

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

ADMINISTRATIVE DECISION

IN THE MATTER OF

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

DOCKET NO.: 21-097

**REFUND CLAIM
DISALLOWANCE**
(Sales and Use Taxes)

DATE OF CLAIM: 04/22/20
(\$ ██████████)¹

RAY HOWARD, ADMINISTRATIVE LAW JUDGE

APPEARANCES

This case is before the Office of Hearings and Appeals upon a written protest dated June 18, 2020, submitted by ██████████ ██████████, on behalf of ██████████ ██████████, the Taxpayer. The Taxpayer protested the denial of a refund claim by the Department of Finance and Administration (“Department”). The Audit ID Number is ██████████ and the Claim Period was from 02/01/17 to 02/28/19.

A telephone hearing was held on December 1, 2020, at 9:00 a.m., in Little Rock, Arkansas.² The Department was represented by Brad Young, Attorney at Law - Office of Revenue Legal Counsel (“Department’s Representative”). Present for the Department were Jaime Jarrett - Tax Auditor, and Adam Hillis – Audit Supervisor. The Taxpayer was represented by ██████████ ██████████ (individually, “Taxpayer’s Witness”), and ██████████ ██████████ (collectively, “Taxpayer’s Representatives”).

¹ The refund claim was denied in its entirety.

² All participants appeared via telephone.

The record remained open after the hearing for the submission of post-hearing briefs. The Department's initial post-hearing brief was filed on February 1, 2021. The Taxpayer's post-hearing brief was filed on March 1, 2021. The Department's final post-hearing brief was filed on March 15, 2021.³

FINDINGS OF FACT/CONTENTIONS OF THE PARTIES

The Tax Auditor presented testimony consistent with the information set forth in the Department's Answers to Information Request⁴ and she also testified that: (1) the Taxpayer is a [REDACTED]; (2) she reviewed the refund claim submitted by the Taxpayer (including invoices and information about the items purchased); (3) the refund request related to purchases of chemical reagents for use in the Taxpayer's [REDACTED]; (4) a diagnostic reagent is a drug but it not a prescription drug under GR-38; (5) if a drug can be purchased without a prescription, it does not qualify as exempt under GR-38; (6) she visited a vendor website and was able to take a reagent sale-pack all the way to the cart for purchase (she was able to do the same thing for different reagents on the websites of different vendors); (7) the reagents that she was able to take all the way to a cart for purchase, without a prescription, are the same type of drugs involved in the refund claim (See Department Exhibit 2); (8) the diagnostic reagents do not qualify as exempt under GR-38 because they are consumed in the [REDACTED] and not dispensed by prescription; (9) a drug that [REDACTED] [REDACTED] is not dispensed by prescription; (10) she was furnished no information to show that the reagents had to be prescribed by a physician or that any of the reagents were

³ This brief only incorporated the Department's initial post-hearing brief by reference.

⁴ This document was received into evidence and is contained in the case file.

prescribed by a physician; (11) the FDA labeling requirements that reagents by labeled “Rx only” does not automatically qualify the reagents for the exemption under GR-38; (12) she was furnished no information about who ordered the reagents in this case (the invoices did not reflect who ordered the reagents or if the person ordering was a physician as defined by GR-38); (13) she was provided no information to show that any of the reagents were purchased through a prescription as defined by GR-38; (14) if a doctor orders a blood test and a reagent is used in the performance of the blood test, the reagent would not qualify as a prescription drug because the doctor ordered a test and not a particular reagent; (15) she was furnished no information to show that any physician ordered the use of a particular reagent in any test; (16) even if a physician signed a purchase order for the reagents, the reagents would not qualify as prescription drugs because there is no evidence that any of the reagents were dispensed by prescription to patients as required by GR-38(C); (17) some of the reagents in this refund claim were part of test kits (See Department Exhibit 6); (18) some of the test kits contained [REDACTED] [REDACTED] which are not items that are exempt from as prescription drugs; (19) the test kits were invoiced with a single non-itemized price (See Department Exhibit 6 – P. 1-3); and (20) even if the reagents in the test kits were exempt prescription drugs, the test kits would be taxable as bundled transaction under GR-93 (some items in the test kits were subject to tax and there is no breakdown of the items in the test kits).⁵

⁵ At a later point in the hearing, the Taxpayer’s Representatives conceded the test kits / bundled transactions.

Upon cross-examination, the Tax Auditor testified that: (1) the FDA classifies the reagents in test kits as RX only prescriptions; (2) the [REDACTED] in the kits are for collection and detection [REDACTED]; (3) she did not ask test kits to be broken out by the Taxpayer; (4) she did not explain the problems with the test kits to the Taxpayer; (5) she disallowed the test kits because they were not prescription drugs; (6) her research to determine if the reagents could be legally purchased did not involve any of the vendors the Taxpayer actually purchased from; (7) she did not conclude any of the purchases of reagents but she was able to put them in her cart and put her information in (she did not communicate with any of the vendors); (8) with respect to the issue of who ordered the reagents, she did not ask for any prescriptions or the information concerning the identity of doctors [REDACTED]; (9) GR-38(C) provides that the exemption applies to sales of drugs that can only be legally dispensed by prescription; (10) a hospital can make an exempt purchase of prescription drugs if the drugs are dispensed to a patient; (11) when a doctor orders a test, the reagents are not dispensed to patients, the reagents never leave [REDACTED]; (12) GR-38(C) does not say that a drug has to leave a facility to be exempt; (13) prescription drugs purchased by a hospital, kept in inventory, and then dispensed to patients would be exempt from tax (she is not sure of the taxability if those same drugs expired and were discarded rather than dispensed to patients); and (14) the fact that a drug may be purchased illegally does not mean that the same drug could not be purchased by a physician⁶ exempt as a prescription drug.

⁶ The Department's Representative stated that the Department would stipulate that Advanced Practice Registered Nurses, Nurse Practitioners, and Physician Assistants can prescribe prescription drugs. The Taxpayer's Representatives contended that: (1) in the Department's

The Department's Representative contended that: (1) this case involves the prescription drug exemption; (2) the Taxpayer has failed to establish that it was entitled to the exemption; (3) the Department's position is that prescription drugs are drugs that a physician prescribes to a patient while he or she is in a [REDACTED];⁷ (4) penicillin and a Covid vaccine are examples of prescription drugs and the Department has always taken the position that those types of drugs can be purchased by [REDACTED] as exempt prescription drugs; (5) purchases of reagents, which stay [REDACTED], are consumed [REDACTED], and are not prescribed by a physician, are not tax exempt; and (6) this case is limited to reagents.

The Taxpayer's Witness presented testimony consistent with the information set forth in the Taxpayer's Answers to Information Request⁸ and he also testified that: (1) prescription drugs purchased by [REDACTED] are exempt from tax under Ark. Code Ann. § 26-52-406(a)(1) (Repl. 2020); (2) the Taxpayer purchased the reagents involved in this refund claim; (3) the Department agrees that the reagents are drugs and that the reagents were purchased for human use; (4) the reagents in this refund claim were labeled "Prescription Only" as required by the FDA; (5) an email from the FDA states that, "any prescription device may be dispensed legally only with a valid prescription from a medical practitioner licensed by law to administer prescription products"; (6) another email from the FDA states that, "if the product is labeled as 'Rx Only' it would need an order from a licensed healthcare

Answers to Information Request, the Department took the position that only physicians and surgeons can prescribe prescription drugs under GR-38.2; and (2) there is no prescription drug that can only be prescribed by a physician or a surgeon.

⁷ The Department's Representative said that he used the word [REDACTED] since this case involves a [REDACTED].

⁸ This document was received into evidence and is contained in the case file.

provider”; (7) an email for the Arkansas State Board of Pharmacy states that, “any item that is ‘Rx Only’ requires a prescription or order from a provider before it can be sold or dispensed to an individual”; (8) the Department’s interpretation of GR-38(C) is that the drug must be dispensed which is not our interpretation; (9) the reagents were legally purchased;⁹ (10) the Department claims that diagnostic reagents are not exempt because they are not dispensed by prescription; (11) GR-38(C) states that the exemption applies to sales of drugs that “can” only be legally dispensed by prescription but GR-38(C) does not require that the drugs be purchased to be dispensed or that the drug be dispensed; (12) GR-38(C) does not require that drugs leave a healthcare facility or be introduced into a patient’s body; (13) he can not locate any information that indicates the Department takes the position that the prescription drug exemption is not allowed for drugs that expire and are not dispensed to patients; (14) the Department’s position that reagents are not prescription drugs because they are not dispensed is arbitrary; (15) other drugs are prescription drugs even though they are not dispensed to patients;¹⁰ (16) he was told by an auditor of the Department that purchases of prescription drugs by a [REDACTED] are exempt from tax even when the [REDACTED] is the end user of the drugs;¹¹ (17) vendors do not normally require a [REDACTED] to provide a prescription to purchase prescription drugs; (18) whether or not reagents are dispensed is irrelevant; (19) the Taxpayer’s [REDACTED] has

⁹ The Department’s Representative stated that the Department is not disputing the fact that the reagents were legally purchased.

¹⁰ At this point, the Department’s Representative stated that there is a distinction between drugs and prescription drugs.

¹¹ The Department’s Representative stated that: (1) there is a difference between drugs that leave [REDACTED] and drugs that are consumed [REDACTED]; and (2) there is not evidence that any of the reagents were specifically prescribed by a physician.

prescriptive authority and determines the tests performed [REDACTED]; (20) where the prescription comes into play is not relevant if the FDA requires the drug be labeled as “For Prescription Use Only”; (21) diagnostic reagents are exempt in other states under the Streamlined Sales and Use Tax Agreement; and (22) there was no request by the Department for the Taxpayer to produce evidence that [REDACTED] [REDACTED] ordered any of the reagents.¹²

The Taxpayer’s Representatives contended that: (1) the reagents are exempt prescription drugs; and (2) the Taxpayer’s [REDACTED] and the drugs used for each test are determined by a doctor or other medical professional.

ISSUE

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

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:

¹² The Department’s Representative stated that the Taxpayer’s [REDACTED] purchases reagents [REDACTED] [REDACTED] that are never prescribed.

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

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,¹³ and sales tax is imposed on sales of tangible personal

¹³ See Ark. Code Ann. § 26-53-101 et seq. (Repl. 2020).

property or taxable services made by in-state vendors/sellers to in-state purchasers.¹⁴ Ark. Code Ann. § 26-52-103(35)(A) (Repl. 2020) and Ark. Code Ann. § 26-53-102(24)(A) (Repl. 2020) define “tangible personal property” to mean “personal property that can be seen, weighed, measured, felt, or touched or that is in any other manner perceptible to the senses.” The reagents at issue in this matter are tangible personal property and generally taxable. Ark. Code Ann. § 26-52-406 (Repl. 2020) provides a tax exemption for certain purchases of drugs and states as follows:

(a)(1) The gross receipts or gross proceeds derived from the sale, purchase, or use of prescription drugs by licensed pharmacists, hospitals, or physicians when sold, purchased, or administered for human use and from the sale of oxygen sold for human use on prescription of a licensed physician shall be exempt from the Arkansas gross receipts tax levied by this chapter and the Arkansas compensating use tax levied by the Arkansas Compensating Tax Act of 1949, § 26-53-101 et seq.

(2) The withdrawal of prescription drug samples for free distribution from a stock or inventory, whether located within or outside the State of Arkansas, is exempt from the tax imposed by this chapter.

(b) The Secretary of the Department of Finance and Administration shall adopt such appropriate rules as the secretary deems necessary to assume the effective and efficient administration of the exemption provided for in this section and to prevent abuse thereof.

Pursuant to the authority granted in Ark. Code Ann. § 26-52-406(b) (Repl. 2020), the Department promulgated Arkansas Gross Receipts Tax Rule GR-38 to administer the exemption for prescription drugs. GR-38 provides, in pertinent part, as follows:

A. The gross receipts or gross proceeds derived from the sale, purchase, or use of prescription drugs by licensed pharmacists,

¹⁴ See Ark. Code Ann. § 26-52-101 et seq. (Repl. 2020).

hospitals, or physicians when the drugs are sold, purchased, or administered for human use shall be exempt from tax.

B. DEFINITIONS.

1. "Drug" means a compound, substance, or preparation, and any component of a compound, substance, or preparation, other than "food and food ingredients," "dietary supplements," or "alcoholic beverages" that is the following:

a. Recognized in the official United State Pharmacopoeia, official Homeopathic Pharmacopoeia of the United States, or official National Formulary, and supplement to any of them; or

b. Intended for use in the diagnosis, cure, mitigation, treatment, or prevention of disease; or

c. Intended to affect the structure or any function of the body.

d. Examples of drugs include, but are not limited to, the following: radioactive isotopes; medical grade gases; vaccines; and legend drugs.

2. "Physician" means a licensed medical practitioner authorized by Arkansas law to prescribe drugs that are used for human consumption. Physicians include surgeons, dentists, podiatrists, and osteopaths. (See GR-38.2.)

3. "Prescription" means an order, formula, or recipe issued in any form of oral, written, electronic, or other means of transmission by a physician.

C. **The exemption applies to sales of drugs that can only be legally dispensed by prescription.** Drugs that may be purchased without a prescription are not eligible for the exemption even if the drug is prescribed by a physician. [Emphasis added].

The post-hearing briefs filed by the parties contain arguments regarding multiple issues; however, it is only necessary to address one dispositive issue.

The Department's post-hearing brief stated as follows:

2. Does the purchase of a reagent qualify for the prescription drug exemption if it is not dispensed with a prescription?

No. Arkansas Gross Receipts Tax Rule GR-38(C) provides that the exemption for prescription drugs applies to sales of drugs that can only be dispensed by prescription. In Docket No. 20-321, the Hearing Officer stated, "Since the Taxpayer has not established that the reagent kits may only be dispensed by prescription (as required by Arkansas Gross Receipts Tax Rule GR-38(C)), the Taxpayer's

exemption claim for the reagent kits was properly denied.” In the Taxpayer’s subsequent revision request, the Taxpayer argued:

There is no requirement in the statute that the drug be “dispensed.” This is again a criterion imposed exclusively by GR-38(C).

The Commissioner of Revenue rejected this argument:

In your revision request, you do not appear to dispute the hearing officer’s conclusion that “the reagent kits are not dispensed but utilized within the Taxpayer’s [REDACTED].” (citation omitted). Instead, you argue that this part of Arkansas Gross Receipts Tax Rule GR-38(C) is invalid because Ark. Code Ann. § 26-52- 406(a)(1) (Supp. 2019) does not include the same “dispensed language.” . . . Arkansas Gross Receipts Tax Rule GR-38(C) does not conflict with the plain language of the statute and appears on its face to be consistent with the Secretary’s statutory mandate that the rule assume the affective and efficient administration of the prescription drug exemption and to prevent abuse.

The Taxpayer has not provided a valid basis for the Office of Hearings and Appeals to overturn the ruling of the Commissioner and the previous rulings of the Office of Hearings and Appeals. [Footnotes omitted, P. 3].

With respect to the requirements of GR-38(C), the Taxpayer’s post-hearing brief provided, as follows:

GR-38.C does not require drugs to be dispensed

The first requirement of GR-38.C includes drugs “that *can* only be dispensed by prescription.” The question isn’t whether the drug is ultimately dispensed; it’s whether it *can* be dispensed without a prescription. The reagents in our refund are “Rx Only” items, and per the FDA and the Arkansas State Board of Pharmacy, they cannot be dispensed without a prescription.

In fact, the Department allows the exemption for drugs that can only be dispensed by prescription but that aren’t ultimately dispensed. For instance, the Department’s audit staff testified that expired and/or discarded prescription drugs remain exempt, even if they aren’t ultimately dispensed. [P. 3].

The reagents at issue in this matter are used or consumed [REDACTED] and are not dispensed. Given the holding in the Commissioner's Revision previously issued to the Taxpayer, failure to fulfill the requirement that the reagents are "dispensed" is dispositive. Consequently, the Department correctly denied the Taxpayer's refund claim.

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.¹⁵

OFFICE OF HEARINGS & APPEALS



RAY HOWARD
ADMINISTRATIVE LAW JUDGE

DATED: April 26, 2021

¹⁵ See Board of Trustees of Univ. of Arkansas v. Andrews, 2018 Ark. 12.