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

IN THE MATTER OF [redacted] **ACCT. NO.:** [redacted]	**COMPENSATING (USE) TAX REFUND CLAIM DENIAL** **AUDIT NO.** [redacted] **AUDIT PERIOD: FEB. 2015 THROUGH JANUARY 2018**
DOCKET NO.: 19-323	**AMOUNT DENIED (** [redacted] **)**

TODD EVANS, ADMINISTRATIVE LAW JUDGE
APPEARANCES

This case is before the Office of Hearings and Appeals upon written protest dated September 12, 2018, signed by [redacted], Senior Manager – Tax Accounting, on behalf of the [redacted], the Taxpayer. The Taxpayer protested a refund claim denial issued by the Department of Finance and Administration ("Department"). The Department was represented by John Theis, Attorney at Law, Revenue Legal Counsel ("Department's Representative").

At the request of the Taxpayer, this matter was submitted on written documents. A briefing schedule was established for the parties by email dated January 25, 2019. The Department's Representative filed his Opening Brief on January 23, 2019. The Taxpayer filed his Response Brief on February 26, 2019. The Department filed its Reply Brief on March 12, 2019. The record was closed and the matter was submitted for a decision on March 13, 2019.

ISSUE

Whether the Department's refund claim denial is correct under Arkansas law. Yes.

FACTS AND CONTENTIONS OF THE PARTIES

Within his Opening Brief, the Department's Representative provided certain factual allegations, stating as follows in pertinent part[1]:

> [redacted] ("Taxpayer") produces [redacted] Taxpayer's corporate headquarters is in [redacted] Taxpayer entered into a contract with CHEP whereby CHEP leases pallets used by Taxpayer to ship its products to customers. Taxpayer states that, under its rental agreement for the pallets, CHEP charges Taxpayer a per-pallet issue fee as well as transfer fees and daily rental fees.
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> Taxpayer further explained that the CHEP pallets are loaded with Taxpayer's products which are then transferred to Taxpayer's customers. Taxpayer alleges that the pallets are not returned to it. Instead, Taxpayer contends that the pallets are typically returned to CHEP under a separate agreement between Taxpayer's customer and CHEP.
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> Correspondence between CHEP and Taxpayer and agreements between those parties indicate that Taxpayer has access to between [redacted] and [redacted] CHEP pallets during a 12-month period. **Exhibit #1.** The available information indicates that Taxpayer requests that pallets be delivered to Taxpayer by CHEP as needed. Taxpayer receives incentives, in the form of reduced pricing, by convincing Taxpayer's customers to join into a pallet pooling program with CHEP. **Exhibit #1.** Taxpayer potentially pays a higher price to obtain pallets from CHEP if a substantial percentage of the pallets used by Taxpayer are shipped to customers that do not participate in the CHEP pooling program. **Exhibit #1**.
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> Taxpayer filed a sales tax and short-term rental tax refund claim with the Arkansas Department of Finance and Administration ("DFA") on or about May 8, 2018. **Exhibit# 2.** This refund claim is based on a vendor assignment of the refund from CHEP to Taxpayer. **Exhibit #2.** DFA allowed a portion of the requested refund but disallowed a portion of the refund claim totaling [redacted]. That refund claim denial was issued on July 13, 2018 **(Exhibit #3)** and Taxpayer timely filed its protest and requested an administrative hearing to consider its protest on September 12, 2018. **(Exhibit #4**)
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> Taxpayer contends that it is entitled to a sales tax and short-term rental tax refund because its lease of pallets from CHEP are entitled to the sale for resale exemption. This exemption claim is based on Taxpayer's

[1] All exhibits support the statements for which they are cited.

contention that the pallets in question are non-returnable pallets as described in Gross Receipts Tax Rule GR-53.

Within his Opening Brief, the Department's Representative noted that the CHEP pallets were owned by CHEP at all times. He asserted that a taxpayer must be regularly engaged in reselling the items that are sold to its customers to qualify for the sale for resale exemption. Since the Taxpayer did not own the CHEP pallets, he reasoned that the Taxpayer may not resell those pallets. Additionally, he stated that no evidence has been presented by the Taxpayer to demonstrate that it re-leases the CHEP pallets to its customers. Absent evidence that the pallets were either resold or re-leased, he asserted that the Taxpayer cannot qualify for the sale for resale exemption. He also argued that, because the pallets are owned by CHEP and subject to CHEP's retaking of possession, the pallets are properly characterized as returnable pallets, which are specifically taxable under Arkansas Gross Receipts Tax Rule GR-53(C)(5)(a). He concluded his analysis by averring that the economic reality of the CHEP pallet transactions is the Taxpayer pays several fees (including a daily rental fee and an [redacted] fee for any pallets not returned to CHEP) to obtain temporary possession of the pallets that must be returned to CHEP, which he insisted prevented the pallets from being characterized as nonreturnable pallets that are resold to customers as part of the final products.

Within his Response Brief, the Senior Manager asserted that the pallets should qualify for the sale for resale exemption as exempt packaging. However, he additionally noted that the original rental agreement had been revised and no

longer mentioned a "daily rental fee.,"[2] which he argued meant that the short-term rental tax was no longer applicable. He further averred that any CHEP pallets sent to nonparticipating distributors implied the pallets were nonreturnable and, thus, qualified as exempt packaging.

Within his Reply Brief, the Department's Representative provided a summary of the various documents provided by the Taxpayer is proceeding, stating as follows[3]:

> A review of the various documents submitted by Taxpayers reveals that for all periods after September 20, 2015, a daily rental fee was imposed by CHEP on the pallets it leased to Taxpayers. Even in the absence of such a daily rental fee, Taxpayers have not provided any information indicating the lease term for pallets was for a period of more than thirty (30) days. Accordingly, Taxpayers have not satisfied their burden of proof to demonstrate that their payment or short-term rental tax was inappropriate.
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> A review of the documents supplied by Taxpayers as part of this Administrative Hearing will assist in understanding this matter. The attached **Exhibit #1** is a letter agreement between Taxpayers and CHEP dated May 25, 2012. The document indicates that Taxpayers are leasing pallets from CHEP and that the letter agreement is intended to reinstate the May 8, 2008 agreement to be effective for the period of June 1, 2012, through May 31, 2015. Further, the May 25, 2012 letter agreement indicates that Appendix 1 and 2 of the May 8, 2008 letter agreement are deleted and replaced with Appendix 1 and 2 attached to the May 25, 2012 letter agreement.
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> The document attached hereto as **Exhibit #2** was provided by Taxpayers and is entitled "Appendix 1". This document appears to be the Appendix 1 referenced in **Exhibit #1** and contains terms relevant to the time period of June 1, 2012, through May 31, 2015. This document reflects that CHEP charges Taxpayers an Issue Fee of [redacted] for each CHEP pallet issued to Taxpayers, subject to adjustments. This Appendix 1 indicates that "Daily

[2] Initially, the Senior Manager provided a letter dated August 28, 2015. Among other changes, that letter revises the issue fee (assuming an average cycle time for the CHEP pallets by the Taxpayer of only [redacted]. The Taxpayer also provided an April 13, 2017 letter that revises certain fees under the agreement and then incorporates the revision into the original agreement and states "all of the terms of the Agreement remain in full force and effect."

[3] The Department's description of the provided documents is accurate based on a reading of those documents.

Rent and Transfer Fees will not apply." This document also provides for fee adjustments to be paid by Taxpayers if specific benchmarks are not achieved. These benchmarks deal with reducing the number of CHEP pallets used by Taxpayers that must be washed, a reduction of the number of CHEP pallets transferred to Non-Cooperative Distributors ("NCD's") because Taxpayers use [redacted] with those NCD's and a reduction in the number of CHEP pallets transferred to NCD's because the NCD's become participants in CHEP's pallet pool program. Additionally, Appendix 1 provides that Taxpayers are to pay CHEP in the amount of [redacted] for each CHEP pallet assigned to Taxpayers that are lost or destroyed.

The document attached as **Exhibit #3** is also entitled Appendix 1. This Appendix #3 is different from the document provided by Taxpayers and identified as **Exhibit #2.** This **Exhibit #3** covers time periods from September 1, 2013, through August 31, 2016. This **Exhibit #3** does not appear to relate to the letter agreement provided and attached as **Exhibit #1** because the time periods covered are different. No letter agreement has been provided related to this **Exhibit #3** and **Exhibit #3** is not signed by Taxpayers or CHEP. Consequently, it is unclear whether this **Exhibit #3** was ever mutually executed between Taxpayers and CHEP.

The attached **Exhibit #4** was supplied by Taxpayers with their Response Brief. This document is a letter agreement dated August 28, 2015 and indicates that Taxpayers and CHEP are currently parties to an agreement dated May 8, 2008, as amended by a letter agreement between the parties dated August 30, 2013. As previously indicated, the May 8, 2008 letter agreement has not been provided for review. Additionally, the August 30, 2013 letter agreement has also not been supplied by Taxpayers. **Exhibit #4** refers to the May 8, 2008 letter agreement as amended by the August 30, 2013 letter agreement, as the "Agreement". This **Exhibit #4** provides that Appendix 1 to the May 8, 2008 letter agreement is deleted and replaced with the terms of this August 28, 2015 letter agreement. **Exhibit #4** states that **"**No other terms or provisions of the Agreement will be deemed amended or otherwise modified, and the Agreement remains in full force and effect." The second page of this **Exhibit #4** indicates that the Agreement begins on September 20, 2015 and expires three (3) years therefrom. The seventh page or this **Exhibit #4** provides for a "**Daily Rent for Existing Equipment: Daily Rent for the Quantity of Equipment on Hire is due in an amount equal to (i) one-half of [redacted] average cycle time, as for the immediately preceding twelve (12) months (as reflected in CHEP's books and records) multiplied by (ii) the previously applicable weighted average daily rental rate, multiplied by (iii) the quantity of Equipment on Hire (stock balance) to [redacted] division as of the Effective Date as reflected on CHEP's books and records)."** (emphasis added)

> The document attached as **Exhibit #5** was also provided by Taxpayers with their Response Brief. This document is a letter agreement between CHEP and Taxpayers dated April 13, 2017. **Exhibit #5** again indicates that CHEP and Taxpayers are parties to an agreement dated May 8, 2008, as amended by a letter agreement dated August 28, 2015 (Attached as **Exhibit #4**). As previously mentioned, the May 8, 2008 agreement has not been provided to DFA by Taxpayers as part of its Protest of the Refund Claim Denials. This **Exhibit #5** indicates that it is effective beginning April 7, 2017. This **Exhibit #5** addresses three (3) specific issues. These three (3) issues are: Cycle Time, Issue Fee Adjustment, and Fuel Calculator. **Exhibit #5** then provides that "Except for any modification of and/or amendment to the Agreement as specifically herein provided (a) no other term, condition or provision of the Agreement will be considered to be altered or amended hereby; and (b) all terms of the Agreement remain in full force and effect. . .. [Footnotes omitted.]

Within his Reply Brief, the Department's Representative began his analysis addressing the application of the short-term rental tax. The Department's Representative noted that Exhibit #4 indicated that the daily rental fee was applicable from September 20, 2015 through the remainder of the refund period and continued at least until April 7, 2017 according to Exhibit #5. He asserted that a daily rental fee is indicative of a short-term duration for the pallet leases, warranting the application of the short-term rental tax. For monthly filings preceding September 20, 2015, he noted that the Taxpayer paid short-term rental tax for those tax periods and has failed to present the governing lease contract or any other evidence to indicate that the pallet leases had a long-term duration for the earlier periods, preventing the Taxpayer from proving entitlement to a refund claim for those tax periods. Addressing the sale for resale exemption, the Department's Representative argued that, because title to the CHEP pallets remained with the lessor, the Taxpayer cannot resell those items to its customers and the intent of each pallet rental was that the pallets would

ultimately be returned to CHEP. For these reasons, he averred that the sale for resale exemption is not applicable even if some pallets are ultimately not returned by certain customers.

After a general discussion of the burdens of proof in tax proceedings and a discussion of the applicable law, the parties' argument shall be addressed with a legal analysis and associated conclusions.

CONCLUSIONS OF LAW

Burdens 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). Ark. Code Ann. § 26-18-507 (Repl. 2012) provides for a refund of any state tax 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.

I. Application of Use Tax

Arkansas Compensating (Use) Tax generally applies to the privilege of storing, using, distributing, or consuming tangible personal property and taxable services within the State of Arkansas that were purchased outside this state. Ark. Code Ann. § 26-53-106 (Supp. 2017). Initially, the CHEP pallets qualify as tangible personal property whose leases are taxable unless an exemption is shown to apply. Sales tax exemptions must be applied uniformly to Arkansas Use Tax. Ark. Code Ann. § 26-53-112(2) (Supp. 2017).

An exemption does exist for sales for resale. Ark. Code Ann. § 26-52-401(12)(A) (Supp. 2017) grants a narrow exemption for sales for resale, stating as follows:

> Gross receipts or gross proceeds derived from sales for resale to persons regularly engaged in the business of reselling the articles purchased, whether within or without the state if the sales within the state are made to persons to whom gross receipts tax permits have been issued as provided in § 26-52-202.

Arkansas Gross Receipts Tax Rule GR-53(C) discusses the application of the sale for resale exemption to manufacturers, providing as follows in relevant part:

> SALE FOR RESALE - MANUFACTURERS.
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> 1. Goods, services, wares, merchandise, and property sold for use in manufacturing, compounding, processing, assembling, or preparing for sale, can be classified as having been sold for resale purposes only in the event such goods, services, wares, merchandise, or property becomes a recognizable integral part of the manufactured, compounded, processed, assembled, or prepared products. Sales of goods, services, wares, merchandise, and property not conforming to this requirement are classified as being for consumption or use of the purchaser thereof and are taxable. For purposes of this subsection, the following definitions shall apply:
>   a. "Recognizable" means capable of being recognized in the finished product. The capability to recognize the effect of goods, wares, merchandise, or property upon the finished product is insufficient to establish that the goods, wares, merchandise or property has been resold.
>   b. "Integral" means essential to the completeness of the finished product.
> 2. Services shall be considered a recognizable and integral part of the finished product if:
>   a. The services were actually performed on the items or articles being sold; and
>   b. The services enhance the value of the items being sold.
> 3. Other services performed for businesses engaged in manufacturing, compounding, processing, assembling, or preparing items for sale shall not be entitled to the sale for resale exemption.
> 4. Manufacturers, compounders, processors, assemblers, and preparers of goods for sale must also satisfy the requirements found in GR-53(A)-(C).
> 5. Packaging Materials.
>   a. Generally, the sale of materials used by the manufacturer or processor to package the finished product for sale or delivery is exempt if the materials become part of the finished product. Shrink wrap and strapping which bind the finished product together for shipment to the consumer are exempt. Non-returnable pallets which are delivered with the final product are also exempt. Returnable pallets are taxable.
>   b. Materials purchased by the manufacturer or processor to transport the product to the customer and which are owned by and returned to the manufacturer or which do not become part of the finished product received by the consumer are taxable. Dunnage bags

> which prevent containers of products from shifting during transit are taxable.

Here, the records show that, at least for the period of September 20, 2015 through September 20, 2018, the Taxpayer remitted a daily rental charge for the CHEP pallet rentals. Additionally, CHEP, at all times, retained ownership of the pallets and merely leased those pallets to the Taxpayer. Some pallets do become lost, destroyed, or damaged and require the payment of a compensation fee. It is evident, however, that both CHEP and the Taxpayer intend to have all of the pallets returned to CHEP. The discussions within the documents (providing objectives and incentives to minimize the quantity or potential for lost or damaged pallets) further support this finding. The record does not support a finding that the Taxpayer was "regularly engaged in the business of reselling" the CHEP pallets to its customers as packaging material by a preponderance of the evidence. The Taxpayer has not proven entitlement to the sale for resale exemption even as to the Non-Cooperative Distributors. Consequently, this portion of the refund denial is sustained.

II. 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.

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

Arkansas Special Excise Tax Rule ET-5(D) states the following:

> Lessors must maintain sufficient records to establish the intended term of the rental. In the absence of adequate documentation, **payment by the lessee for rental charges for periods of less than thirty (30) days shall be evidence that the term of the rental was for less than thirty (30) days.** [Emphasis supplied.]

Here, the records show that, at least for the period of September 20, 2015 through September 20, 2018, the Taxpayer remitted a daily rental charge for the CHEP pallet rentals, indicating a short-term rental period. Additionally, according to the August 28, 2015 letter, the parties appear to have anticipated a cycle time for the pallets of [redacted]. Arkansas Special Excise Tax Rule ET-5(D) and Ark. Code Ann. § 26-18-506 (Repl. 2012) provide that a taxpayer must maintain adequate records of the duration of the lease term. Further, the Taxpayer has not demonstrated that the earlier agreements utilized a longer rental period than the later agreements. It is the Taxpayer's burden to prove entitlement to a refund claim. Based on the record, it is not proven by a preponderance of the evidence that the Taxpayer improperly paid short-term rental tax on its CHEP pallet rentals.

DECISION AND ORDER

The refund denial 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. 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.[4]

OFFICE OF HEARINGS & APPEALS

TODD EVANS
ADMINISTRATIVE LAW JUDGE

DATED: March 22, 2019

[4] *See Board of Trustees of Univ. of Arkansas v. Andrews*, 2018 Ark. 12.