

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

ADMINISTRATIVE DECISION

IN THE MATTER OF [REDACTED]
[REDACTED]
AS ASSIGNEE OF [REDACTED]
AND [REDACTED]

**REFUND CLAIM
DISALLOWANCE
(Sales and Use Tax)
ACCT. NO.:** [REDACTED]

DOCKET NO.: 16-290

(\$ [REDACTED])

RAY HOWARD, ADMINISTRATIVE LAW JUDGE

APPEARANCES

This case is before the Office of Hearings and Appeals upon a written protest dated November 1, 2015, signed by [REDACTED] - Tax Consultant ([REDACTED]) on behalf of [REDACTED] as assignee of [REDACTED] the Taxpayer. The Taxpayer protested the denial of a refund claim resulting from an audit conducted by Zanilla Young, Tax Auditor – Northeast Audit District, for the Department of Finance and Administration (“Department”). The Audit Number is [REDACTED].

An administrative hearing was held on March 16, 2016, at 2:00 p.m., in Jonesboro, Arkansas. The Department was represented by Tim Howell, Attorney at Law, Office of Revenue Legal Counsel. The Tax Auditor and Adam Hillis, Audit Supervisor, appeared for the Department. The Taxpayer was represented by [REDACTED] - Tax Consultant.

FINDINGS OF FACT/CONTENTIONS OF THE PARTIES

The Taxpayer provides utility services to residents of [REDACTED] Arkansas. The utility services provided by the Taxpayer include electricity, water, sewage, and solid waste removal. The Taxpayer claimed that it paid tax in error to vendors, [REDACTED] on certain items of tangible personal property used for wastewater treatment and the processing of drinking water.

Subject to the applicability of an exemption, deduction, or credit, use tax is imposed on sales of tangible personal property made by out-of-state vendors/sellers to in-state purchasers for storage, use, or consumption in this state,¹ and sales tax is imposed on sales of tangible personal property made by in-state vendors/sellers to in-state purchasers.² The items the Taxpayer contends were exempt from tax are set forth below with the arguments presented by the Taxpayer, the arguments presented by the Department, and a legal analysis.

ISSUE

Whether the Department's denial of the Taxpayer's claim for refund, with respect to the issues/items addressed at the hearing, should be sustained? Yes, in part.

CONCLUSIONS OF LAW

Standard of Proof

Ark. Code Ann. § 26-18-313 (Supp. 2015) provides, in pertinent part, as follows:

¹ See Ark. Code Ann. § 26-53-101 et seq. (Repl. 2014 & Supp. 2015).

² See Ark. Code Ann. § 26-52-101 et seq. (Repl. 2014 & Supp. 2015).

(a) When the state seeks to impose a tax under the terms of a state tax law, then the statute imposing the tax shall be strictly construed in limitation of the imposition of the tax.

(b) When a taxpayer claims to be entitled to a tax exemption, deduction, or credit under the terms of a state tax law, then the statute providing the tax exemption, deduction, or credit shall be strictly construed in limitation of the exemption, deduction, or credit.

(c) 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**.

(d) When the meaning of a state tax law is in controversy, the burden of establishing the proper construction of the statute shall be on the party claiming application of the tax or benefit of the tax exemption, deduction, or credit.

(e) Words used in statutes imposing a tax and in statutes providing for a tax exemption, deduction, or credit shall be given their plain and ordinary meaning, not their narrowest possible meaning.

(f)(1) Statutes imposing a tax and statutes providing a tax exemption, deduction, or credit shall be fairly and reasonably construed, taking into consideration the purpose and spirit of the tax, exemption, deduction, or credit and the public policy at the time the statute was passed.

(2) If after taking this section and other applicable rules of statutory construction into account, a well-founded doubt exists with respect to the meaning of a statute imposing a tax or providing a tax exemption, deduction, or credit, the rule of strict construction shall require that the doubt be resolved against the tax, exemption, deduction, or credit. [Emphasis added].

A preponderance of the evidence means the greater weight of the evidence.

See 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 that:

[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.

Ark. Code Ann. § 26-18-507 (Repl. 2012) provides for a refund of any state taxes erroneously paid in excess of the taxes lawfully due. 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.

Authority

Arkansas Gross Receipts Tax Rule GR-66 (“GR-66”) addresses the tax exemption for pollution control machinery and states, in pertinent part, as follows:

E. WASTEWATER TREATMENT PLANTS.

1. Machinery and equipment used in a city or county wastewater treatment plant are exempt if the machinery and equipment is used to remove contaminants from wastewater. The treatment process begins when solids are first removed from the wastewater and ends when all solids and other contaminants are removed from wastewater.

2. The water treatment process does not include:

a. Collecting wastewater from locations outside of the treatment plant and delivering wastewater to the treatment plant; or

b. Disposing of solids or other contaminants removed from wastewater.

3. The following items are examples of exempt machinery and equipment provided that the machinery and equipment is used during the water treatment process as described in GR-66(E)(1) above:

Examples: pipes, pumps, valves, screens, screen baskets, gates, blowers, fans, skimmers, aerators, diffusers, equalization basins, concrete flumes, conveyor belts, flow meters, grit separators, grit removal equipment, back flow preventers, chlorination equipment, digester equipment, vacuators, and air eductors.

4. The following items are examples of taxable items: materials used in constructing improvements to real estate, housing for machinery, handrails, ladders, paint, lighting equipment, pump stations, lift stations, pipes and equipment utilized in sewage collection outside of the treatment area, machinery and equipment

which control the flow of wastewater into the treatment facility, sludge de-watering equipment, machinery and equipment used for measuring, controlling, or testing the treatment process, sludge pumping equipment, and sludge application system.

With respect to computer hardware and software, Arkansas Gross Receipts Tax Rule GR-25 (“GR-25) states, in part:

- A. Sales tax is levied on the gross receipts or gross proceeds received from sales of computer hardware, computer software, and the service of repairing or maintaining computer equipment or hardware in any form. Software that is delivered electronically or by load and leave is not taxable.

Refund Claim

PH Sensors for Testing Wastewater. The Taxpayer purchased two (2) ph sensors for testing wastewater during the treatment process. The Taxpayer’s representative argued that the sensors should be exempt from tax as pollution control equipment used indirectly by the Taxpayer during the treatment process under GR-66(A). The Department’s representative contended that the sensors are subject to tax pursuant to GR-66(E)(4).

Machinery and equipment used for testing the wastewater treatment process are specifically identified as taxable items in GR-66(E)(4). Consequently, the Department correctly denied the Taxpayer’s refund request relating to the purchase of the ph sensors.

Testing Equipment Used in the Processing of Potable Water. The Taxpayer purchased some items of equipment used for testing water during the process of converting non-consumable water into consumable water. The Taxpayer’s representative contended that the items were exempt testing equipment under GR-55(I) which states, in part that, “[t]esting equipment that is

used to measure the quality of the manufactured article of commerce and otherwise meets the requirements for exemption as manufacturing machinery and equipment is exempt from tax.”

In Larry Walther v. Carrothers Construction Company of Arkansas, LLC, 2016 Ark. 209, the Arkansas Supreme Court held that the treating and cleaning of water to generate potable water is not manufacturing for the purposes of Ark. Code Ann. § 26-52-402 (Supp. 2015). The Taxpayer failed to prove that the pertinent testing equipment was exempt from tax. Consequently, the Department correctly denied the Taxpayer’s refund request relating to the purchase of the testing equipment used in the processing of potable water.

Computer Hardware and Software. An invoice from a vendor reflects that the Taxpayer purchased a computer server and software updates / support. The computer server is taxable as computer hardware under GR-25(A).

With respect to the pertinent software, the Tax Auditor stated that a representative of the vendor informed her that a disc was provided to the Taxpayer. The Taxpayer’s representative contended that the software was not delivered to the Taxpayer through a tangible medium. The City Treasurer of [REDACTED] reviewed the invoice relating to the software and his email stated that, “[t]his is a renewal to our software, the upgrades are downloaded from the internet.” The greater weight of evidence presented regarding the relevant software preponderates in favor of a finding that the software was not subject to tax under GR-25(A). Consequently, the Department incorrectly denied the Taxpayer’s refund request relating to the purchase of computer software support and upgrades.

DECISION AND ORDER

The refund claim denial is sustained, in part. The file is to be returned to the appropriate section of the Department for further proceedings in accordance with this Administrative Decision and applicable law. Pursuant to Ark. Code Ann. § 26-18-405 (Supp. 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 - Policy & Legal, P.O. Box 1272, Rm. 2440, Little Rock, Arkansas 72203. 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 notice of a denial of a claim for refund by following the procedure set forth in Ark. Code Ann. § 26-18-406 (Supp. 2015).

OFFICE OF HEARINGS & APPEALS



RAY HOWARD
ADMINISTRATIVE LAW JUDGE

DATED: May 23, 2016