

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

ADMINISTRATIVE DECISION

IN THE MATTER OF

████████████████████
ACCT. NO.: ██████████

**REFUND CLAIM
DISALLOWANCE**

DOCKET NO.: 20-538

(\$██████████)¹
PERIOD: 01/01/13 - 08/31/14

RAY HOWARD, ADMINISTRATIVE LAW JUDGE

APPEARANCES

This case is before the Office of Hearings and Appeals upon a written protest dated August 25, 2016, signed by ██████████, on behalf of ██████████ ██████████, the Taxpayer. The Taxpayer protested the denial of a refund claim resulting from an audit conducted by Lori Cummings, Southeast Audit District,² for the Department of Finance and Administration (“Department”). The Audit Number is ██████████.

This case was submitted on written documents at the request of the Taxpayer. The Department was represented by Michelle Baker, Attorney at Law, Office of Revenue Legal Counsel. The Taxpayer was represented by ██████████ ██████████, the Taxpayer’s ██████████. A Briefing Schedule was mailed to the parties on February 10, 2020. The Taxpayer’s

¹ The total amount of the claimed refund was \$██████████.
² This is currently a part of the Southern Audit District.

Opening Brief was filed on March 5, 2020. The Department's Response Brief was filed on April 9, 2020. This matter was submitted for decision on May 4, 2021.

FINDINGS OF FACT/CONTENTIONS OF THE PARTIES

The Taxpayer operates [REDACTED] in Arkansas. During the audit period, the Taxpayer purchased items of tangible personal property and services. As a [REDACTED], the Taxpayer accrued and remitted tax on some purchases of tangible personal property and services.

Subject to the applicability of an exemption, a 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 The Taxpayer requested a refund of the tax paid on certain purchases of certain tangible personal property and services.

Ark. Code Ann. § 26-18-507 (Repl. 2020) provides for a refund of any state tax erroneously paid in excess of the taxes lawfully due. The arguments presented by the Taxpayer, the arguments presented by the Department, and a legal analysis are set forth below.

ISSUE

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

³ See Ark. Code Ann. § 26-53-101 et seq. (Repl. 2020).

⁴ See Ark. Code Ann. § 26-52-101 et seq. (Repl. 2020).

CONCLUSIONS OF LAW

Standard of Proof

Ark. Code Ann. § 26-18-313(c) (Repl. 2020) 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) (Repl. 2020). 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) (Repl. 2020). 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) (Repl. 2020).

A 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. 2020).

Refund Claim

Repair of [REDACTED]. The Taxpayer's Opening Brief addressed the repair service at issue and stated, as follows:

[REDACTED] - [REDACTED] operates a [REDACTED] is sent to a [REDACTED] for [REDACTED]. The [REDACTED] that is [REDACTED] is then treated and released to [REDACTED]. The [REDACTED] was repaired by [REDACTED] in [REDACTED] contends that the repair meets the requirements under GR-66(E) and therefore tax exempt since [REDACTED] has to [REDACTED] before releasing it back [REDACTED]. [P. 1].

The Department's Response Brief addressed the Taxpayer's contentions regarding the [REDACTED] and stated, in pertinent part, as follows:

To demonstrate entitlement to the exemption, the taxpayer must first: (1) prove that the [REDACTED] is utilized by the taxpayer to prevent or reduce air or water pollution which might otherwise result from manufacturing operations and (2) provide written documentation from the Arkansas Department of Environmental Quality (ADEQ) or the United States Environmental Protection Agency (the EPA) verifying that the repaired [REDACTED] is required by state or federal law to be installed and utilized to control pollution or contamination. Arkansas Gross Receipts Tax Rule GR-66(A)(1)-(2). The taxpayer's refund claim identifies the purchase as one of repairs to a [REDACTED]. Neither the taxpayer's refund claim, protest, or initial brief provide specific information concerning how the [REDACTED] prevents or reduces air or water pollution that might otherwise result from the operation of taxpayer's facility. Similarly, each document is devoid of written documentation from ADEQ or the EPA evidencing that the

██████████ is required by state or federal law to be installed and used to control pollution or contamination.

Further, to qualify for the claimed exemption, the ██████████ must be used to ██████████. Arkansas Gross Receipts Tax Rule GR-66(E)(1). The taxpayer's refund claim, protest, and initial brief are all devoid of facts that would demonstrate whether the ██████████ is used to ██████████. It was the auditor's understanding that the ██████████ was a part of a ██████████. Arkansas Gross Receipts Tax Rule GR-66(E)(4) specifically identifies ██████████ equipment as an example of a taxable item.

Lastly, while Arkansas Gross Receipts Tax Rule GR-66 extends the exemption to the purchase of repair parts, it does not specifically extend the exemption to the purchase of services to repair pollution control machinery. It is true that Arkansas Gross Receipts Tax Rule GR-9.18 extends the exemption for purchases of machinery and equipment used directly in manufacturing to services associated with the initial installation, alteration, addition, or replacement of that equipment, but that rule specifically states that the service of the repair of exempt machinery is taxable. Arkansas Gross Receipts Tax Rule GR-9.18(D). It is also true that Ark. Code Ann. § 26-52-447 (Supp. 2019), provides a refund for the purchases of services associated with the repair of machinery and equipment that is used directly in manufacturing an article of commerce in this state; however, the refund is not available for the purchase of parts or labor associated with pollution control machinery and equipment. As the taxpayer's purchase from ██████████ pertained not only to the purchase of a parts but also services to repair the ██████████, there is no statutory or regulatory provision that extends the exemption to charges for the services associated with the repair of the ██████████ even if it were determined that the ██████████ met all criteria for exemption under Arkansas Gross Receipts Tax Rule GR-66. For these reasons, the taxpayer has failed to meet its burden of proving entitlement to exemption and therefore the claimed refund and the denial of the refund for the purchases from ██████████ should be sustained. [P. 5-6].

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

A. The gross receipts or gross proceeds derived from the sale of pollution control machinery and equipment are exempt from the tax if:

1. The machinery and equipment is utilized, either directly or indirectly, by manufacturing or processing plants or facilities, or cities or towns in Arkansas to prevent or reduce air or water pollution or contamination which might otherwise result from the operation of the plant or facility; and,

2. The machinery and equipment is required by Arkansas or federal law or regulations to be installed and utilized to control pollution or contamination as evidenced by written documentation from the Arkansas Department of Environmental Quality or the United States Environmental Protection Agency.

...

C. Replacement and repair parts for pollution control machinery and equipment are exempt from tax if the machinery or equipment to be repaired or refurbished was initially exempt under this rule.

...

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.

Even assuming that the [REDACTED] facilitated or participated in pollution control and was used directly or indirectly in pollution control, the record is void of any written evidence establishing that the [REDACTED] is required by state or federal law or regulations to be installed and utilized to control pollution or contamination. See GR-66(A)(2). It is noteworthy that state and federal laws establish standards for manufacturers regarding pollution control. Generally, the laws are silent on the method or manner in which manufacturers achieve those standards. As manufacturers have a wide array of available methods and machinery and equipment to utilize in pollution control, GR-66 requires documentation as evidence a particular item is in fact pollution control

machinery or equipment. Consequently, the Taxpayer failed to establish that the [REDACTED] qualified as exempt pollution control machinery or equipment under GR-66(A).⁵

Furthermore, even if the [REDACTED] qualified as exempt machinery under GR-66(E)(1), the service of repairing the [REDACTED] was taxable under Arkansas Gross Receipts Tax Rule 9.18(D) which provides that, “[t]he service of repair of exempt machinery is taxable.” Consequently, the Department correctly denied the Taxpayer’s refund claim relating to [REDACTED].

Inspection and Repair Services. The Taxpayer’s Opening Brief addressed services performed on its [REDACTED] and stated, as follows:

[REDACTED] - [REDACTED] hired [REDACTED] to provide inspection and repair services to their [REDACTED] has since provided an itemized breakdown between inspection and repair charges. Therefore, [REDACTED] contends that the inspection charge is tax exempt since inspection services are not among the specifically enumerated taxable services listed in the Arkansas Sales and Use Tax Rules. [P. 1].

The Department’s Response addressed the Taxpayer’s contentions regarding inspection services and stated, as follows:

This involves purchases associated with a [REDACTED]. A [REDACTED] is a device for [REDACTED] of a building. It is a [REDACTED] rather than an [REDACTED]. A safety article concerning the taxpayer's [REDACTED] verifies usage of [REDACTED] in [REDACTED] as does a job posting by taxpayer. A copy of the article and the job posting are both attached to this brief as Exhibit 4. An image of a [REDACTED] is also attached to this brief as Exhibit 5. The image of the [REDACTED] demonstrates the [REDACTED] is a machine, which has been defined by the Arkansas Supreme Court as "any device consisting of two or more resistant,

⁵ In light of this finding, any issue concerning a refund under Ark. Code Ann. § 26-52-447 (Repl. 2020) is moot.

relatively constrained parts, which, by a certain predetermined intermotion, may serve to transmit and modify force and motion so as to produce some given effect or to do some desired kind of work." *Heath v. Research-Cottrell, Inc.*, 258 Ark. 813, 529 S.W.2d 336 (1975). Accordingly, the repair of a belt manlift is subject to tax. Ark. Code Ann. § 26-52-301(3)(B)(i)(r) (Supp. 2019).

The taxpayer's refund claim identifies Arkansas Gross Receipts Tax Rule GR-3 as the authority for its claim regarding the purchases from [REDACTED]. This rule provides definitions for terms contained within the Department's gross receipts tax rules and it is unclear why the taxpayer cited to this rule in support of its claim for refund. The taxpayer's protest states that the taxpayer erroneously remitted tax on inspection charges but fails to cite any legal authority for its protest as it relates to this purchase. The taxpayer finally states within its initial brief that it is entitled to a refund of tax paid for inspection services as those services are not specifically enumerated as taxable services.

As stated herein, Arkansas gross receipts tax is levied upon sales of tangible personal property and certain enumerated services. The inspection of machinery such as a [REDACTED] is not a specifically enumerated taxable service. However, the documentation that has been provided by the taxpayer demonstrates that [REDACTED] not only performed inspection services but also repaired the taxpayer's manlift(s). The [REDACTED] invoices provided to the taxpayer at the time of service or shortly after consist of lump sum charges for the services provided by [REDACTED].

When taxable and non-taxable transactions are included as part of the total consideration received for a sale, the entire proceeds of the sale are subject to sales tax. *Weiss v. Best Enterprises, Inc.*, 323 Ark. 712, 718, 917 S.W.2d 543, 546 (1996). Since the original invoices from [REDACTED] did not separately state charges for taxable and non-taxable transactions, tax was due on entire invoice amount.

As of the date of this responsive brief, the Department has not been provided with a copy of any contract the taxpayer may have with [REDACTED] that would identify the specific charges for the various services performed by [REDACTED], nor has the taxpayer provided any other documents that explain and support how [REDACTED] arrived at the breakout figures. Regardless, [REDACTED]'s original invoices to the taxpayer do not break out the charges for the various services provided and the taxpayer has failed to cite to any statute or rule that would permit the charges on the lump-sum invoices to be broken out after the fact to support a claim for refund. Instead, the law is clear that the entire gross proceeds derived from charges for taxable and non-

taxable transactions will be subject to tax unless those transactions are separately stated. For these reasons, the taxpayer has failed to meet its burden of proving entitlement to the claimed refund and the denial of the refund for the purchases from GP should be sustained. [Footnotes omitted, P. 6 – 7].

Based upon the assertions in the briefs of the parties, there is no dispute that repairs of the Taxpayer's ██████ were taxable services under Arkansas Gross Receipts Tax Rule GR-9. Under the facts and circumstances of this case, the Department's argument that, "[s]ince the original invoices from ██████ did not separately state charges for taxable and non-taxable transactions, tax was due on entire invoice amount[,]”⁶ is persuasive. Following a long line of decisions beginning with Ferguson v. Cook, 215 Ark. 373, 220 S.W.2d 808 (1949), the Arkansas Supreme Court has declined to create a divisible tax. In Ragland, Commissioner v. Miller Trane Service Agency, 274 Ark. 227, 623 S.W.2d 520 (1981), the Arkansas Supreme Court quoted the definition of “gross receipts” or “gross proceeds” and stated, in part:

In Larey, Comm'r of Rev. v. Dungan-Allen, 224 Ark. 908, 428 S.W.2d 71 (1968), the appellee argued that the incidence of the gross receipts tax should be divided between non-taxable revenue derived from professional services consultation and taxable revenue derived from taking the photographs. We said that while the consultation service alone would not be taxable under 84-1903(d), when coupled, however, with a taxable service where the value of the end product is enhanced, the total consideration received for the consultation and sale of the photograph is taxable. In Ferguson v. Cook, 215 Ark. 373, 220 S.W.2d 808 (1949), we said, in reference to the definition of gross proceeds or gross receipts, ‘where one sells an article in the preparation of which for sale he has expended labor, which adds to its value and was necessary to make it salable, he must pay the sales tax on the price received, without deduction for the value of the labor performed.’

⁶ See Weiss v. Best Enterprises, Inc., 323 Ark. 712, 718, 917 S.W.2d 543, 546 (1996).

Here, the total consideration paid by appellee's customers is for the package of services, i.e., inspection, maintenance and repairs, which it agreed to perform during the period covered by the contract. Maintenance and repairs of the machinery are taxable services. Inspection of the equipment is a prerequisite to the routine maintenance and repair and is an integral part of the contract. This inspection involves labor performed pursuant to the sale of taxable services; therefore, the cost of such an inspection cannot be deducted from the total amount of consideration paid for the full service contract. Appellee's insurance coverage for reimbursement to it for repairs it made, plus 3% sales tax, was for its benefit. In summary, appellant's claim is properly based upon the total consideration received by appellee for the sale of its package contract.

Appellant next contends that the trial court erred in finding that it should tax only those services performed by appellee which are specifically listed in 84-1903(c)(3). It appears undisputed that 'check' and 'examine,' or inspection services, provided by appellee do not fit within the appellee's other services which are within the ambit of the sales tax statute. However, the unlisted services enhance the value of the full coverage contract and increase the marketability of the taxable services provided by appellee. Therefore, under the rationale of Belvedere Sand and Gravel v. Heath, *supra*; Larey v. Dungan-Allen, *supra*; and Ferguson v. Cook, *supra*, the cost of these unlisted services cannot be deducted from the total consideration received.

Id. at 230 – 231, 623 S.W.2d at 522-523.

Without contemporaneous documents produced at the time of inspections and/or services to separately state the charges for non-taxable services and taxable services, the controlling legal authority supports the Department's position relating to the taxability of the gross proceeds remitted by the Taxpayer for repair services on its [REDACTED].⁷ Consequently, the Department correctly assessed tax on the total gross proceeds paid by the Taxpayer for [REDACTED]

⁷ In light of this finding, it is not necessary to consider the implications of Weiss v. Best Enterprises, Inc., *supra*, or Arkansas Gross Receipts Tax Rule GR-93 ("Bundled Transactions").

Burden of Proof. The Taxpayer failed to prove, by a preponderance of the evidence, that the claimed refund relating to [REDACTED] repairs and inspection/repair services to [REDACTED] was erroneously paid and in excess of the taxes lawfully due under Ark. Code Ann. § 26-18-507 (Repl. 2020).

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 this Administrative Decision and applicable law.

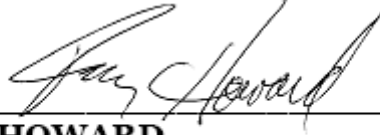
Pursuant to Ark. Code Ann. § 26-18-405 (Repl. 2020), unless the Taxpayer requests in writing within twenty (20) days of the mailing of this decision that the Commissioner of Revenues revise the decision of the Administrative Law Judge, this Administrative Decision shall be effective and become the action 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 (Repl. 2020) 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.⁸

OFFICE OF HEARINGS & APPEALS



RAY HOWARD
ADMINISTRATIVE LAW JUDGE

DATED: May 6, 2021

⁸ See Board of Trustees of Univ. of Arkansas v. Andrews, 2018 Ark. 12.