language copied from the letter attached to the Taxpayer's Protest Form, and stated as follows:

The taxpayer is a manufacturing facility in [REDACTED], Arkansas. It is a subsidiary of [REDACTED], which manufactures [REDACTED]. In February 2017, the Department received a refund claim from the taxpayer for taxes paid in relation to the purchase of a [REDACTED] truck, battery, and charger from [REDACTED]. A copy of the refund claim is attached to this brief as Exhibit A.

The refund claim was assigned to auditor Chad Stratton. On February 21, 2017, Mr. Stratton contacted [REDACTED], the Controller of the [REDACTED] facility to obtain information about the purchases. He was advised that the [REDACTED] truck is used to unload [REDACTED] parts from delivery vehicles and to transport those parts between a storage area and the manufacturing line. Based upon this information, Mr. Stratton determined that the [REDACTED] truck was used prior to manufacturing and the purchase of the [REDACTED] truck and its accessories did not qualify for the exemption found in Ark. Code

¹ See Department Exhibit A – P. 4.

² See Department Exhibit A – P. 1 - 7.

Ann. § 26-52-402 (Repl. 2012 and Supp. 2017), and the taxpayer's claim for refund was denied. Copies of the auditor's Summary of Findings, as well as the subsequent Notice of Refund Claim denial, are attached to this brief as Exhibits B and C.

In March 2017, the taxpayer protested the refund claim denial. This protest has already been delivered to the Office of Hearing and Appeals. The taxpayer's protest provides the following pertinent information concerning the taxpayer, the taxpayer's processes, and the role of the fork truck in this process:

[REDACTED]

...Our largest manufacturing facility is located in [REDACTED]*

[REDACTED]

*We have four separate facilities in [REDACTED]
include a [REDACTED] plant which [REDACTED]*

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED] and part
[REDACTED] gh
[REDACTED] ty to
[REDACTED] truck

[REDACTED] due to
the marrow aisle configuration. This would cause a major disruption to floe in the
[REDACTED] room and impact the entire facility. The [REDACTED] truck is a critical piece
of equipment in our manufacturing process.

The pallets are unloaded and then moved in the narrow aisle staging area by the
[REDACTED] [sic] truck where they will be picked one part at a time and moved to
the [REDACTED] center.

In Arkansas Gross Receipts tax rules, section 55 provides for exemptions from the
tax for machinery and equipment used directly in the manufacturing process.

The purchase we made in July 2015 was a replacement to an existing [REDACTED]
truck that was worn out from years of service. GR-55 states that replacement
machinery is exempt from tax is the equipment (A) is used in production, (B)
performs an essential function in the manufacturing process, (C) is utilized "any
time from the initial stage where the raw material is first acted upon and changed
in any essential respect through the completion and packaging of the article of
commerce." (D) is not hand tools or equipment used in administrative functions,
(E) the replacement is for substantially all that is needed to perform the essential
function, and (F) performs a sperate distinct function in the manufacturing
operation. From the above detailed description of how this equipment in used in
our facility, we believe that we have provided the necessary support that
illustrates how we meet each of these requirements and satisfy the tax exemption
criteria.

...

A taxpayer's claim of entitlement to exemption must be denied unless all requirements set forth in the statute creating the exemption are met. For example, and in addition to other requirements, purchases of machinery and equipment must be used directly in manufacturing to qualify for exemption claimed by the taxpayer. To be considered used directly, the machinery and equipment must be used in actual manufacturing from the time

manufacturing begins through completion and packaging of the finished product, and is limited to machinery and equipment used in actual production during the manufacturing process. Ark. Code Ann. 26-52-402(c)(1) (Repl. 2014 & Supp. 2017).

The relevant statutes provide examples of machinery and equipment that are considered used directly in manufacturing, as well as examples of machinery and equipment that are not considered used directly in manufacturing. Examples of machinery and equipment that are not considered to be used directly in manufacturing include: **(1) machinery and equipment that handle raw, semi-finished, or finished product prior to the beginning of the manufacturing process or after the manufacturing process has ceased; [emphasis added]** (2) machinery and equipment used to store finished product; (3) hand tools; (4) machinery, equipment, and tools used in maintaining and repairing any type of machinery and equipment; **(5) transportation equipment used before manufacturing begins or after manufacturing has completed; [emphasis added]** (6) office machines and equipment not used in controlling or measuring the manufacturing process; (7) machinery and equipment used to produce replacement or repair parts used or consumed in the manufacturer's own manufacturing process; and (8) all other machinery and equipment not used directly in manufacturing as defined within the code. Ark. Code Ann. § 26-52-402(c)(2)(A)(iii) to (iv) and (C)(i) to (ix) (Repl. 2014 & Supp. 2017).

The taxpayer claims the truck it purchased qualifies for exemption as replacement machinery. As stated above, this exemption is found in Ark. Code Ann. 26-52-402(a)(2) (Repl. 2014 & Supp. 2017), and the exemption must be denied unless it is proven by a preponderance of the evidence that the following requirements have been met: **(1) the machinery or equipment being replaced must be used directly in manufacturing articles of commerce at a manufacturing facility in this state; [emphasis added]** (2) the manufacturer must replace substantially all of the machinery and equipment required to perform an essential function in the manufacturing process; and (3) the replacement machinery or equipment must either be more efficient or have a longer useful life than the machinery or equipment being replaced. Ark. Code Ann. 26-52-402(a)(2)(A) and (B) (Repl. 2014 & Supp. 2017). If the machinery handles or transports raw, semi-finished, or finished product prior to the beginning of the manufacturing process or after manufacturing has ceased, state law provides that the machinery is not considered used directly in manufacturing. Ark. Code Ann. 26-52-402(c)(2)(A)(iii) to (iv) and to (ix) (Repl. 2014 & Supp. 2017).

The taxpayer's protest makes it clear that raw or semi-finished [REDACTED] parts are shipped from its [REDACTED] plants, and are delivered to the [REDACTED] room at the [REDACTED] plant. The [REDACTED] parts are later picked to be moved to a [REDACTED] center. The purchased truck is used to replenish the [REDACTED] part [REDACTED] (i.e. to add more [REDACTED] parts to be picked and moved to the production center). The [REDACTED] parts are assembled into [REDACTED] in the [REDACTED] center. The truck is not used to move the [REDACTED] parts through the assembly process or to handle the [REDACTED] parts while assembly is taking place; instead, the truck is used to replenish [REDACTED] parts prior to the point at which assembly begins in the [REDACTED] plant. Assuming the taxpayer is arguing that its manufacturing process begins at the [REDACTED] plants, and the truck is therefore used in actual production, the argument must fail. Exemptions are to be narrowly construed **against** entitlement to the exemption. Interpreting the exemption to apply when materials delivered into this state have been first acted upon outside the state broadens the exemption rather than limiting it. . . .

In support of its protest, the taxpayer attached redacted Opinions [REDACTED] and [REDACTED] to its protest. It is important to note that, unlike the truck purchased by the taxpayer, the forklifts at issue in Opinions [REDACTED] and [REDACTED] were identified as being used in actual production. The forklift at issue in Opinion [REDACTED] was not only used to feed raw materials into a manufacturing machine, but was also used to transport the material from machine to machine on the line during processing, all of which occurred at the same in-state facility. The forklifts at issue in Opinion [REDACTED] were similarly used between the point at which manufacturing began ([REDACTED] treatment) and the point at which it ended ([REDACTED] cutting), all of which occurred at the same in-state facility. [P. 1-8, Footnotes omitted].

ISSUE

Whether the Department's denial of the Taxpayer's claim for refund should be sustained? Yes.

CONCLUSIONS OF LAW

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.

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).

The Taxpayer bears the burden of proving by a preponderance of the evidence that the claimed refund was erroneously paid and in excess of the taxes lawfully due under Ark. Code Ann. § 26-18-507 (Repl. 2012).

Refund Claim

Subject to the applicability of an exemption, deduction, or a credit, use tax is imposed on sales of tangible personal property or taxable services made by out-of-state vendors/sellers to in-state purchasers for storage, use, or consumption in this state,³ and sales tax is imposed on sales of tangible personal property or taxable services made by in-state vendors/sellers to in-state purchasers.⁴ Ark. Code Ann. §§ 26-52-103(30)(A) (Supp. 2017) and 26-53-102(25)(A) (Supp. 2017) define “tangible personal property” to mean “personal property that may be seen, weighed, measured, felt, or touched or that is in any other manner perceptible to the senses.” The items of equipment purchased by the Taxpayer⁵ were tangible personal property. Consequently, the Department satisfied its burden of proof regarding taxability.

The ultimate question is whether the case file contains sufficient evidence to establish that the items of equipment purchased by the Taxpayer⁶ were exempt from tax under the provisions of Ark. Code Ann. §§ 26-52-402 (Supp. 2017) or 26-53-114 (Repl. 2014). The provisions of Ark. Code Ann. §§ 26-52-402(a)(1) (Supp. 2017) and 26-53-114(a)(1) (Repl. 2014) provide an exemption for machinery and equipment used directly in manufacturing and purchased to expand an existing facility. See GR-55(C). The provisions of Ark. Code Ann. §§ 26-52-402(a)(2) (Supp. 2017) and 26-53-114(a)(1) (Repl. 2014) provide an exemption for machinery and equipment purchased to replace substantially all of an existing piece of machinery or equipment used directly in manufacturing and

³ See Ark. Code Ann. § 26-53-101 et seq. (Repl. 2014 & Supp. 2017).

⁴ See Ark. Code Ann. § 26-52-101 et seq. (Repl. 2014 & Supp. 2017).

⁵ See Department Exhibit A – P. 4.

⁶ See Department Exhibit A – P. 4.

necessary to perform an essential function in the manufacturing process. See GR-55(D). Ark. Code Ann. § 26-52-402(a)(3) (Supp. 2017) provides a sales tax exemption for pollution control machinery and equipment.⁷

The Taxpayer contended that component parts (of the products to be manufactured or assembled at its facility in Arkansas) are work-in-process materials that were started in another state or country “and shipped into the Arkansas production site for further processing.”⁸ The Taxpayer did not cite any legal authority in support of its proposed interpretation of Ark. Code Ann. §§ 26-52-402 (Supp. 2017) or 26-53-114 (Repl. 2014). The Taxpayer’s argument, regarding work-in-process, is not persuasive.

The provisions of Ark. Code Ann. §§ 26-52-402(c)(2)(A)(iii) (Supp. 2017) and 26-53-114(c)(3)(A)(iii) (Repl. 2014) are controlling authority in this case and state that, “[m]achinery and equipment which handle raw, semifinished, or finished materials or property before the manufacturing process begins are not used directly in the manufacturing process.” A preponderance of the evidence does not support a finding that the items of equipment purchased by the Taxpayer⁹ were used directly in manufacturing under the provisions of Ark. Code Ann. §§ 26-52-402 (Supp. 2017) or 26-53-114 (Repl. 2014). Consequently, the Department correctly denied the Taxpayer’s refund claim.

DECISION AND ORDER

The refund claim denial is sustained. The file is to be returned to the appropriate section of the Department for further proceedings in accordance with

⁷ The use tax exemption for pollution control machinery and equipment is codified at Ark. Code Ann. § 26-53-114(a)(3) (Repl. 2014).

⁸ See Page 1 of the letter attached to the Taxpayer’s Protest Form.

⁹ See Department Exhibit A – P. 4.

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 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 (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.¹⁰

OFFICE OF HEARINGS & APPEALS



RAY HOWARD
ADMINISTRATIVE LAW JUDGE

DATED: August 9, 2018

¹⁰ See Board of Trustees of Univ. of Arkansas v. Andrews, 2018 Ark. 12.