



STATE OF ARKANSAS

**Department of Finance  
and Administration**

**REVENUE LEGAL COUNSEL**

Post Office Box 1272, Room 2380

Little Rock, Arkansas 72203-1272

Phone: (501) 682-7030

Fax: (501) 682-7599

<http://www.dfa.arkansas.gov>

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**RE: Opinion No. 20190718 Sales Tax – Manufacturing Exemption – Poultry Processor**

Dear ██████████:

Your letter requesting a legal opinion has been referred to me for response. In your letter you state the following:

*Are these scenarios taxable?*

*We spray and dip poultry products into a compound to make sure that no bacteria is on the product. It is a vinegar mixer and it is in line on the manufacturing process. Is this mixer taxable?*

*We send samples of our poultry products to customers. The cost of those products include labor, overheads and materials (meat and packaging). Is that whole cost taxable?*

*We use a film over a cold table. This process is to freeze the finished product. Is the film that we use taxable?*

*We are a poultry processor. For GR-55 is there a difference in manufacturing vs. processing? I could say we manufacture poultry.*

From information you provided from the supplier of the poultry spray and dip product, this product is a peroxyacetic acid-based microbiocide developed for use in Federally inspected meat, poultry, and seafood processing locations. Your supplier's information further states that if used as directed, the microbiocide will help reduce contamination and cross-contamination of edible food products. Additionally, you provided more information regarding the samples that you provide to customers including that the samples are provided free of cost; that the samples consist of frozen, fresh, and cooked forms of your products; and that the samples are provided in the processed form in which they came off the production line. Further, you explained that the film, which is a waxed plastic paper mix, is placed on the line with the chicken placed on top of

the film. The film is a barrier to allow the movement of the chicken over the cold table and prevents the chicken from sticking to the cold table. The table helps freeze the chicken faster before it goes into a spiral freezer.

## **RESPONSE**

Before answering your specific questions, a short discussion of the law and rules concerning Arkansas Gross Receipts (“Sales”) Tax and Compensating Use (“Use”) Tax is appropriate.

### Arkansas Gross Receipts Tax & Compensating Use Tax - Generally

The Arkansas Gross Receipts Tax is a tax imposed on the sale of tangible personal property and certain enumerated services and not on the property or services themselves. Ark. Code Ann. § 26-52-101 *et seq.*, (Repl. 2014 & Supp. 2017). Therefore, when a sale occurs in Arkansas (an intrastate sale), a taxable event occurs and gross receipts tax should be collected and remitted. *See* Arkansas Gross Receipts Tax Rule GR-5(A). A sale is an Arkansas or intrastate sale when tangible personal property or services is sold to a consumer and the seller is engaged in an established business or sells in an established matter within Arkansas. *See* Arkansas Gross Receipts Tax Rule GR-5(B).

The Arkansas Compensating Tax Act of 1949 is a complimentary legislative enactment with the intended purpose of fairly subjecting the interstate sale of tangible personal property and taxable services into Arkansas to equal taxation. Where tangible personal property or services are purchased for use or consumption in Arkansas from a seller in another state and delivery is made in Arkansas, then the sale is subject to Arkansas Compensating Use Tax. *See* Ark. Code Ann. § 26-53-101 *et seq.* (Repl. 2014 & Supp. 2017); *see also* Arkansas Gross Receipts Tax Rule GR-5(C)(2). “Sale” means any transaction resulting in the transfer of either the title or possession, for a valuable consideration, of tangible personal property or taxable services regardless of the manner, method, instrumentality, or device by which such transfer is accomplished. Arkansas Gross Receipts Tax Rule GR-3(M)(1). Sale includes the exchange, barter, lease, or rental of tangible personal property or taxable services. *Id.*

Out-of-state vendors have the responsibility to register with the State of Arkansas and collect tax from their customers within Arkansas in accordance with Ark. Code Ann. § 26-53-121 (Repl. 2014 & Supp. 2017). Sections 17 and 18 of Act 822 of the 92<sup>nd</sup> General Assembly of Arkansas (“Act 822”) require remote sellers and marketplace facilitators to collect sales and use tax on the sale of tangible personal property, taxable services, digital code, or specified digital products. Sections 17 through 19 of Act 822 became effective via an emergency clause contained in Section 28 on July 1, 2019. The language of Act 822 requires that thresholds of one hundred thousand dollars (\$100,000) or two hundred (200) transactions be met for the sales to be “subject to Arkansas sales or use tax[.]” *See* Acts 2019, No. 822, §§ 17 & 19. However, if the vendor has not collected and remitted the tax the Arkansas purchaser is still responsible for use tax. A purchaser’s obligation to report and remit use tax is independent of the vendor’s compliance with

the law. Ark. Code Ann. §§ 26-53-123 (Repl. 2014 & Supp. 2017) & 26-53-125 (Repl. 2014 & Supp. 2017).

Microbiocide spray and dip

Pursuant to Arkansas Gross Tax Receipts Rule GR-55.1, chemicals used in manufacturing may be exempt from gross receipts or use tax. GR-55.1 reads in pertinent part as follows:

A. Chemicals used in manufacturing may be exempt from gross receipts or use tax if the following occur:

1. The chemicals become a recognizable, integral part of the manufactured goods (see GR-53(C));
2. The chemicals are “equipment” (see GR-55.1(D)); or,
3. The provisions of this rule are met.

B. DEFINITIONS.

1. “Catalyst” means a substance that initiates or provokes a chemical reaction allowing such reaction to proceed under milder conditions, such as lower temperatures or with less resistance to reaction.
2. “Chemical” means an element, combination of elements, or a compound obtained by a chemical process.
3. “Reagent” means any substance which by reason of its capacity for taking part in certain reactions is used for various purposes, including detecting, examining, or measuring other substances or in preparing materials. A reagent is also a substance used to convert one substance into another by means of the reaction that it causes. To be a reagent for purposes of this exemption, a substance must be primarily used as a reagent.
4. “Solution” means a chemical in a liquid form that contains a dissolved substance.

C. MANUFACTURING OPERATIONS.

1. The gross receipts or gross proceeds derived from the sale of catalysts, chemicals, reagents, and solutions which are consumed or used directly in manufacturing or processing articles of commerce at manufacturing or processing plants or facilities in the State of Arkansas are exempt from gross receipts tax. “Manufacturing or processing” has the same meaning as set forth in Ark. Code Ann. § 26-52-402(b) and GR-55.
2. For purposes of this section, the term “substance” means only chemicals, catalysts, reagents, or solutions as defined in GR-55.1(B). A substance may be in the form of liquid, solid, or gas.
  - a. A substance is consumed or used in manufacturing or processing an article of commerce if it is used to produce or prevent a chemical or physical effect during the manufacturing process and the chemical or physical effect, or prevention of that effect, is a direct and necessary step in the production of the article.

\* \* \*

The microbiocide spray and dip that you use on the poultry production line is a chemical or solution that is being used directly in the manufacturing or processing of the poultry products to prevent the chemical or physical effect of microbial growth on product on the production line. Therefore, the purchase of the microbiocide spray and dip should be exempt from sales or use tax. Arkansas Gross Receipts Tax Rule GR-55.1.

#### Processed Product Samples Provided to Customers

The taxability of the gratuitous provision of processed product samples to your customers is governed by Arkansas Code Annotated § 26-52-322 (Repl. 2014) and Arkansas Gross Receipts Tax Rule GR-18(D). The gifting of samples to customers is a “withdrawal from stock.” As used in Arkansas Code Annotated § 26-52-322 (Repl. 2014), “withdrawal from stock” means the withdrawal or use of goods, wares, merchandise, or tangible person 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. “Person” includes any individual, partnership, limited liability company, limited liability partnership, corporation, estate, trust, fiduciary, or any other legal entity. Ark. Code Ann. § 26-52-103(22) (Repl. 2017). Arkansas Gross Receipts Tax Rule GR-18(D) reads, in pertinent part, as follows:

#### D. WITHDRAWAL FROM STOCK.

1. Withdrawal of purchased goods. 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.

#### 2. Withdrawal of manufactured or processed goods.

**a. A business that manufactures or produces products and sells the products to third parties or at retail may at times transfer title to certain of those products to itself or give the products to another person or entity. The business should report and remit tax on the sales price of the products rather than the value of the raw materials used to manufacture or produce the products.**

\* \* \*

Arkansas Gross Receipts Tax Rule GR-18(D) (emphasis added); *see also Walther v. Flis Enterprises, Inc.*, 2018 Ark. 64.

The gratuitous provision of samples to your customers is a taxable withdrawal of manufactured or processed goods. Arkansas Gross Receipts Tax Rule GR-18(D)(2)(a). You stated that your company is a direct pay permit holder that purchases raw materials (poultry) both in-state and from out of state without paying sales or use tax. Your company should remit sales or use tax on

the sales price of the processed poultry samples. GR-18(D)(2)(a). If unprocessed product purchased tax-free from out of state vendor(s) was used to create the processed samples, then use tax should be self-assessed and remitted on the sales price. Ark. Code Ann. § 26-53-101 *et seq.* (Repl. 2014 & Supp. 2017). Samples made from unprocessed product purchased tax-free from in-state vendor(s) are subject to sales tax on the sales price. Ark. Code Ann. § 26-52-101 *et seq.* (Repl. 2014 & Supp. 2017).

### Waxed Plastic Paper Film

Arkansas Code Annotated §§ 26-52-402 (Supp. 2017) and 26-53-114 (Repl. 2014) provide, respectively, a sales and a use tax exemption for certain machinery and equipment used directly in manufacturing subject to the further qualifying subparts that define the specific requirements of the exemptions under each statute. Arkansas Gross Receipts Tax Rule GR-55 was promulgated to implement and clarify the above-cited statutes.

Arkansas Gross Receipts Tax Rule GR-55 provides in pertinent part:

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 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.

C. PLANT EXPANSION. The gross receipts or gross proceeds derived from the sale of machinery and equipment **purchased and used to expand a manufacturing plant or facility in Arkansas** are exempt from tax **if:**

1. The machinery and equipment satisfy the requirements of GR-55(B)(1), (B)(2), and (B)(3); and either
2. The purchase of the machinery results in an economic expansion of the taxpayer's plant or facility (regardless of whether there is a physical expansion) by:
  - a. Increasing production, volume; or,
  - b. Increasing employment; or,
  - c. Increasing the number of different types or models of property that can be manufactured; or
3. The purchase of the machinery results in a physical expansion of the taxpayer's plant or facility regardless of whether there is an economic expansion.

D. REPLACEMENT MACHINERY. Machinery and equipment **purchased to replace existing machinery and equipment and used directly** in producing, manufacturing, fabricating, assembling, processing, finishing or packaging of articles of commerce at manufacturing or processing plants or facilities in this state will be exempt from the tax if:

1. The machinery and equipment satisfies the requirements of GR-55(B)(1), (B)(2), and (B)(3); and
2. The **“machinery and equipment purchased to replace existing machinery” means that substantially all of the machinery and equipment required to perform an essential function is physically replaced with new machinery.** The term “substantially” is intended to exclude routine repairs and maintenance and partial replacements - but is not intended to mean that foundations and minor components that can be economically adapted, rebuilt, or refurbished must be substantially replaced when such replacement would be more expensive or impractical than adapting, rebuilding or refurbishing the old foundation or minor components.

\* \* \*

Arkansas Gross Receipts Tax Rule GR-55 (emphasis added); *See also* Ark. Code Ann. §§ 26-52-402 (Supp. 2017) & 26-53-114 (Repl. 2014).

The purchase of the Waxed Plastic Paper Film is tangible personal property subject to sales or use tax unless an exemption applies. Ark. Code Ann. §§ 26-53-101 *et seq.* (Repl. 2014 & Supp. 2017) & Ark. Code Ann. § 26-52-101 *et seq.* (Repl. 2014 & Supp. 2017). The film appears to be a consumable material that is used and consumed in the manufacturing process. The film does not qualify for the manufacturing exemption because the film is not machinery or equipment being purchased to create or expand a manufacturing plant or facility as required by the statutes and rule. Arkansas Gross Receipts Tax Rule GR-55(B) & (C); *see also* Ark. Code Ann. §§ 26-52-402 (Supp. 2017) & 26-53-114 (Repl. 2014). Further, the film does not qualify for the manufacturing exemption because the film is not machinery or equipment purchased to “substantially” replace existing machinery and equipment. Arkansas Gross Receipts Tax Rule GR-55(D); *see also* Ark. Code Ann. §§ 26-52-402 (Supp. 2017) & 26-53-114 (Repl. 2014). Therefore, the purchase of the Waxed Plastic Paper Film is subject to sales or use tax.

Definition of “Manufacturing” under GR-55

You inquired, as a poultry processor, whether there is a difference in “manufacturing” and “processing” for purposes of Arkansas Gross Receipts Tax Rule GR-55. “Manufacturing” includes those operations commonly understood within their ordinary meaning, and shall also include mining; quarrying; extracting and refining of brine, oil, and gas; cotton ginning; the drying of rice, soybeans and other grains; the manufacturing of feed; **the processing of poultry** or eggs and livestock and the hatching of poultry; . . .” Arkansas Gross Receipts Tax Rule GR-55(F)(4) (emphasis added).

Legal Opinions Issued by the Department

In accordance with Arkansas Gross Receipts Tax Rule GR-75, this opinion is based upon my understanding of the facts as set out in your inquiry and as current Arkansas laws and rules govern those facts. Any change in the facts or law could result in a different opinion. Please be advised that this opinion may only be binding upon 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,

David G. Scott, CFA, Attorney  
Revenue Legal Counsel

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