



STATE OF ARKANSAS
**Department of Finance
and Administration**

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June 21, 2016

[REDACTED]

Re: Sales Tax—In-Process Storage Tanks
Manufacturing Machinery and Equipment Exemption
Opinion Number 20140817S

Dear [REDACTED]:

By letter dated August 8, 2014, you requested a Revenue Legal Counsel Opinion regarding the applicability of the manufacturing machinery and equipment exemption to In-Process Storage Tanks (“IPSTs”). The request was made on behalf of an unidentified/anonymous/generic Company X that was planning on purchasing approximately 134 replacement IPSTs for use in its roofing rock granule processing facility located in Arkansas. The anticipated purchase was to take place within the next one to three years to replace the existing IPSTs that had been purchased in approximately 1946, at the time the facility was initially constructed.

By letter dated June 16, 2015, I provided the requested Opinion. That letter reviewed the operations of Company X from the initial mining and quarrying operations¹, through transportation to the roofing rock granule facility, the operational processes at that facility, and then transportation of the product to the specific customer. Thereafter, that letter analyzed several United States and Arkansas Supreme Court decisions concerning what did and did not constitute “manufacturing”, as that term is commonly understood. That analysis will not be repeated here, but is instead adopted by reference. Essentially, manufacturing implies a change, but not all change is manufacturing. In order to be considered manufacturing, there must be a transformation. A new and different article must emerge having a distinctive name, character, or use. A raw material must be changed or transformed into a new and different article. *See* cases cited in original Opinion letter dated June 16, 2015.

After analyzing the case law referenced in the preceding paragraph regarding what does and does not qualify as manufacturing, the original Opinion letter concluded as follows:

¹ As pointed out in that original response, “machinery and equipment utilized for the actual mining and quarrying operation” could qualify for the manufacturing machinery and equipment exemption if it is used and “carried on at the same site and as part of the continuous mining operation”. *See* Arkansas Gross Receipts Tax Rule GR-59. That exemption is not applicable to the IPSTs because the IPSTs are not a part of the mining and quarrying operation and are not a part of the continuing mining operation. Instead, the IPSTs become involved only after the initially crushed rock is transported away from the mining and quarrying operation to the roofing rock granule facility.

In the instant case, the taxpayer's process begins and ends with rocks. The initial crushed rock from the mining and quarrying operation is transported to another facility where it is heated, dyed, and further crushed into rock granules and, therefore, make it into a marketable form, but it is not being transformed into a new and different product. It is rock going into the facility and it is rock coming out of the facility for sale to specific shingle manufacturing customers. Accordingly, the taxpayer is not engaging in manufacturing as that term is commonly understood.

See Opinion 20140817, p. 5.

By letter dated September 24, 2015, you attempted to provide a more detailed explanation of the relevant facts and requested a reconsideration of the original Opinion. Your letter then attempts to distinguish the cases cited in my letter dated June 16, 2015 from the facts in the present situation involving the IPSTs. However, virtually all of the facts set forth in your letter were known, considered, and are set forth in the original Opinion letter.² Your letter concluded by stating that if I needed additional information to contact [REDACTED] and provided me with her contact information.

Upon receiving and reviewing your reconsideration request and the information contained therein, I did contact [REDACTED]. I informed [REDACTED] informally that I did not see any information contained in the reconsideration request that would change the Department of Finance and Administration's position regarding the inapplicability of the manufacturing machinery and equipment exemption to the IPSTs. However, I did inform [REDACTED] that I was aware of a similar case that was currently pending before that Arkansas Supreme Court that might have some bearing on my response to the reconsideration request. [REDACTED] and I agreed that we would await the Opinion and ruling in that case before proceeding with a response to the reconsideration request. The case to which I was referring was *Walther v. Carrothers Constr. Co. of Arkansas, LLC*, which has now been decided.

The facts in *Walther v. Carrothers Constr. Co. of Arkansas, LLC*, 2016 Ark. 209, ___ S.W.3d ___, ("Carrothers") involved a municipal waterworks system. The City of Russellville created the City Corporation to operate, maintain, and improve the city's municipal waterworks system. The source of water for the system was the Illinois Bayou which flows downstream through Pope County before joining Lake Dardanelle in the Arkansas River. The waters of the Illinois Bayou were not suitable for drinking by the residents of Russellville, so a water treatment plant was established which involved a three-phase process which includes the pretreatment, clarification, and final filtration of surface water that is turned into potable drinking water.

² The original Opinion letter dated June 16, 2015, also concluded that the IPSTs did not qualify as manufacturing machinery and equipment because an "article of commerce" was not being produced. The IPSTs were not being used to produce a product to be placed on the market for retail sale to the general public. Instead, the IPSTs were being used to produce custom items for specific customers in response to specific orders. See Ark. Code Ann. § 26-52-402 (Supp. 2015); see also Arkansas Gross Receipts Tax Rule GR-55(F)(6). Stated alternatively, Company X crushes rock into rock granules and dyes the rock granules to the specifications of specific shingle manufacturing customers. By your letter requesting a reconsideration of the original Opinion, you state that Company X does maintain an inventory of its product for retail sale to the general public. However, for the reasons stated herein, there is no need to address this issue.

In 1998, Carrothers Construction Company of Arkansas, LLC (“Carrothers”) contracted to construct an expansion of the water-treatment plant, which included the purchase of several items of machinery and equipment which were installed at the plant. Following an audit assessment by the Arkansas Department of Finance and Administration (“Department”), Carrothers filed suit claiming that the purchases qualified for the manufacturing machinery and equipment exemption. Carrothers subsequently filed a motion for summary judgment based upon this exemption. The Department responded asserting that the water treatment facility was not a manufacturer of water, but instead was only cleaning the water for human consumption. The circuit court agreed with Carrothers, finding that it was entitled to claim the manufacturing machinery and equipment exemption, and granted the motion for summary judgment. The Department filed a timely appeal.

The Department’s sole point on appeal was that the water-treatment plant merely cleans water and does not manufacture it. Therefore, the manufacturing machinery and equipment exemption was not applicable. Carrothers responded asserting that the extensive and complex three-phase chemical and mechanical process of converting raw surface water into potable drinking water did constitute manufacturing.

The Arkansas Supreme Court agreed with the Department and reversed the circuit court’s granting of summary judgment in favor of Carrothers. The Court noted that tax-exemption cases are reviewed de novo, citing *Weiss v. Bryce Co., LLC*, 2009 Ark. 412, 330 S.W.3d 756. Next, the Court noted that the first rule of statutory construction is to construe the statute just as it reads by giving words their ordinary and usually accepted meaning. *Aluminum Co. of Am. v. Weiss*, 329 Ark. 225, 946 S.W.2d 695 (1997). Further, the Court recognized that there is a strong presumption in favor of the taxing power of the state and that all tax-exemption provisions must be strictly construed against the exemption, citing *Weiss v. Bryce Co. LLC*, 2009 Ark. 412, 330 S.W.3d 756. *Carrothers*, 2016 Ark. 209, at pp. 5-6, ___ S.W.3d at ___.

Regarding the ultimate issue in the case, i.e., whether the process of turning water not suitable for human consumption into potable human drinking water constituted manufacturing, the Arkansas Supreme Court cited several of the cases cited and summarized in the original Opinion letter dated June 16, 2015. On this issue, the Court concluded as follows:

Here, Russellville’s water-treatment plant did not manufacture or process a new product. Through an elaborate three-phase process, the water-treatment plant turned river water into drinking water. That water was taken from the Illinois Bayou, and that water was supplied to the residents of Russellville. **It was water in the beginning, and it was water in the end. Carrothers acquired materials and constructed a facility to treat and clean the water, but it did not manufacture the water. Thus, Carrothers is not entitled to the manufacturing exemption** pursuant to section 26-52-402. We hold that Carrothers is not entitled to summary judgment as a matter of law. Accordingly, we reverse the decision of the circuit court and remand for a calculation of the actual tax.

Carrothers, 2016 Ark. 209 at pp. 8-9, ___ S.W.3d at ___ (emphasis added).

In *Carrothers*, “[i]t was water in the beginning, and it was water in the end.” In the present matter, it is rock in the beginning, and it is rock in the end. This Arkansas Supreme Court ruling does not provide a basis for a change in the original Opinion dated June 16, 2015. To the contrary, this decision strengthens the conclusion reached in that Opinion. **The process involved at the roofing rock granule facility does not qualify as “manufacturing”, as that term is commonly understood. The purchase of the replacement IPSTs will not qualify for the manufacturing machinery and equipment exemption.**

As a final matter, you are requesting information based on an unidentified/anonymous/generic client or for general information purposes, therefore, please be aware of GR-75, which provides that a letter opinion may only be relied on by a seller if it is addressed to him or is tendered by a customer to whom it is addressed. Requests for letter opinions must specifically describe the person claiming an exemption and set forth all material facts relevant to the questioned sale or transaction. In order to receive a binding opinion you must submit a request specifically describing the person claiming an exemption, and specifically detailing that person’s factual circumstances. A letter opinion may not be relied on if more than three (3) years old, but may be renewed on request.

This opinion is based on my understanding of the facts as set forth in your inquiry, and the application of Arkansas laws, rules, and regulations to those facts. Any change in the facts or law could result in a different opinion.

Please do not hesitate to contact me in the event you have any questions regarding this Opinion. Your time and attention to this matter are greatly appreciated.

Sincerely,

Tim E. Howell, Attorney at Law
Revenue Legal Counsel