



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

**REVENUE LEGAL COUNSEL**

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June 17, 2019

**VIA EMAIL ONLY**



RE: Sales Tax- Manufacturing  
Opinion 20190510

Dear [REDACTED]:

I am writing in response to your November 21, 2018 request for a Revenue Legal Opinion concerning sales and use tax for manufacturing:

Our company is developing a Solar Energy Generation Facility (Solar Farm) in Arkansas. ... Could you please clarify how the Arkansas Department of Finance and Administration has treated Electric Generation Facilities, and whether the Solar equipment and materials installed at a Solar Farm would qualify for the Manufacturing Exemption, and whether a construction contractor may use this exemption on purchase of materials incorporated into and installed at the project?

In your request, you provided a list of items relating to the Solar Farm. In a subsequent email dated May 30, 2019, you provided the following descriptions of the listed items:

Solar Energy Generation Facility Materials:

*Solar Panels.* Photovoltaic solar panels absorb sunlight as a source of energy to generate electricity.

*Piles/panel supports.* Posts driven into the ground to support the racking and trackers, which support and rotate the solar panels.

*Trackers.* Device that orients Panels toward the sun.

*Foundations.* Concrete foundation to support equipment such as inverters and transformers.

*Inverters.* A solar inverter converts the variable direct current (DC) output of a photovoltaic (PV) solar panel into a utility frequency

alternating current (AC) that can be fed into a commercial electrical grid.

*Collection System- electrical cables/conduit/accessories.* Electrical Cabling that transports the electricity from the panels to the inverters and then to the project substation.

*Substation Equipment, Main Power Transformer.* Substation is where the electricity is collected and converted (transformed) to the voltage typically needed to sell to the purchaser of the electricity.

*O&M control Equipment.* Computers/Software located in the O&M building used to monitor and operate the solar farm.

*SCADA (Supervisory Control and Data Acquisition Software).* Computers/Software located in the O&M building used to monitor and operate the solar farm.

*Operations and Maintenance Building.* Building that houses monitoring equipment, and may also act as office for operational personnel and spare parts storage.

*Transmission Line.* Line that leaves the project substation and carries the electricity to the interconnection point of the utility transmission grid.

*Switchyard and Interconnection.* Point of Interconnection with the utility transmission grid.

*Civil Materials (aggregate, fences, etc.).* Materials for access roads, fence to surround substation, etc.

*Security System Cameras.* Recorders to provide site security.

During our May 30, 2019 phone conversation, you confirmed that the proposed Solar Farm will be a new facility in Arkansas.

## **RESPONSE**

### ***Summary***

The following items of machinery and equipment identified in your request would qualify for the manufacturing exemption if used directly in the manufacturing process: solar panels, piles/panel supports, trackers, inverters, collection system-electrical cables/conduit/accessories, substation equipment, main power transformer, transmission line, switchyard and interconnection, O&M control equipment, and SCADA. A contractor may claim the exemption if the contractor purchases

the machinery and equipment in connection with a construction contract with a manufacturer who will use the machinery and equipment to generate electricity ultimately for retail sale to the general public.

### *Discussion*

The Arkansas Gross Receipts (Sales) Tax is generally applicable to the sale of tangible personal property and certain enumerated services. Ark. Code Ann. § 26-52-301 (Supp. 2017). The tax is computed based on the total value of consideration paid for the taxable property or service. *Id.*; *see also* Ark. Code Ann. § 26-52-103(19) (Supp. 2017). When a sale of tangible personal property or the performance of such an enumerated service occurs in Arkansas, a taxable transaction occurs, and the tax should be collected and remitted. Arkansas Gross Receipts Tax Rule GR-5.

The Arkansas Compensating (Use) Tax is due on the purchase of any tangible personal property that is purchased out of state and brought into Arkansas for use, storage, consumption, or distribution. Ark. Code Ann. § 26-53-106 (Supp. 2017). “Use,” with respect to tangible personal property, means the exercise of any right or power over tangible personal property incident to the ownership or control of that tangible personal property. Ark. Code Ann. § 26-53-102(30)(A) (Supp. 2017). The compensating use tax is assessed when the transportation of the property has come to rest or when the property has become commingled with the general mass of property in the state. Ark. Code Ann. § 26-53-106(b) (Supp. 2017); *see also Martin v. Riverside Furniture Corp.*, 292 Ark. 399, 401-02, 730 S.W.2d 483, 485 (1987). Once the transportation has ceased or the property is commingled, the property is no longer in the stream of interstate commerce and is subject to the compensating use tax. *See Martin*, 292 Ark. at 402, 730 S.W.2d at 485; *see also Skelton v. Federal Express Corp.*, 259 Ark. 127, 131, 531 S.W.2d 941, 94 (1976). There is a presumption that tangible personal property shipped, mailed, expressed, transported, or brought to this state by a purchaser was purchased from a vendor for storage, use, distribution, or consumption in this state. Ark. Code Ann. § 26-53-106(d)(2) (Supp. 2017). The tax shall be paid at the rate of the location of delivery. Ark. Code Ann. § 26-52-521(b)(2) (Supp. 2017).

The purchase of the machinery and equipment identified in your request is the purchase of tangible personal property. Under Arkansas law, the sale or purchase of tangible personal property is generally subject to Arkansas gross receipts/sales tax or compensating use tax. Ark. Code Ann. § 26-52-301 (Supp. 2017) and Ark. Code Ann. § 26-53-106 (Supp. 2017). However, Arkansas law specifically provides certain exemptions from this general rule:

(a) There is specifically exempted from the tax imposed by this chapter the following:

(1)(A) Gross receipts or gross proceeds derived from the sale of tangible personal property consisting of machinery and equipment **used directly** in producing, manufacturing, fabricating, assembling, processing, finishing, or packaging of articles of commerce at manufacturing or processing plants or facilities in the State of Arkansas. ...

(B) The machinery and equipment will be exempt under this subdivision (a)(1) if it is purchased and **used to create new**

**manufacturing or processing plants or facilities within this state**  
or to expand existing manufacturing or processing plants or facilities  
within this state[.]

....

(2)(C) It is the intent of this subdivision (a)(2) to provide the exemptions in subdivision (a)(1) of this section and this subdivision (a)(2) as incentives to encourage the location of new manufacturing plants in Arkansas, the expansion of existing manufacturing plants in Arkansas, and the modernization of existing manufacturing plants in Arkansas through the replacement of old, inefficient, or technologically obsolete machinery and equipment; and

....

(c)(1)(A) It is the intent of this section to exempt only such machinery and equipment as shall be used directly in the actual manufacturing or processing operation at any time from the initial stage when actual manufacturing or processing begins through the completion of the finished article of commerce and the packaging of the finished end product.

(B) As used in this subsection, **“directly” is used to limit the exemption to only the machinery and equipment used in actual production during processing, fabricating, or assembling raw materials or semifinished materials into the form in which such personal property is to be sold in the commercial market.**

(2) For purposes of this subsection, the following definitions, specific inclusions, and specific exclusions shall apply and represent the intent of the General Assembly as to its interpretation of the term “used directly”:

(A)(i) Machinery and equipment used in actual production includes machinery and equipment that meet all other applicable requirements and which cause a recognizable and measurable mechanical, chemical, electrical, or electronic action to take place as a necessary and integral part of manufacturing, the absence of which would cause the manufacturing operation to cease.

(ii) “Directly” does not mean that the machinery and equipment must come into direct physical contact with any of the materials that become necessary and integral parts of the finished product.

(iii) Machinery and equipment which handle raw, semifinished, or finished materials or property before the manufacturing process begins are not used directly in the manufacturing process.

(iv) Machinery and equipment which are necessary for purposes of storing the finished product are not used directly in the manufacturing process.

(v) Machinery and equipment used to transport or handle a product while manufacturing is taking place are used directly;

(B) Machinery and equipment used directly in the manufacturing process includes without limitation the following:

....

(iii) Testing equipment to measure the quality of the finished product at any stage of the manufacturing process;

(iv) **Computers and related peripheral equipment that directly control or measure the manufacturing process;** and

(v) Machinery and equipment that produce steam, electricity, or chemical catalysts and solutions that are essential to the manufacturing process but which are consumed during the course of the manufacturing process and do not become necessary and integral parts of the finished product;

(C) Machinery and equipment “used directly” in the manufacturing process shall not include the following:

(i) Hand tools;

(ii) Machinery, equipment, and tools used in maintaining and repairing any type of machinery and equipment;

(iii) Transportation equipment, including conveyors, used solely before or after the manufacturing process has been started or completed;

(iv) Office machines and equipment including computers and related peripheral equipment not directly used in controlling or measuring the manufacturing process;

(v) **Buildings;**

(vi) Machinery and equipment used in administrative, accounting, sales, or other such activities of the business;

(vii) All furniture;

(viii) **All other machinery and equipment not used directly in manufacturing or processing operations as defined in this section;** and

....

(d) The Director of the Department of Finance and Administration may promulgate rules and regulations for the orderly and efficient administration of this section.

Ark. Code Ann. § 26-52-402 (Supp. 2017) (emphasis added).<sup>1</sup>

The Department has promulgated the following rule to provide additional guidance:

A. The gross receipts or gross proceeds derived from sales of tangible personal property consisting of machinery and equipment used directly in producing, manufacturing, fabricating, assembling, processing, finishing, and/or packaging of articles of commerce at

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<sup>1</sup> An analogous statutory provision exempts manufacturing machinery and equipment from the Arkansas compensating use tax. Ark. Code Ann. § 26-53-114 (Repl. 2014).

manufacturing plants or facilities in Arkansas are exempt from the tax if, and only if, the machinery and equipment is purchased and used for purposes set forth in this rule.

B. NEW MANUFACTURING PLANTS. The gross receipts or gross proceeds derived from the sale of machinery and equipment purchased and used to create new manufacturing plants or facilities in Arkansas are exempt from the tax if:

1. The machinery and equipment performs one or more essential functions and is utilized directly in the manufacturing process; and
2. The machinery and equipment is utilized in actual manufacturing operations at any time from the initial stage where the raw material is first acted upon and changed in any essential respect through the completion and packaging of the article of commerce, as defined in GR-55(F)(6) of this rule; and
3. The machinery and equipment does not consist of hand tools, buildings, transportation equipment, office machines and equipment, machinery and equipment used in administrative, accounting, sales or other such activities of the business involved, or any and all other machinery and equipment not directly used in the manufacturing operation.

Arkansas Gross Receipts Tax Rule GR-55(A) and (B). The rule defines the term “article of commerce” to include “any property to be placed on the market for retail sale to the general public and any property which becomes a recognizable integral part of a manufactured product in its finished and packaged form ready to be placed on the market for retail sale. Custom items which are produced for specific customers in response to special orders and which are not readily marketable to the general public are not articles of commerce.” *Id.* at GR-55(F)(6).

The rule also describes the circumstances under which the exemption can pass through to the manufacturer’s contractor:

G. CONTRACTORS. A contractor may claim an exemption from sales tax for machinery and equipment that meets all the requirements for exemption as manufacturing machinery and equipment if the contractor purchases the machinery and equipment in connection with a construction contract with a manufacturer who will use the machinery and equipment for manufacturing articles of commerce. A contractor may not claim the manufacturing exemption on items of machinery and equipment that the contractor will use to perform installation or construction work necessary to complete or perform the contract with the manufacturer.

*Id.* at GR-55(G).

The Arkansas Supreme Court has recognized that the generation of electricity is a manufacturing process. *Morley v. Brown & Root*, 219 Ark. 82, 87, 239 S.W.2d 1012, 1015 (1951). Further, generated electricity may constitute an article of commerce if the generator places the electricity on the market for retail sale ultimately to the general public in the usual course of business. *Morley v. E.E. Barber Construction Co.*, 220 Ark. 485, 491, 248 S.W.2d 689, 692 (1952). The electricity that the Solar Farm will generate meets this definition. *See Heath v. Research-Cottrell, Inc.*, 258 Ark. 813, 820, 529 S.W.2d 336, 339 (1975) (“Like any other manufacturing facility, a power processing plant converts raw materials into a salable product.”). In this instance, the raw material is sunlight or solar power and the salable product is marketable AC electricity.

### ***Manufacturing Machinery and Equipment Exemption for Specific Items***

You have stated that the proposed Solar Farm will be a new facility. Therefore, the Solar Farm would qualify as a “new manufacturing plant” within the meaning of Ark. Code Ann. § 26-52-402(a)(1)(B) (Supp. 2017). The manufacturing process in this situation is the conversion of solar energy into electricity. That process begins with the harvesting of solar energy by the solar panels, and the process ends with the delivery of marketable high voltage AC electricity to the power grid.

Generally, in order for machinery and equipment to qualify for the manufacturing exemption, the taxpayer must use the machinery and equipment “directly” in the manufacturing process. Ark. Code Ann. § 26-52-402(a)(1)(A) and (c)(1)(B) (Supp. 2017). Based on the information you have provided, the solar panels, piles/panel supports, trackers, inverters, collection system-electrical cables/conduit/accessories, substation equipment, main power transformer, transmission line, and switchyard and interconnection would qualify for the manufacturing machinery and equipment exemption. The Solar Farm will use these items of machinery and equipment in transporting and handling the product at the various stages of the manufacturing process. Specifically, the Solar Farm will use these items directly in and during the process of manufacturing electricity.

In addition, you have stated that the O&M control equipment and SCADA (Supervisory Control and Data Acquisition Software) are computers/software used to monitor and operate the Solar Farm. Based on your description, these items also may qualify for the manufacturing machinery and equipment exemption because they are computers and related peripheral equipment that directly control or measure the manufacturing process. Ark. Code Ann. § 26-52-402(c)(2)(B)(iv) (Supp. 2017). However, if the function of this equipment is to monitor and operate aspects of the Solar Farm that do not directly control or measure the manufacturing process – *e.g.*, the operation of entrance gates or the testing monitoring of external factors – then the answer could be different. If you would like a final determination on these items, please provide additional information and submit a supplemental opinion request.

The remaining items that you have identified in your request – foundations, operations and maintenance building, civil materials, and security system – do not qualify for the manufacturing machinery and equipment exemption because they do not act directly on the manufacturing process of generating electricity. *See id.* at § 26-52-402(c)(2)(C)(v) & (viii); *see also* Arkansas Gross Receipts Tax Rule GR-55(B)(3).

***Contractors***

Arkansas Gross Receipts Tax Rule GR-55(G) provides that a contractor may claim an exemption from sales tax for machinery and equipment that meets all the requirements for exemption as manufacturing machinery and equipment if the contractor purchases the machinery and equipment in connection with a construction contract with a manufacturer who will use the machinery and equipment for manufacturing articles of commerce. A contractor may not claim the manufacturing exemption on items of machinery and equipment that the contractor will use to perform installation or construction work necessary to complete or perform the contract with the manufacturer.

In the situation you have described, a contractor who purchases items of machinery and equipment that meet all of the requirements for the manufacturing exemption as described above may claim the exemption *if* the contractor purchases the machinery and equipment in connection with a construction contract with a manufacturer who will use the machinery and equipment to generate electricity. A contractor may not claim the manufacturing exemption on items of machinery or equipment that the contractor will use to perform installation or construction work necessary to complete or perform the contract with the manufacturer.

This opinion is based on my understanding of the facts as set out in your inquiry and as current Arkansas laws and rules govern those facts. Any changes in the facts or law could result in a different opinion. Please note that only you as the requestor may rely on this opinion and only to the extent that all material facts relative to the sale or transaction in question are contemplated by your legal opinion request and this legal opinion. Pursuant to Arkansas Gross Receipts Tax Rule GR-75(B), this opinion only will be binding on the Department for three (3) years from the date of issuance.

A copy of the Arkansas Gross Receipts Tax Rules referenced in this letter is available online at [http://www.dfa.arkansas.gov/offices/policyAndLegal/Documents/et2008\\_3.pdf](http://www.dfa.arkansas.gov/offices/policyAndLegal/Documents/et2008_3.pdf).

Sincerely,

A handwritten signature in blue ink that reads "Brad Young". The signature is written in a cursive, flowing style with a long horizontal stroke at the end.

Brad Young, Attorney  
Revenue Legal Counsel