

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

**ADMINISTRATIVE DECISION**

**IN THE MATTER OF**

**ACCT. NO.:** [REDACTED]

**DOCKET NOS.: 16-498**

**16-499**

**GROSS RECEIPTS TAX  
AND COMPENSATING  
USE TAX ASSESSMENTS**

**AUDIT NO.:** [REDACTED]

(\$ [REDACTED] – Sales Tax)

(\$ [REDACTED] – Use Tax)<sup>1</sup>

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**RAY HOWARD, ADMINISTRATIVE LAW JUDGE**

**APPEARANCES**

This case is before the Office of Hearings and Appeals upon a written protest dated February 24, 2016, signed by [REDACTED], Executive Vice-President, on behalf of [REDACTED] (“Taxpayer”). The Taxpayer protested assessments of Gross Receipts Tax (“sales tax”) and Compensating Use Tax (“use tax”) resulting from an audit conducted by Megan Summitt, Tax Auditor – Central Audit District of the Office of Field Audit, for the Department of Finance and Administration (“Department”).

A telephone hearing was held on July 11, 2016, at 10:00 a.m., in Little Rock, Arkansas. The Department was represented by Lisa Ables, Attorney at Law, Office of Revenue Legal Counsel. The Tax Auditor and Robin Moody, Audit Supervisor, appeared for the Department. [REDACTED] and [REDACTED], Attorneys at Law ([REDACTED]), appeared at

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<sup>1</sup> The Taxpayer did not contest the use tax assessment.

the hearing, via telephone, and represented the Taxpayer. [REDACTED] appeared for the Taxpayer, via telephone.

### **ISSUE**

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

### **FINDINGS OF FACT/CONTENTIONS OF THE PARTIES**

The Department's responses to the Answers to Information Request provided, in part:

. . . . There were also invoices for sales of [REDACTED], [REDACTED], and other tools that Taxpayer had provided to its customers at no charge. The "no charge" invoices contained the notation "[REDACTED]," which the Taxpayer explained meant that the tool remained the property of Taxpayer. Specifically, a [REDACTED]" was an agreement between Taxpayer and the customer that the tool would be provided to the customer at no charge on the customer's agreement to: (1) purchase a certain volume of [REDACTED] exclusively from the Taxpayer (the sales volume amount varied from agreement to agreement); (2) return the tool to Taxpayer for any needed repairs (no charge to the customer); (3) purchase the tool outright if damaged by the customer due to improper use, thereby rendering the [REDACTED] void; and (4) return the tool to Taxpayer if the terms regarding the purchase volume of [REDACTED] is not met.

The Auditor determined that a tool provided to a customer under the [REDACTED] agreement generated a zero (\$0.00) sales price invoice for that tool. A zero (\$0.00) sales price invoice was also generated for any repairs to the tool, as well as for any parts used in the repair of that tool. . . .

The Auditor reviewed all "[REDACTED]" invoices reflecting a tool price of zero (\$0.00) and a request was made to see Taxpayers' purchase orders for all of the tools listed on such invoices in order to determine the tax liability for the cost of the tools. Taxpayer was able to provide purchase orders for only 21 of 34 tools. A tool average was computed for the missing purchase orders (Exhibit 4). The Auditor noted several invoices containing the description: "repairs including replacement parts." These invoices had to be treated as a withdrawal from stock because it was not possible to determine the actual cost in the field review. The Auditor asked the

Taxpayer to research its purchase orders in an effort to obtain the cost of the parts associated with these invoices; Taxpayer was unable to associate the invoiced parts with any of the parts purchased. Taxpayer then ran a report of the tools that were repaired in [REDACTED] and computed an average parts cost of [REDACTED], which the Auditor applied to the Arkansas invoices (Exhibit 5). The labor associated with the repairs were not charged to the customers.

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Taxpayer's protest is limited to the adjustments made to gross receipts tax assessed on sales of tools that Taxpayer claims were lent to customers for no charge under a customer (" [REDACTED] ") agreement. The [REDACTED] agreement is an agreement between Taxpayer and the customer wherein Taxpayer allows the customer to use the tool at no charge in exchange for the customer's promise to purchase a pre-determined number of [REDACTED] exclusively from the Taxpayer in the future. Taxpayer disagrees with the assessment claiming the tools are . . . not subject to taxation as a lease for \$0.00 for an indefinite term (beyond 30 days) for consideration. [P. 2-4].

The Taxpayer sells [REDACTED] and [REDACTED] to various customers in Arkansas. A typewritten document attached to [REDACTED] responses to the Taxpayer's Answers to Information Request ("Exhibit A") provided, in pertinent part, as follows:

. . . . As an incentive for an industrial customer to use [REDACTED], it will provide that customer a [REDACTED] which is common in industry practice. Per an agreement, the customer can use the [REDACTED] for as long as they are a customer and continue to purchase [REDACTED] and [REDACTED]. When a customer chooses to use a tool, the invoice that is issued by [REDACTED] to the customer lists the tool but shows a charge of \$0.00.

[REDACTED] industrial customers use the [REDACTED] to incorporate the [REDACTED] and [REDACTED] into products during the manufacturing process that is ultimately resold. Approximately 70% of [REDACTED] clients are industrial customers, including, but not limited to, those customers in the [REDACTED], [REDACTED] and [REDACTED]

[REDACTED] outlined its positions in its protest which was filed on or about February 24, 2016. The Department's position is that each tool is subject to tax as a withdrawal of stock because

██████████ is "either giving it or loaning it to the customer." Not only is this an incorrect application of the facts but it is also a misstatement of the law.

Ark. Regs. GR-18 provides as follows:

If a seller has a retail permit and purchases goods from its suppliers without paying tax to those suppliers claiming the "sale for resale" exemption and the seller withdraws the merchandise from stock and gives the merchandise to customers or other third parties, or uses the merchandise itself, then the value of this merchandise is a part of the seller's gross receipts or gross proceeds and the seller must remit the tax on the purchase price of the goods paid by the seller.

Merriam-Webster Online Dictionary defines the term "give" to "make a present to another." ██████████ did not "give" the tools to its customers because it retains title to the property and the customer must return the tools if they do not maintain a certain level of purchasers of ██████████. In addition, the term "loan" is not even used in GR-18. ██████████ leases the tools to its customers and such action is not considered a withdrawal of stock under Arkansas law.

The Department argues that there is no lease in this case because there is no consideration. However, the Department relies upon no authority for this statement. The Department itself acknowledges that the invoice reflects a separate itemized price for the tools and states that it "is irrelevant that the price listed is \$0.00." In fact, a review of the Arkansas sales tax rate charts shows that \$0.00 is indeed a sales price for an item. Moreover, the consideration in this case is the continued obligation to purchase ██████████. [P. 1-2].

The Tax Auditor testified that: (1) she conducted an audit of the Taxpayer; (2) the sales tax assessment involved unreported withdrawals from stock; (3) seventy percent [70%] of the Taxpayer's clients are industrial customers which incorporate ██████████ and ██████████ ██████████ into marketable products; (4) ██████████ are ██████████ or ██████████ used to insert ██████████ or ██████████ into products that will ultimately be resold; (5) the parties agreed on a three [3] month sample of the months in the audit period; (6) she reviewed sales invoices

and many invoices reflected zero taxes; (7) upon review of the zero tax invoices, she determined that the Taxpayer provided many items to its customers at no charge; (8) the no-charge invoices were labeled as [REDACTED] and the tools reflected a price of \$0.00;<sup>2</sup> (9) a representative of the Taxpayer [REDACTED] told her a [REDACTED] indicated that tools would be provided at no expense to a customer with an understanding that [REDACTED] would be purchased exclusively from the Taxpayer, the volume of [REDACTED] to be purchased varied from agreement to agreement, and the Taxpayer would repair or replace broken tools except in cases of improper use [including use of [REDACTED] not purchased from the Taxpayer];<sup>3</sup> (10) if volume requirements in a [REDACTED] were not met, the Taxpayer would pick up the tools; (11) she received several purchase orders<sup>4</sup> relating to the [REDACTED] tools for the sample months; (12) she computed an average for the missing purchase orders for [REDACTED] tools based upon the twenty-one [21] available purchase orders; (13) [REDACTED] repairs included replacement parts which were invoiced to the customers at no charge and the average cost of repair parts over the audit period was [REDACTED] per invoice; (14) no labor was charged for repairs so no tax was assessed; (15) the Taxpayer retained ownership of the [REDACTED] tools; (16) the Taxpayer purchased the [REDACTED] tools it allowed its customers to use at no charge [\$0.00] exempt as sales-for-resale; (17) the Taxpayer also purchased the repair parts for [REDACTED] tools exempt as sales-for-resale; (18) the [REDACTED] tools and [REDACTED] repair parts were assessed as taxable withdrawals from stock; (19) a [REDACTED] agreement required continued use of the

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<sup>2</sup> See Department's Exhibit 8 – P. 2.

<sup>3</sup> In those cases, the customer was required to purchase the tool.

<sup>4</sup> 21 out of 34 purchase order invoices.

Taxpayer's [REDACTED]; (20) free of charge, no charge, and \$0.00 are all the same but the invoices reflected \$0.00 for the [REDACTED] tools; and (21) she did not obtain a copy of a signed [REDACTED] agreement during the audit.

[REDACTED] testified that: (1) the industrial portion of the Taxpayer's business uses a large volume of [REDACTED]; (2) [REDACTED] agreements allow the Taxpayer to keep track of tools; (3) the Taxpayer retains ownership of the tools; (4) a customer's use of tools, and any applicable service, is based on an agreement to continue to purchase [REDACTED]; (5) the Taxpayer purchases thousands of tools per year; (6) if a customer stops purchasing [REDACTED], the Taxpayer will retrieve the [REDACTED] tools and refurbish the tools for further use if possible; (7) when there is no charge for tools that are shipped to an industrial customer, the [REDACTED] language is printed on the invoice so the Taxpayer can track the types and numbers of tools in the possession of the customer; (8) invoices reflect \$0.00 so the tools can be tracked, the Taxpayer's system can pull the tools out of stock and the Taxpayer can track the location of the tools; (9) all tools are purchased exempt as sales-for-resale; (10) effectively, the Taxpayer is leasing the tools for \$0.00; and (11) the future consideration for the leases in the amount of \$0.00 is continued purchases of [REDACTED].

The record remained open until July 18, 2016, for the submission of additional evidence.

## **CONCLUSIONS OF LAW**

### **Standard of Proof**

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

(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.

## Sales Tax Assessment

As a general rule, all sales of tangible personal property in the State of Arkansas are taxable unless a specific statutory exemption is applicable. See Ark. Code Ann. § 26-52-101 et seq. (Repl. 2014). Ark. Code Ann. § 26-52-103(21)(A) (Repl. 2014) defines “tangible personal property” as “personal property that can be seen, weighed, measured, felt, or touched or that is in any other manner perceptible to the senses.” [REDACTED] are tangible personal property.

The liability for sales tax on sales of tangible personal property is upon the seller in most circumstances. See Ark. Code Ann. § 26-52-517 (Repl. 2014). Ark. Code Ann. § 26-52-103(19) (Repl. 2014) defines “sale,” in pertinent part, as follows:

(A) “Sale” means the transfer of either the title or possession except in the case of a lease or rental for a **valuable consideration** of tangible personal property regardless of the manner, method, instrumentality, or device by which the transfer is accomplished.

(B) “Sale” includes the:

(i) Exchange, barter, lease, or rental of tangible personal property; [Emphasis added].

On July 15, 2016, [REDACTED] submitted a letter on behalf of the Taxpayer which summarized the legal arguments, as follows:

. . . . As was stated at the hearing [REDACTED] purchases tens of thousands of [REDACTED]. Because [REDACTED] does not know at the time it purchases the tools whether it will sell or lease the tools, it buys the tools without sales tax and provides a valid resale certificate to its tool vendors (see Ark. Regs. GR-3 and GR-20). [REDACTED] sells roughly 30 percent of its tools and collects and remits state sales tax on these sales, if appropriate. The remaining tools are generally leased to [REDACTED] industrial customers. The tools are leased pursuant to a [REDACTED], and the customer can use the [REDACTED] for as long as they are a customer and continue to purchase [REDACTED]. Most of the [REDACTED] Agreements have a

minimum level of purchases of [REDACTED] in order to continue to lease the tool. When a customer chooses to lease a tool, the invoice that is issued by [REDACTED] to the customer lists the tool but shows a charge of \$0.00.

As a matter of convenience and practice, [REDACTED] does not maintain [REDACTED] Agreements in its files, but instead inserts the relevant language of the [REDACTED] Agreements directly on the invoice. For example, as provided in Department Exhibit 8, the invoice states that pursuant to a [REDACTED] Agreement, the tool remains the property of [REDACTED] the tool can be continued to be used by the customer as long as the customer continues to exclusively purchase [REDACTED] from [REDACTED] for that tool and the price listed for the tool is \$0.00. Both parties acknowledge that the invoice reflects a price of \$0.00 for the tool. As discussed at the hearing, Arkansas considers a transfer of tangible personal property in exchange for \$0.00 a taxable sale. This is documented by the Arkansas sales tax rate charts that shows the initial taxable bracket to be \$0.00 to \$0.07. Because the Arkansas rate chart includes \$0.00 as taxable consideration, a lease for that amount, which is considered a sale is a transfer for consideration. The tax base would be \$0.00 which under Arkansas law would incur \$0 tax. Ark. Code Ann. § 26-52-103(13), see also <http://www.dfa.arkansas.gov> (Tax Rate Charts).

Moreover, as discussed at the hearing a taxable lease in Arkansas is defined as any transfer of possession or control of tangible property for a fixed or indeterminate term for consideration. Ark. Code Ann. § 26-53-102(15). The term "consideration" is not defined by the statute but has been broadly defined in a recent Arkansas Supreme Court case to mean conferring a pecuniarily measurable benefit on one party or imposing a pecuniarily measurable detriment on one other. *Holbrook v. Healthport, Inc., et. al.*, 2014 Ark 146, 432 SW3d 593 (2014). The consideration in this case is twofold. First, [REDACTED] customers must continue to buy [REDACTED] from [REDACTED] in order to keep using the [REDACTED]. This is clearly a pecuniary measurable detriment on [REDACTED] customers. This continuing obligation to purchase also confers a pecuniary measurable benefit on [REDACTED] because [REDACTED] will continue to sell its [REDACTED] at a particular level. [P. 1-2].

The Taxpayer's reliance, on a tax chart which illustrates the rounding of tax to the nearest cent and the definition of "consideration" in Holbrook v. Healthport, Inc., *supra*, is misplaced. The Arkansas Supreme Court has held that

a taxpayer's structuring of a transaction and the terms affixed to particular charges are not controlling, rather the economic reality of a transaction must govern over form when addressing the tax implications. Rineco Chemical Industries, Inc. v. Weiss, 344 Ark. 118, 40 S.W.3d 257 (2001). The Taxpayer's arguments, in support of an expansive interpretation of "valuable consideration," are not persuasive. The Arkansas Supreme Court has declined to give an expansive reading to the statutory definitions of "sale" and "valuable consideration" and in Rineco Chemical Industries, Inc. v. Weiss, *supra*, stated:

. . . According to Rineco, the only point at issue here is whether Rineco received "valuable consideration" under this definition as a result of the transfer of the packaged waste/fuel to the cement kilns and power plants. Rineco maintains that it did because the transfer of the product to the kilns and power plants benefitted Rineco because it allowed the company to stay in business and maintain a relationship with potential customers for the fuel product.

In making its argument, Rineco seeks an expansive interpretation of the term "sale" and specifically the term "valuable consideration" under § 26-52-103(a)(3)(A). This same argument, however, was made to this court and rejected in *Hervey v. Southern Wooden Box*, 253 Ark. 290, 486 S.W.2d 65 (1972), when the predecessor statute to § 26-52-103(a)(3)(A), which was Ark. Stats. Ann. § 84-1902(c) (Repl. 1980), was interpreted.

Id. at 124, 40 S.W.3d at 261-262 (2001).

Ark. Code Ann. § 26-52-322 (Repl. 2014) defines a withdrawal from stock and states:

(a) As used in this section, "withdrawal from stock" means the withdrawal or use of goods, wares, merchandise, or tangible personal property from an established business or from the stock in trade of the established reserves of an established business **for consumption or use** in the established business or **by any other person**.

...

(c) The Director of the Department of Finance and Administration may promulgate rules to implement this section. [Emphasis added].

Pursuant to subsection (c) of Ark. Code Ann. § 26-52-322 (Repl. 2014), Arkansas Gross Receipts Tax Rule GR-18(D)(1) provides that:

If a seller has a retail permit and purchases goods from its suppliers without paying tax to those suppliers claiming the "sale for resale" exemption and the seller withdraws the merchandise from stock and gives the merchandise to customers or other third parties, or uses the merchandise itself, then the value of this merchandise is a part of the seller's gross receipts or gross proceeds and the seller must remit the tax on the purchase price of the goods paid by the seller.

The Taxpayer's [REDACTED] and repair parts were purchased exempt from tax as sales-for-resale. In some cases, the Taxpayer provided [REDACTED] and repair parts to customers for \$0.00, when the customers would enter into a [REDACTED] agreement to purchase [REDACTED]. The Taxpayer's classification of the [REDACTED] agreements as leases for \$0.00<sup>5</sup> is not determinative.

Based upon the facts and circumstances of this case, and given the controlling and persuasive authority cited above, the Department correctly calculated the tax liability of the Taxpayer based upon a determination that [REDACTED] (and repair parts) the Taxpayer provided to customers for \$0.00 were subject to tax as withdrawals from stock under Ark. Code Ann. § 26-52-322 (Repl. 2014) and Arkansas Gross Receipts Tax Rule GR-18(D)(1).

### **Interest**

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

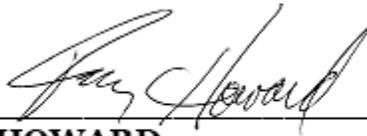
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<sup>5</sup> The Taxpayer's argument is that the leases for \$0.00 would constitute sales with transfers of consideration (so the "tax base would be \$0.00 which under Arkansas law would incur \$0 tax").

**DECISION AND ORDER**

The proposed assessments are 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. 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 of a tax deficiency by following the procedure set forth in Ark. Code Ann. § 26-18-406 (Supp. 2015).

**OFFICE OF HEARINGS & APPEALS**



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**RAY HOWARD**  
**ADMINISTRATIVE LAW JUDGE**

DATED: August 9, 2016