

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

**ADMINISTRATIVE DECISION**

**IN THE MATTER OF** [REDACTED]  
[REDACTED]  
**(ACCT. NO.:** [REDACTED] **)**

**COMPENSATING (USE) TAX  
REFUND CLAIM DENIAL  
AUDIT NO.** [REDACTED]  
**AUDIT PERIOD: DEC. 2015  
THROUGH APRIL 2016**

**DOCKET NOS.: 21-341**

**AMOUNT DENIED:** [REDACTED]

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**TODD EVANS, ADMINISTRATIVE LAW JUDGE**

**APPEARANCES**

This case is before the Office of Hearings and Appeals upon written protest dated November 23, 2020, signed by [REDACTED] (“Senior Vice President”) on behalf of the [REDACTED] the Taxpayer. The Taxpayer protested an assessment issued by the Department of Finance and Administration (“Department”).

A hearing was held in this matter on May 12, 2021, at 9:00 a.m. in Little Rock, Arkansas. The Department was represented by Brad Young, Attorney at Law, Office of Revenue Legal Counsel (“Department’s Representative”). Also present for the Department was Jennifer White (Auditor), Michael Carver (Audit Supervisor) and Melissa Guin (District Manager). [REDACTED]

[REDACTED] (“Taxpayer’s Representative”), [REDACTED]  
[REDACTED], appeared at the hearing and represented the Taxpayer. Also present for the Taxpayer was [REDACTED]

[REDACTED] (“Procurement Manager”), [REDACTED] (“Engineer”), and [REDACTED] (“Director”).

**ISSUE**

Whether the Department’s refund denial is correct under Arkansas law.  
Yes, in part.

**FACTUAL AND LEGAL CONTENTIONS OF THE PARTIES**

**A. Prehearing Filing**

**1. Department’s Filing**

Within his Answers to Information Request, the Department’s Representative provided the following general information within his factual summary:

- **State the issue(s) (points of protest).**
  - Did the Taxpayer meet its burden to prove that it was entitled to a tax exemption on invoices related to the [REDACTED] of its [REDACTED] and [REDACTED] facilities? (No.)
  - Did the Taxpayer meet its burden to prove that it improperly paid sales and use tax on non-taxable services related to clerical work, warehousing services, [REDACTED] testing services, and landscaping? (No.)
  - Did the Taxpayer meet its burden to prove that it paid sales and use tax on the nontaxable initial installation, alteration, addition, refinishing, replacement, or repair of non-mechanical, passive, or manually operated components of buildings or other improvements or other structures affixed to real estate? (No.)
  - Did the Taxpayer meet its burden to prove that the [REDACTED] [REDACTED] installation, [REDACTED] stairs, and control room repairs were nontaxable initial installations in new construction? (No.)

- Did the Taxpayer meet its burden to prove that its purchase of a [REDACTED] was a nontaxable purchase of testing equipment? (No.)

- **Discuss in detail the facts upon which you rely to support your case.**

The Taxpayer operates a [REDACTED]. The Taxpayer [REDACTED]. The Taxpayer is a direct pay permit holder.

On or about December 20, 2018, the Taxpayer submitted a refund request for tax period December 1, 2015 through March 31, 2016.<sup>1</sup> The records that the Taxpayer submitted included a flash drive consisting of a completed Form 2004-6 refund claim packet, accounts payable tax accrual reports, purchase invoices, and purchasing documents. The auditor audited the Taxpayer's refund schedule by tracing to the purchase invoices and accounts payable tax accrual reports and information in the Department's record of tax payments to verify the information submitted. The auditor prepared schedules. Schedule A<sup>2</sup> identified the allowed purchases under the Taxpayer's refund claim. The auditor allowed a total refund amount of [REDACTED],<sup>3</sup> which represented tax paid on the installation and repairs to real property, purchase of exempt services, and purchase of non-enumerated services.

Schedule B – Refund Claim Disallowed Purchases identified purchases for which the Taxpayer had not demonstrated its entitlement to a tax exemption.<sup>4</sup> The auditor determined that the purchases in Schedule B consisted of taxable purchases of landscaping services, mechanical repairs, tangible personal property, and purchases for which the Taxpayer had not provided sufficient documentation. For ease of reference, the auditor also prepared Schedule C – Refund Claim Basis for Adjustment Summary, that identified the regulatory bases for disallowing amounts within the refund claim.<sup>5</sup> Schedule D – Refund Claim Taxpayer Disagreed Disallowed Purchases, identifies all non-

<sup>1</sup> The Department's Representative cited Exhibit 1.

<sup>2</sup> The Department's Representative cited Exhibit 2.

<sup>3</sup> The Department's Representative cited Exhibit 3 and noted that the refund amount was [REDACTED] less a [REDACTED] in the amount of [REDACTED].

<sup>4</sup> The Department's Representative cited Exhibit 4.

<sup>5</sup> The Department's Representative cited Exhibit 5.

conceded disallowed purchases for which the Taxpayer disagreed with the auditor's adjustments.<sup>6</sup> Schedule E – Taxpayer Disallowed Purchases Correspondence, listed disagreed purchase along with available detail and correspondence from the Taxpayer:<sup>7</sup>

- Schedule E, Attachment 1 – 8/7/2019 Taxpayer Response Schedule;<sup>8</sup>
- Schedule E, Attachment 2 – 6/17/2020 Taxpayer Provided Images;<sup>9</sup> and
- Schedule E, Attachment 3 – 8/31/2020 Taxpayer Contested Issues Email.<sup>10</sup>

On October 5, 2020, the Department issued a Notice of Claim Denial.<sup>11</sup> The Taxpayer timely filed this protest.

Regarding the [REDACTED] services, the Department's Representative rejected the Taxpayer's claim that such services represented services associated with the [REDACTED]. While the facilities were new, he averred that the Taxpayer and its vendors have failed to detail the associated services that were purchased. He noted that the invoices from [REDACTED]<sup>12</sup> involve purchases of labor, paint, equipment, and gaskets but does not detail what was done or that the transactions were associated with new constructions or substantially modified buildings. Additionally, he acknowledged that the [REDACTED] invoices<sup>13</sup> involve purchases of various labor services, but again failed detail what was done or that

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<sup>6</sup> The Department's Representative cited Exhibit 6.

<sup>7</sup> The Department's Representative cited Exhibit 7.

<sup>8</sup> The Department's Representative cited Exhibit 8.

<sup>9</sup> The Department's Representative cited Exhibit 9.

<sup>10</sup> The Department's Representative cited Exhibit 10.

<sup>11</sup> The Department's Representative cited Exhibit 11.

<sup>12</sup> See Department's Exhibit 12. These invoices discuss [REDACTED] [REDACTED] cabling, [REDACTED] with various laborers, equipment rentals, and paint and other material purchases.

<sup>13</sup> See Department's Exhibit 13. These invoices list a [REDACTED] support, cabling, and various laborers.

the transactions were associated with new constructions or substantially modified buildings.

Regarding the alleged nontaxable services, the Department's Representative initially noted that the invoices associated with the intern clerical services and warehouse support services<sup>14</sup> involves a cleaning company (whose services are generally taxable) and the Taxpayer has failed to provide evidence to clarify the performed services. The Department's Representative stated that the invoices involving services characterized as [REDACTED]<sup>15</sup> fail to detail the performed services and no other breakout has been provided to establish the performance of nontaxable services. Addressing the invoices associated with [REDACTED]<sup>16</sup>, the Department's Representative stated the invoices discussed the [REDACTED] but the Taxpayer's engineer described the transaction as part of a [REDACTED]. No other documentation was provided. Discussing the [REDACTED] invoices<sup>17</sup>, he asserted that the associated invoices involve [REDACTED] [REDACTED], which he characterized as taxable erosion control landscaping under Arkansas Gross Receipts Tax Rule GR-9.2(C)(1).

Regarding the alleged mechanical repairs, the Department's Representative asserted that the Taxpayer failed to establish that handrails, stairs, and platforms are not taxable repairs to components of machinery. With

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<sup>14</sup> See Department's Exhibit 14. These invoices include the labor for various workers (including a "clerical intern" and "warehouse support") and ATV and vehicle rentals.

<sup>15</sup> See Department's Exhibit 15. These invoices list charges for "operational support".

<sup>16</sup> See Department's Exhibit 16. These invoices list charges for labor and material to assist water [REDACTED]

<sup>17</sup> See Department's Exhibit 17. These invoices list charges for [REDACTED] [REDACTED], line repairs, and truck and other equipment rentals.

respect to [REDACTED], he stated that the Taxpayer's failed to provide sufficient detail to establish entitlement to an exemption.

Regarding the [REDACTED]<sup>18</sup>, [REDACTED] stairs<sup>19</sup>, and [REDACTED]<sup>20</sup>, he asserted that the Taxpayer failed to establish entitlement to an exemption and that the associated services were not simple repairs.

Regarding the [REDACTED] invoice<sup>21</sup>, he argued that the Taxpayer has not provided evidence to establish that the [REDACTED] is actually used to test intermediate product and qualifies as testing equipment.

## **2. Taxpayer's Filing**

Within his Answers to Information Request, the Taxpayer's Representative provided the following background information and an analysis, stating as follow in relevant part<sup>22</sup>:

### **The Taxpayer**

[REDACTED]

### **The Refund Claim**

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<sup>18</sup> See Department's Exhibit 18. These invoices list charges for field labor and materials for [REDACTED]

<sup>19</sup> See Department's Exhibit 19. This invoice only lists [REDACTED] stairs.

<sup>20</sup> See Department's Exhibit 20. These invoices list motion sensors, conduits, a portable building swap, [REDACTED], associated labor, tubing, tray cables, panels, tape, and cable ties.

<sup>21</sup> See Department's Exhibit 21. This invoice lists six [REDACTED] without additional detail.

<sup>22</sup> Citations omitted.

█ submitted a refund claim to the Department of Finance and Administration (“Department”) for the use taxes accrued on certain █ purchase transactions that should qualify as either nontaxable or exempt purchases. The auditor assigned to the refund claim approved a portion of the refund claim and disallowed certain transactions primarily stating that the service was either a mechanical repair or that insufficient documentation was provided to support the exemption claimed. During the course of the refund claim review, █ provided the auditor with additional documentation, research, email representations from vendors and plant personnel, and access to plant personnel to provide clarity as to the nature of the refund purchases. On October 05, 2020, the Department issued a Notice of Claim Denial and a Protest of Refund Claim Denial was filed timely by █

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### **Refund Transactions**

Arkansas imposes a sales tax on the sales of tangible personal property and specifically enumerated taxable services. Arkansas also provides exemptions from the sales tax for certain services and tangible personal property and as a result, █ is requesting a refund of use tax paid on transactions which (i) are not enumerated as taxable pursuant to Arkansas statute, or (ii) qualify for the available exemptions in Arkansas.

#### ***I. New Construction and █ Services*** ***Tax Authority***

Pursuant to Ark. *GR-9.17(B)(1)* and Ark. *GR-9.17(C)(2)* the initial installation of mechanical and non-mechanical equipment is not subject to Arkansas tax when the installation is provided in connection with the construction or substantial modification of a building or other improvement or structure affixed to real estate.

“Initial installation” shall mean **the first time setting up for use or service of the tangible property** by connecting, fastening, attaching, joining, securing, building in, mounting, or otherwise **affixing the property in the required location**, except when the installation is provided in connection with the construction or substantial modification of a building or other improvement or structure affixed to real estate.

Arkansas sales and use tax regulations state that the **service of initial installation** of flooring, motors, electrical appliances or devices, household appliances, or **machinery in a newly constructed or substantially modified building or other improvement or structure affixed to real estate is not taxable**. Individuals or businesses that provide labor to install flooring, motors, electrical appliances or devices, household appliances, or machinery in new construction are acting as contractors and are not providing taxable

services. The contractor should either pay tax to the supplier on the materials and equipment used in the installation, or self-assess tax as a withdrawal from inventory (stock) on the purchase price of all materials.

The test for determining whether items are “fixtures” is: (i) whether the items are **annexed** to the realty; (ii) whether the items are appropriate and **adapted** to the use or purpose of that part of the realty to which the items are connected; and (iii) whether the party making the annexation **intended** to make it permanent.

In a 2017 administrative decision, a taxpayer argued that its (undisclosed item) was installed and attached into new real property and should be tax exempt. However, the Department argued that while the item may be attached to new real estate, the item was not permanently affixed to real estate because it was simply bolted to the concrete. Further, the Department argued that the item could be unbolted without damaging the realty and therefore should be subject to use tax as tangible personal property. The ALJ noted that while the Department's argument that *whether or not an item can be removed without injury to the real estate* was an important consideration for purposes of the decision, it should not be viewed as a separate “fourth test.” Ultimately, the ALJ ruled that the item at issue was attached to realty – both hardwired and plumbed – and that, in its absence, the concrete slab and utility service for the item would have to be removed with significant damage to the real estate.

In *Cowan v. Thompson*, 178 Ark. 44, 49, 9 S.W.2d 790 (1923), the opinion of the Arkansas Supreme Court stated that definitions of the word “repair” include: (1) “to restore to a sound or good state”; and (2) “to restore or reinstate as in former standing.” The restoration of an electrical device (or machinery) to its original state, by or through calibration, is a repair of the electrical device (or machinery). Consequently, calibrations are generally taxable.

### New Construction

██████ is requesting a refund for use tax remitted on purchases of initial installation of machinery during the new construction of ████████ and the ████████ facility. ████████ has met its burden of proof to show that:

- (1) The work was performed during the new construction of the ████████ and ████████ facilities; and
- (2) The work that was performed was for newly constructed improvements or structures affixed to real estate.

In regards to the first point, Taxpayer has requested a refund for several purchases from ████████ (invoice numbers ████████ ████████) for the installation of ████████ and ████████



other permanent fixtures at the [REDACTED] facility. These services occurred from October 2015 through March [REDACTED] which were prior to the operational start-up of its [REDACTED] and [REDACTED] facilities.

In regards to the second point, the piping was (i) annexed to the realty, (ii) and designed (i.e., adapted) specifically for the transportation of the [REDACTED] manufactured at [REDACTED] and (iii) intended to be a permanent installation transporting [REDACTED] for the duration of its production at the plant. Please refer to the pictures in Exhibit 1 on pages 61-62 for pictures of the new [REDACTED] and [REDACTED] facility.

In fact, [REDACTED] qualified for and received the [REDACTED] sales and [REDACTED]

These initial installations of fixtures such as piping were done as part of the construction of the new [REDACTED] and [REDACTED] facilities. Therefore, [REDACTED] initial installation charges related to the construction of the new [REDACTED] and [REDACTED] facility also qualify for the exemption.

#### [REDACTED] Services

[REDACTED] is requesting a refund for use tax remitted in December 2015 and January [REDACTED] on purchases of [REDACTED] and from [REDACTED].

[REDACTED] has met its burden of proof to show that:

- (1) The [REDACTED] start up, support, and shut down services were performed during the new construction stage of the [REDACTED] and [REDACTED] facilities; and
- (2) These services did not involve any taxable “repairs” to machinery.

[REDACTED] services, by nature, are always provided prior to the operational start-up of a new plant because [REDACTED].

[REDACTED] is claiming a refund for use tax accrued on [REDACTED] services provided from [REDACTED]. The startup and shut down services were performed prior to and alongside the

performance testing. The performance testing was performed in [REDACTED]  
[REDACTED]

Prior to the operational start-up of plants, manufacturers hire contractors to ensure the plant functions as intended when production begins, and this involves [REDACTED] start-up, support, and performance tests reports. **From a legal perspective, the construction contract is considered completed when all stages of the construction are complete, and the plant passes the performance test.** Please refer to pages 63 - 73 of Exhibit 1 for the performance test report, which shows the [REDACTED] performance testing started on [REDACTED] and ended [REDACTED]. A [REDACTED] service is the process of ensuring that all systems and components of the facility are operating as designed. [REDACTED] and [REDACTED] provided [REDACTED] services at the newly constructed [REDACTED] and [REDACTED] facility to ensure they were designed, installed, and operating in accordance with [REDACTED] set standards.

[REDACTED] services are performed in conjunction with the construction and prior to start-up of the facilities and may involve minor fixes to ensure the facilities will operate as intended when they do become operational. The [REDACTED] services are not related to the repair of previously operational equipment, and as such qualify for exemption under Ark. GR-9.17(C)(2). The [REDACTED] services do not fall under the definition of "repair" in *Cowan v. Thompson*, 178 Ark. 44, 49, 9 S.W.2d 790 (1923) which means: (1) "to restore to a sound or good state"; and (2) "to restore or reinstate as in former standing". The equipment commissioned is not to (i) restore to a sound or good state, or (2) to restore or reinstate as in former standing. The equipment was not previously operational, the [REDACTED] service was to ensure that it will work as intended and not to restore the equipment to its former standing as there was no baseline for its former standing. It is evident that the [REDACTED] services performed were nontaxable and associated with the new construction.

In summary, [REDACTED] accrued used tax on services such as [REDACTED] performed prior to the operational start-up of the [REDACTED] and [REDACTED] facilities. These services were provided during the initial construction phase to ensure the plant functions as intended and are not subject to Arkansas sales tax as part of the initial installation of machinery in a newly constructed or substantially modified building or other improvement or structure affixed to real estate.

#### Documentary Support Provided

Please refer to Exhibit 1 for detailed support.

█ has provided pictures of the new █ facilities. Please refer to pages 61-62 of Exhibit 1. █ has also provided purchase orders which served as █ highest leveling of documentation at the time. The purchase orders tie the services provided by the contractors which are referenced on the invoices to the █ of the new █ facility. █ is a standard industry practice for manufacturers as it relates to newly constructed or substantially modified plants and █ is no different. Please refer to email correspondence on pages 86-87 of Exhibit 1 from █ engineer detailing what █ services entail.

Additionally, █ has provided their █ and █ annual reports which support the new construction or expansion of the █. █ also provided performance test reports which were conducted in █ to certify the plant, and the results of the performance test was issued in █. █ Manufacturers typically hire third party companies to run performance test reports to certify the standard of the plant and the services provided by their contractors in constructing the facilities. The performance test certification is one of the final steps performed prior to starting production. When the results of the performance test results are accepted by the manufacturer, then the plant is then ready to begin production. █ accepted the results of the performance test report and began production at the plant in █.

## ***II. Non-Mechanical, Passive, or Manually Operated Components of Buildings or Structures Affixed to Real Estate***

### Tax Authority

Arkansas sales and use tax regulations state that the **initial installation, alteration, addition, . . . refinishing, replacement, or repair of non-mechanical, passive or manually operated components of buildings or other improvements or structures affixed to real estate**, including but not limited to the following: walls, ceilings, doors, locks, windows, glass, heat and air ducts, roofs, wiring, breakers, breaker boxes, electrical switches and receptacles, light fixtures, pipes, plumbing fixtures, fire and security alarms, intercoms, sprinkler systems, parking lots, fences, gates, fireplaces, and similar components which become a part of real estate after installation, are **not taxable services**. The contractor must either pay tax to the supplier on the materials used in the work, or self-assess tax as a withdrawal from inventory (stock) on the purchase price of the materials used.

The test for determining whether items are “fixtures” is: (i) whether the items are **annexed** to the realty; (ii) whether the items are appropriate and **adapted** to the use or purpose of that part of the realty to which the

items are connected; and (iii) whether the party making the annexation **intended** to make it permanent.

*Arkansas Department of Finance Opinion Gross Receipts Tax and Metal Staircases Opinion No. 20170624 (4/23/2018)*, the Revenue Legal Counsel held that a taxpayer who fabricates, installs, repairs, alters or replaces staircases is not required to collect sales tax from its customers because the taxpayer is not providing a taxable service. Additionally, in *Arkansas Department of Finance Decision Administrative Hearing Decision 18-342 (06/03/2019)*, the ALJ concluded that a taxpayer's installation of a steel platform cannot be considered a component part of the manufacturing machinery because the "platform does not perform a 'recognizable and measurable mechanical, [REDACTED] electrical or electronic action' in the manufacturing process but merely provides access to the machinery for employees."

#### Initial Installation of Non-Mechanical or Passive Fixtures

[REDACTED] is a [REDACTED] and [REDACTED] has both non-mechanical or passive and non-passive fixtures attached to realty around the plant. The passive parts include but are not limited to handrails, stairs, platforms affixed to realty. The passive parts [REDACTED] is requesting a refund for are found all around the plant and some such as the handrails, stairs, and platforms serve as a safety mechanism and provide access to various parts of the plant. During the refund period as with any [REDACTED] [REDACTED] installed, maintained, and repaired passive fixtures attached to realty such as handrails, stairs, and platforms. [REDACTED] purchases the services such as initial installation to non-mechanical or passive fixtures from [REDACTED] (invoice numbers [REDACTED]), [REDACTED] ([REDACTED]), and [REDACTED] ([REDACTED])).

[REDACTED] has met its burden of proof to show that:

- (1) The fixtures are non-mechanical or passive in nature; and
- (2) The installations are fixtures to realty.

The Department asserts [REDACTED] did not meet its burden to prove that the installation of these items were exempt as non-mechanical or passive components of buildings affixed to real estate and not simply repairs to components of existing machinery. However, [REDACTED] provided numerous images of the handrails, platforms, and other passive fixtures and their specific locations around the plant that can be found in Exhibit 2 on pages 55, 57, and 60. The images provided relate to the transactions for which [REDACTED] is requesting a refund for use tax erroneously paid. From the images provided, it is clear to see that the handrails are not located near to, and neither are they connected to any specific piece or pieces of machinery. It

is evident that the handrails are (i) annexed to the realty, (ii) and designed (i.e., adapted) to the use or purpose to get access to the newly constructed area (iii) intended to be a permanent installation. Similarly to the platforms referenced in *Arkansas Department of Finance Decision Administrative Hearing Decision 18-342 (06/03/2019)*, the handrails, staircases, and platforms at the [REDACTED] plant do not perform a recognizable and measurable mechanical, [REDACTED] electrical or electronic action in the manufacturing process but merely provides employees access to the machinery.

[REDACTED] also accrued use tax on the installation of [REDACTED] by [REDACTED] and [REDACTED] stairs by [REDACTED]. The Department asserts [REDACTED] did not provide sufficient documentation to prove that its purchase was entitled to exemption. The [REDACTED] were installed on [REDACTED] piping which is located outside the plant where actual manufacturing activity occurs. The [REDACTED] is (i) annexed to the realty, (ii) designed and adapted for its use which is transportation, and (iii) intended to be a permanent installation. The [REDACTED] is therefore considered a passive fixture attached to realty.

The [REDACTED] stairs were installed around the newly constructed [REDACTED] which store the [REDACTED] manufactured in the [REDACTED] facility. The stairs provide access to the [REDACTED] area that was newly constructed. [REDACTED] also provided images of the [REDACTED] stairs which can be found on page 62 of Exhibit 2, and from the images, it is clear to ascertain that the stairs are not connected to any piece of machinery. It is evident that the stairs are (i) annexed to the realty, (ii) and designed (i.e., adapted) to the use or purpose to get access to the newly constructed [REDACTED] area (iii) intended to be a permanent installation. Therefore, the installation of the stairs is related to the non-taxable initial installation and construction of the [REDACTED] tanks and is the installation of a non-mechanical or passive fixture to realty. Consequently, it is evident that the installation of the [REDACTED] and [REDACTED] stairs were not part of any part of any machinery and is defined as passive fixtures to realty.

[REDACTED] purchased services to install non-mechanical or passive fixtures to realty such as handrails, stairs, platforms, and [REDACTED]. These non-mechanical or passive fixtures were annexed to the realty, adapted to the purpose of the realty to which it was connected, and was intended to be permanent. [REDACTED] has provided ample documentary evidence showing the installations are non-mechanical or connected to any piece of machinery, are attached to the realty, and is intended to be a permanent fixture.

#### *Documentary Support Provided*

Please refer to Exhibit 2 for detailed support.

### ***III. Non-Taxable Services***

#### ***Tax Authority***

Ark. Code Ann. § 26-52-301 and Ark. Code Ann. § 26-52-301 enumerates services that are subject to tax in Arkansas. Generally, services falling outside of the specifically enumerated services are not subject to tax. Some of the services enumerated as taxable include but are not limited to: wrecker and towing services, collection and disposal of solid wastes, cleaning of parking lots, dry cleaning and laundry services and so forth.

#### ***Services Not Enumerated as Taxable***

█ is requesting a refund of use tax paid on services outside of the specifically enumerated services in Arkansas. █ has met its burden of proof to show that the services for which a refund is requested are not enumerated as a taxable service in Arkansas.

- Clerical services provided by interns – █ purchased clerical intern services from █ (█). The interns assisted with administrative functions such as accounting and purchasing activities and filing paperwork in the file room and computer work. These services are not an enumerated taxable service in Arkansas. The Department maintains that the company providing the clerical services, █ is a janitorial services company. However, █ is a service provider who provides an array of services including but not limited to clerical services. As mentioned previously, █ did not have a formal contracting process during the audit period and as such their purchase orders are their highest level of documentary evidence. The purchase orders provided corroborate the invoices submitted which show non-taxable clerical services. The imposition of the Arkansas sales tax must be reasonably and strictly construed in limitation of their application giving the words their plain and ordinary meaning. The plain and ordinary meaning of the enumerated taxable services in Arkansas do not include clerical administrative services.
- Warehouse support services - █ purchased warehouse support services from █ (█). The individuals assisted with warehouse support services such as pulling parts and supplies out of the warehouse and delivering the supplies to different crews located throughout the plant to people who are conducting the actual repairs and maintenance at the plants. These services are not an enumerated taxable service in Arkansas. The Department maintains that the

company providing the warehouse support services, [REDACTED] is a janitorial services company. However, [REDACTED] is a service provider who provides an array of services including but not limited to warehouse support services. As mentioned previously, [REDACTED] did not have a formal contracting process during the audit period and as such their purchase orders are their highest level of documentary evidence. The purchase orders provided corroborate the invoices submitted which show non-taxable warehouse support services. The imposition of the Arkansas sales tax must be reasonably and strictly construed in limitation of their application giving the words their plain and ordinary meaning. The plain and ordinary meaning of the enumerated taxable services in Arkansas do not include warehouse support services.

- [REDACTED] services - [REDACTED] purchased [REDACTED] services from [REDACTED] ([REDACTED]). [REDACTED] provided non-taxable [REDACTED] services through [REDACTED] helped [REDACTED] develop a more efficient maintenance program for their facilities and supported the operations of the [REDACTED] plant. [REDACTED] currently works for [REDACTED] providing the same [REDACTED] plant support [REDACTED] services he provided while working through [REDACTED]. Professional services such as [REDACTED] services are not an enumerated taxable service in Arkansas. The Department asserts that [REDACTED] did not provide a copy of its contractor scope of work-planning and scheduling contract agreement with [REDACTED]. [REDACTED] did not have a contract in place with [REDACTED] at the time, therefore, we must look to the purchase order and invoice which combined describe the services provided. [REDACTED] as a professional engineer was providing consulting and support services for the [REDACTED] plant which are not subject to Arkansas sales tax.
- [REDACTED] services - [REDACTED] purchased [REDACTED] services from [REDACTED]. [REDACTED] services is the process of filling a container with water to test for leaks. The [REDACTED] services were required to test the new construction of the [REDACTED] for leaks. The [REDACTED] which was a component of the newly constructed [REDACTED] facility. [REDACTED] services are not enumerated taxable services in Arkansas. The Department asserts that [REDACTED] did not provide a copy of the written agreement with the vendor or other information that establishes [REDACTED] entitlement to an exemption. [REDACTED] did not have a formal contract in place with [REDACTED]. [REDACTED] did provide notes from discussion with the vendor and an [REDACTED] engineer detailing that a new [REDACTED] was constructed and tested by filling the tank

with water to confirm there were no leaks in the tank in anticipation of product storage.

█ accrued use tax on service transactions which are not enumerated as taxable under Arkansas statute. These services include clerical intern services, warehouse support, █ and █ which do not involve any repair services to mechanical components of the plant. Therefore, these services are also exempt from the sales tax imposed in Arkansas.

#### Documentary Support Provided

Please refer to Exhibit 3 for detailed support.

#### **IV. Testing Equipment**

##### Tax Authority

Testing equipment that is used to measure the quality of the manufactured article of commerce and otherwise meets the requirements for exemption as manufacturing machinery and equipment is exempt from tax. The equipment is exempt if it is used to test any portion of the product from the point when manufacturing begins. Testing equipment that tests the raw materials prior to the beginning of manufacturing is not exempt. Testing equipment that tests items other than the product, or its component parts, is not exempt. For example, equipment that tests whether the manufacturing machinery is functioning properly is not exempt as testing equipment.

█

█ purchased a █ (█). The █ is located in the █ and the product sampling takes place after the manufacturing process begins. The █ is used to test samples of the intermediate █ product. The █ qualifies for exemption under *Ark. GR9-55(I)* which provides an exemption for "testing equipment" used to measure the quality of the manufactured item at any point after manufacturing has started.

█ is requesting a refund of the use tax paid on the testing equipment. █ has met its burden of proof to show that:

1. The █ is a piece of testing equipment; and
2. The █ is used to test intermediate products and not raw materials.



█ performs quality control testing █ they manufacture in order to maintain their set quality standards. Testing the █ is essential to maintaining █ recognizable brand name as a leading █ manufacturer. As part of their quality control testing process, █ purchases █ that are used to █ and test the quality of the █ being manufactured for sale.

The Department asserts that █ did not provide documentation that demonstrates what the █ does or how it functions in the manufacturing process. █ has provided product guidance directly from the manufacturer, █ describing that the █ is used for taking samples. The █ is coded to the █ cost center, meaning this is the area of the plant that it was purchased for and where it is being used. The █ are used to test samples when the manufacturing process has started. The █ plant is an interconnected functioning plant in that █ purchases the raw material

█ can then be processed into █. The █ is located at the █ therefore by virtue of the interconnected functioning of the plant, the █ is testing an intermediate product that has already gone through the █ manufacturing process and will become part of the finished █ produced.

█ accrued use tax on non-taxable testing equipment used to sample and test the █. The purchase of testing equipment used in testing intermediate products are not subject to tax, therefore, █ purchase of the █ is also not subject to Arkansas sales tax.

Documentary Support Provided

Please refer to Exhibit 4 for detailed support.

**B. Hearing Testimony<sup>23</sup>**

**1. Auditor's Testimony**

**A. General Testimony**

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<sup>23</sup> The testimony regarding █ shall not be included within this summary. As will be explained within the analysis section, those invoices are deemed to be outside of this Office's jurisdiction at this time in the absence of a timely protest.

The Auditor testified that the Taxpayer is a [REDACTED] manufacturer. This proceeding arose from a refund claim submitted by the Taxpayer. The Taxpayer provided a usb thumb drive containing invoices, purchase orders, and requisition copies. She requested additional information that was partially provided. The Taxpayer failed to provide all of the requested information. The Taxpayer has other pending refund claims that may be affected by the hearing decision. She has reviewed the Taxpayer's protest and briefing. She has also reviewed the Department's filing and certified the exhibits attached thereto.

B. New Construction and [REDACTED]

i. [REDACTED] Services

While the Taxpayer claims that these invoices are related to the [REDACTED] and [REDACTED] facilities and exempt as initial installations of manufacturing machinery, she denied the items for lack of proof. Though additional documentation was requested, nothing was provided. Some invoices were provided from [REDACTED] but those invoices did not indicate what the services were associated with. She simply could not verify the appropriateness of the exemption claims. The Taxpayer provided an email from the Engineer that stated the invoices were associated with the mechanical completion and [REDACTED] of [REDACTED] however, the email (standing alone) does not establish that an exemption applies.

She reviewed the invoices provided by [REDACTED] Those invoices were also deficient. An email from the Engineer stating that the transactions were associated with the construction and completion of the [REDACTED]

facility for the [REDACTED] plant was also insufficient. She needed more information to verify the accuracy of the emailed statement.

### C. Nonmechanical and Passive Structures Affixed to Real Estate

#### i. Handrails, Stairs, and Platforms

The Auditor testified that the Taxpayer claimed a refund with respect to installations of the handrails, stairs, and platforms. She reviewed the Taxpayer's documentation. Mechanical repairs are generally taxable. The photos have not established entitlement to an exemption for passive, nonmechanical real estate fixtures.

#### ii. [REDACTED]

The Auditor testified that she reviewed invoices from [REDACTED] [REDACTED] [REDACTED]. Those invoices involved [REDACTED] asserted by the Taxpayer to represent new installations. The Department was not able to verify that the claimed exemption applied.

#### iii. [REDACTED] Stairs

The Auditor testified that she reviewed an invoice regarding [REDACTED] [REDACTED] stairs, which was also claimed to be an initial installation. She lacked sufficient information to establish entitlement to the claimed exemption. During the audit, the Taxpayer's personnel ([REDACTED] and the Procurement Manager) indicated that the Taxpayer initially installed only one set of stairs, but [REDACTED] to be installed. The stairs were also discussed during a teleconference with the Taxpayer's personnel.

### D. Nontaxable Services

The Auditor testified that the Taxpayer claimed certain service invoices were nontaxable.<sup>24</sup>

i. Clerical Services

One category of alleged nontaxable items was characterized as clerical services. The Auditor denied the refund for these items due to inadequate documentation. The vendor for these services was [REDACTED]. That vendor generally provides groundskeeping and office cleaning services. This information came from several websites that appeared after a Google search. Additionally, she inquired about the vendor's activities during one of her teleconferences with [REDACTED]. That employee confirmed that the vendor was not a temp agency and did not provide temporary employees. He also stated that the Taxpayer uses a different agency for temporary employees. She requested a written contract or any other documentation to clarify the scope of services, but nothing was provided. The invoices did not specifically state that cleaning services were performed. Arkansas sales tax only applies to specifically enumerated services and clerical services are not listed as taxable services. She based her conclusions on the provided documentation.

ii. Warehouse Support Services

Another category of items was characterized as warehouse labor. The Auditor denied the refund for these items due to inadequate documentation.

iii. [REDACTED] Services<sup>25</sup>

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<sup>24</sup> The associated invoices from [REDACTED] lists line items for warehouse support labor, clerical interns, labor for summer employees - clerical, crew vehicles, crew leaders, skilled labor, rental of [REDACTED]s, laborers, supervisors,

<sup>25</sup> The associated invoices list line items for [REDACTED] and [REDACTED] - [REDACTED] Work, JA [REDACTED], and [REDACTED] - [REDACTED] Plant Support.

Another category of items came from [REDACTED]. The Taxpayer alleged that this transaction solely involved the provision of [REDACTED] services. She was unable to confirm this statement due to inadequate documentation. The Auditor requested a written contract or scope of work related to the transactions but did not receive anything. Simply listing an engineer on invoices from a contractor is insufficient to establish that no taxable services were performed.

iv. [REDACTED] Services

The Auditor testified that the Taxpayer claimed an exemption for [REDACTED] by [REDACTED]. The invoice only mentioned filling water in an [REDACTED].<sup>26</sup> She could not confirm that the associated service would be nontaxable. Though additional records were requested, nothing was provided. The invoice listed [REDACTED] that referenced back to a supply or parts store. Additionally, the attached job cost sheets lists additional materials for the work performed and mentions a water flush. Filling a tank with water may not be a taxable service if that is all that is done. If the filling of a water tank required a repair, it would be considered taxable.

E. Quality Control Machinery and Equipment

i. [REDACTED]

Regarding [REDACTED] from [REDACTED] the Auditor testified that this item generally qualifies as tangible personal property and

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<sup>26</sup> The [REDACTED] states “fill water [REDACTED] and lists various quantities of labor; rental of trucks, a manlift, pumps, and excavator; and includes material cost for reducers, a flange, and piping. Additionally, the Engineer provided an email stating that the service was the filling of the [REDACTED] for testing before beginning operation.

taxable in the absence of an exemption. While the Taxpayer claimed entitlement to an exemption for testing equipment, she never received sufficient information to establish entitlement. The Taxpayer has not explained the purpose or use of the [REDACTED]. It is uncertain whether the [REDACTED] performs any testing or produces readouts.

## **2. Assertions of Department's Representative**

At the beginning of the proceeding, the Department's Representative noted that several invoices were attached to the Taxpayer's prehearing filing but not actually protested. Specifically, he listed the following invoice numbers: [REDACTED]. Since these items were not protested within the initial protest, he argued that any current attempt to protest the refund claim denial with respect to those invoices would be untimely as not occurring within sixty (60) days of the notice of the refund claim denial. Consequently, he reasoned that those items may not be considered for purposes of this proceeding.<sup>27</sup>

The Department's Representative noted that invoices related to the control room have been withdrawn from protest by the Taxpayer.

## **3. Procurement Manager's Testimony**

### **A. General Testimony**

The Procurement Manager testified that the Taxpayer now uses purchase requests to improve planning. After a request is granted, the Taxpayer issues

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<sup>27</sup> The Department was informed that the information and arguments related to the invoices would be received into the record for the proceeding, and a ruling would ultimately be made within the final decision whether the relevant invoices were properly before this Office.

requests for proposals for bids. During the refund claim period, the Taxpayer did not enter contracts with any contractors. They purchased what was needed. Purchase orders were typically signed at that time. He does not know why the filed purchase orders were not signed. He did not provide them to the Department.

B. New Construction and [REDACTED]

i. [REDACTED] Services

Regarding [REDACTED], he testified that the contractor was assisting the Taxpayer in the [REDACTED] services of the plant. At that time, the Taxpayer did not require any other document than a P.O. for payment. The P.O. is dated [REDACTED]. The [REDACTED] invoices do sometimes refer to a company named [REDACTED] was not hired to construct the [REDACTED] project. [REDACTED] was hired to help oversee the installations. He does not believe a written contract existed between [REDACTED] and the Taxpayer. Any work performed directly for the Taxpayer would be billed by purchase order as well. [REDACTED] built the [REDACTED] facility under a written contract with the Taxpayer. [REDACTED] separately billed the Taxpayer for its services. That contract was not provided to the Department. [REDACTED] performed their work under the direction of [REDACTED]. He is unable to differentiate repairs of error from other [REDACTED] services based on the current documentation.

C. Nonmechanical and Passive Structures Affixed to Real Estate

i. Handrails, Stairs, and Platforms<sup>28</sup>

Initially, the associated vendor ( [REDACTED] ) usually provide services rather than just property. He cannot remember ever purchasing property by itself from this vendor. It would be unusual if such an event occurred. All handrails are custom built, attached to real estate fixtures, and intended to be permanent. The Procurement Manager does not know whether the Taxpayer provided the materials to fabricate the handrails and platforms. Typically, materials would be mentioned within an invoice.

Referencing [REDACTED] (listing a [REDACTED] handrail” with an amount due and no separate line item for any services), the Procurement Manager testified that this transaction involved the installation of handrails around the top (i.e. the roof) and bottom (i.e. the ground) of the [REDACTED]. The handrails are attached to the concrete barrier around the equipment on the bottom and to the equipment on the top. The rails are intended to be permanent and designed for their purpose. The handrail is a physical thing and the invoices do not state whether the Taxpayer purchased the handrails or installation services. He does not know whether the handrails can be removed.

Referencing [REDACTED] with an amount due and no separate line item for any services), the Procurement Manager testified this item is a staircase and platform. This item is not attached to the machinery and are back away from the machinery. The item was custom

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<sup>28</sup> The Department’s Representative asserted that it was simply uncertain what was done in these matters and whether the associated stairs and platforms were actually components of machines. Consequently, he averred the Taxpayer has not established entitlement to a refund claim, particularly whether installation of a passive, nonmechanical structure occurred. The Taxpayer’s Representative asserted that the associated invoices involved installations of passive, nonmechanical structures affixed to real estate.



designed for its purposes and is permanently attached. The Taxpayer purchased the platform which is a material object. The invoice does not indicate whether the Taxpayer purchased a platform or installation. He does not think the platform can be removed but does not know how it is attached to the floor.

Referencing [REDACTED] [REDACTED] [REDACTED]” with labor for a journeyman, foreman, rental of a rig truck, welder, tools, small truck, and wheels), the Procurement Manager testified that the handrail is not attached to a machine, only the concrete floor. The item is specifically designed for its purpose and intended to be permanent. The handrails are not part of the machinery and do not physically touch the machine. The handrail is required by OSHA standards for the machine’s operation and can be removed by unbolting it from the floor.

Refencing [REDACTED] with an amount due and no separate line item for any services), the Procurement Manager testified that this transaction involved handrails for the [REDACTED] [REDACTED]. The handrails were custom designed, attached to the concrete foundation (not machinery), and intended to be permanent. No contract existed with [REDACTED] for any of the handrail work. The invoice does not state whether the Taxpayer purchased just the handrail or the installation. He does not know if the handrail can be removed.

ii. [REDACTED]

The Procurement Manager testified that he does not know whether the [REDACTED] were listed as maintenance supplies and materials but would not be surprised if that is the characterization within the general ledger.

iii. [REDACTED] Stairs

Referencing [REDACTED] (listing a “J [REDACTED] Stairs” with an amount due and no separate line item for any services), the Procurement Manager testified that the [REDACTED] is surrounded by concrete containment barrier. The stairs were necessary to get over the barrier to work on the tank. The stairs are not attached to any machinery, only the concrete. The staircase is customized for the wall and intended to be permanent. The invoice does not state whether the Taxpayer purchased just the stairs or the installation. He does not know if the stairs can be removed. The stairs were added as an OSHA requirement. He thinks the stairs were installed at the time of purchase. He does not know if the area had preexisting stairs. If he stated there were preexisting stairs during a teleconference, he does not dispute it.

D. Nontaxable Services

As Procurement Manager, he testified that he can quickly discern between clerical, warehouse, and other labor based upon the billings from [REDACTED]. The Taxpayer did not have a separate contract with that vendor. The Taxpayer is very careful regarding who enters and leave the property due to [REDACTED]. The Taxpayer maintains logs of all individuals entering and leaving the property. He does not know whether the contractors and their employees are prescreened. The Taxpayer just requested a type of help from [REDACTED] which does various things. He does not know whether the workers from [REDACTED] would qualify as exempt temporary employees. The Taxpayer utilizes several temporary worker agencies and does not know why the Taxpayer utilized [REDACTED] for clerical and warehouse support. He

supervised some of the clerical and warehouse support workers but not all of them. He is unaware of anyone that could detail all of their work. He did observe the office workers filing and boxing files.

i. Clerical Services

The Procurement Manager testified that [REDACTED] provides extra help to assist in office filing for [REDACTED] accounting, and file storage issues. These activities involve working within a file room. The individuals would remain in the office and do no other work, not even janitorial services. [REDACTED] also provided janitorial services but specifically billed the services as such. The Taxpayer no longer uses [REDACTED] for clerical help. He cannot explain why some of the invoices with charges for summer clerical or employees (for instance [REDACTED]) are dated in January and February. He averred, however, that they clearly did not occur within the summer. The Taxpayer did not specifically code the expenses to other departments than maintenance, but he has not seen the actual purchase orders.

ii. Warehouse Support Services

[REDACTED] also billed for warehouse labor. Any skilled labor or regular labor billings involved general labor throughout the plant including outdoor work. Warehouse labor involves the assisting of warehouse personnel with unloading trucks, stocking shelves, and issuing parts (essentially managing the inventory). One of the [REDACTED] employees worked on the grounds and moved to the warehouse. Only one [REDACTED] employee worked within the warehouse under the supervision of the warehouse employees. That employee

may have occasionally swept the floors with other warehouse employees, but dedicated janitorial personnel solely worked within the office.

iii. [REDACTED] Services

The Procurement Manager testified that no additional detail exists for the billings from [REDACTED] [REDACTED] was experienced in [REDACTED] plants and helped develop a [REDACTED] for the entire facility. That individual never worked on the plant components. No contract existed between the Taxpayer and [REDACTED]. The invoices do not mention any type of repair activity. He does not know if [REDACTED] provided [REDACTED] credentials. [REDACTED] was an engineer assisting [REDACTED]. He also does not know whether [REDACTED] provided [REDACTED] credentials. [REDACTED] was not an intern but may not have been a licensed engineer.

iv. [REDACTED] Services

The Procurement Manager testified that a contract did not exist between the Taxpayer and [REDACTED] [REDACTED]

E. Quality Control Machinery and Equipment

i. [REDACTED]

The Procurement Manager testified that the account upon the purchase order ([REDACTED]) for the purchased [REDACTED] indicates that it was used for [REDACTED] [REDACTED] handling.

**4. Engineer's Testimony**

A. New Construction and [REDACTED]

i. General Information

Addressing the new [REDACTED] facility, the Engineer testified the new [REDACTED] facility generates [REDACTED]. The new [REDACTED] [REDACTED] tank holds [REDACTED] and required to provide the storage necessary for surges in production to handle sales surges throughout the year. The material must be stored to handle peak and off-season sales. The material must be ready for shipment to fulfill orders.

Addressing the [REDACTED] facility, the Engineer testified the machinery utilizes [REDACTED] [REDACTED] are necessary to obtain the [REDACTED] [REDACTED] that is required. The process also utilizes [REDACTED] [REDACTED] [REDACTED]

Addressing the new [REDACTED] the Engineer testified that it has equipment that takes the [REDACTED] [REDACTED] [REDACTED] [REDACTED] to [REDACTED] The [REDACTED] [REDACTED] [REDACTED] [REDACTED]

Addressing the [REDACTED] [REDACTED] [REDACTED] [REDACTED]

Addressing a diagram of the preceding production process, the Engineer testified the [REDACTED]

[REDACTED]  
[REDACTED]  
[REDACTED]  
[REDACTED]

Addressing a diagram of the new production process, the Engineer noted that the process was basically the same except [REDACTED]

[REDACTED]  
[REDACTED]  
[REDACTED]

ii. [REDACTED] Services

Addressing [REDACTED]<sup>29</sup> and [REDACTED]<sup>30</sup>, the Engineer highlighted that the document specifically states it is associated with [REDACTED] [REDACTED]. The [REDACTED] facility [REDACTED] [REDACTED]. It was newly constructed during the refund claim period. [REDACTED] services occurs after the [REDACTED] and design (i.e. planning), major construction and service phase, and deemed mechanical completion. [REDACTED] involves the testing of systems to confirm completion and can take a month or more to complete. During [REDACTED] errors are often discovered that must be remedied before full operation of the plant. [REDACTED] often involves repairs necessary for the correction of those errors. It is possible that [REDACTED] occurred

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<sup>29</sup> This document has line items for [REDACTED] “ [REDACTED] and “additional work” on [REDACTED]  
<sup>30</sup> This document lists charges for [REDACTED] [REDACTED] with various types of labor, rental of boom truck and operator, and rental of a small truck with various small tools.

under this contract. He cannot tell what services or repairs were performed based on the invoices. A plant is not in a state of operation during [REDACTED] The [REDACTED] services are basically revisions or corrections to prior work completed by [REDACTED] Something could have been missing or improperly installed. Those errors are corrected as part of [REDACTED] [REDACTED] [REDACTED] may have performed repairs to the preexisting work or even simply inspections and testing. Many invoices do involve purchases of just manpower without associated materials; however, significant materials were likely already on site and may have been utilized in the performance of those activities. Some materials were listed on the associated time sheets. The small materials [REDACTED] [REDACTED] are often treated as included in the contract cost and not separately listed. The [REDACTED] invoices do predate the test report.

Addressing a performance test dated [REDACTED] the Engineer testified that, after [REDACTED] operations begin for the plant [REDACTED] [REDACTED]. The plant is then operated for period of time to prove that the appropriate metrics are achieved. [REDACTED] at the end of [REDACTED] This testing was last stage of construction before possession transferred to the Taxpayer as a completed project. The [REDACTED] services were provided before the test.

## B. Nonmechanical and Passive Structures Affixed to Real Estate

### i. [REDACTED]

Regarding [REDACTED]<sup>31</sup>, the Engineer testified that

[REDACTED] are installed [REDACTED]

[REDACTED] could be located between [REDACTED]

[REDACTED] The invoice date indicates that the work was being done prior to [REDACTED]. The [REDACTED] look similar to [REDACTED] that is not a device or a machine. The [REDACTED] is mostly above ground on pipe racks, sometimes at grade level.

ii. [REDACTED] Services

The Engineer testified that the [REDACTED] invoice involves the supplying of water to the new [REDACTED]. [REDACTED] requires a substantial effort to fill with water. The invoice is part of the [REDACTED] stage of the activity. The references to other equipment and materials are consumables to transport water and fill the tank.

[REDACTED]. The date of the invoice indicates that the transaction occurred before the operation of the tank and was not part of a repair.<sup>32</sup> [REDACTED] he does not know what the

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<sup>31</sup> These invoices list the purchases of several [REDACTED]

<sup>32</sup> The Taxpayer also provided an email from the vendor that confirmed no repair services were performed.



excavator was used for, but the piping is very cumbersome and heavy. Perhaps, the excavator assisted in transportation of piping.

The filling of tank requires [REDACTED]. The vendor likely performed only one test. [REDACTED]

### C. Quality Control Machinery and Equipment

#### i. [REDACTED]

Regarding [REDACTED] the Engineer testified that this transaction involves the purchase of a [REDACTED] [REDACTED] allows an operator to obtain a sample of a [REDACTED] (i.e. [REDACTED] for testing. [REDACTED] is used to sample [REDACTED] (i.e. work in progress) to ensure that product specifications are being met. [REDACTED] does not test product quality but simply [REDACTED] from the process for testing within the lab. He does not know how the lab performs [REDACTED]. The sole purpose for [REDACTED]

## 5. Tax Director's Testimony

The Tax Director testified that the Taxpayer's project qualified for the [REDACTED]. [REDACTED], the Taxpayer signed a [REDACTED]

[REDACTED]

**6. Assertions of Taxpayer’s Representative<sup>33</sup>**

Addressing the alleged failure to protest certain invoices, he asserted that the relevant invoices were listed within the disallowed schedules. He averred that those invoices were related to an existing issue category involving invoices related to new construction items. Even though the invoices were not specifically listed as being in protest at the time of the filing of the initial protest, he stated that their relation to an existing protest issue category and the listed invoices allows the consideration of the additional invoices. He noted that the prehearing filing had the additional invoices attached to it.

He began his presentation by providing an overview of the Taxpayer’s business operations. [REDACTED]

[REDACTED]

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<sup>33</sup> The Department’s Representative noted that the Taxpayer’s Representative was not sworn in and any factual statement should be given less weight than actual testimony.

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

He further noted that, during the refund claim period, the Taxpayer did not utilize formal requests for proposals or vendor contracts when purchasing services but procured materials from established vendors. The documentation for those purchases was only the purchase orders and vendor invoices. In 2018, the Taxpayer began utilizing a more formal process that includes requests for proposals and signed contracts.

He noted that the Taxpayer qualified for the [REDACTED] related to its improvements to the manufacturing facility.

After a general discussion of the burdens of proof in tax proceedings and a discussion of the applicable law, the contentions of the parties shall be addressed with a legal analysis and associated conclusions.

## **CONCLUSIONS OF LAW**

### **Burdens 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).

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 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.

Further, it is the duty of every taxpayer to make a return of any tax due under any state tax law and to preserve suitable records to determine the amount due. Ark. Code Ann. § 26-18-506(a) (Repl. 2020). A taxpayer’s records may be

examined by the Department at any reasonable time. Ark. Code Ann. § 26-18-506(b) and (d) (Repl. 2020).

## **Tax Assessment**

### **A. Newly Added Protest Items**

Initially, the Taxpayer's Representative raised objections to the assessment of various invoices that were not originally included within its list of transactions under protest included with the Taxpayer's protest. This category covers [REDACTED] [REDACTED] The Department's Representative objected to the consideration of any invoices that were not originally protested, believing any new objections to be untimely protests. The Taxpayer's Representative acknowledged that the transactions were not originally protested but stated that some of the newly protested invoices were included within the prehearing Answers to Information Request filing.

Ark. Code Ann § 26-18-404 (Repl. 2020) provides the following:

**(c)(1) Within sixty (60) days after service of notice of the proposed assessment or denial of a claim for refund, the taxpayer may file with the secretary a written protest under oath, signed by the taxpayer or the taxpayer's authorized agent, setting forth the taxpayer's reasons for opposing the proposed assessment or the denial of a claim for refund.**

**(2) No administrative relief will be available to a taxpayer who fails to protest or to a taxpayer who fails to request an extension of time to protest a proposed assessment of tax or denial of a claim for refund within the sixty (60) days following the service of notice of the proposed assessment or denial of a claim for refund. [Emphasis supplied.]**

Arkansas Gross Receipts Tax Rule GR-81.2(A) discusses protests, stating the following:

1. Protest of Assessment. If a taxpayer objects to a proposed assessment of tax, the taxpayer **must file his protest in writing within sixty (60) days of receipt of the Notice of Proposed**

**Assessment setting forth under oath facts and/or law supporting the protest of the assessment.** The protest shall be mailed to the address set forth in the Notice of Proposed Assessment. If the taxpayer fails to file a written protest within sixty (60) days of receipt of the Notice of Proposed Assessment, then the Director shall issue by certified mail, return receipt, a Notice of Final Assessment. Failure to pay the Notice of Final Assessment within thirty (30) days of receipt shall subject the taxpayer to the filing of a Certificate of Indebtedness, constituting a judgment, and to the collection remedies available to the Director.

2. **Protest of Refund Claim Denial.** If a taxpayer objects to the denial of a claim for refund, the taxpayer must file his or her protest in writing within sixty (60) days of receipt of the Notice of Claim Denial setting forth under oath facts and law to support the protest. The protest shall be mailed to the address set forth in the notice. The taxpayer shall specify the form of hearing as described in GR-81.2(B)(2). [Emphasis supplied.]

The Department interprets the governing statute and rule to require a protest to specify the specific transactions or issues that are being objected to within the protest and to mandate the filing of the protest within sixty (60) days of the receipt of the Notice of Proposed Assessment. Additionally, the raising of any new bases or issues for protest are considered to be additional protests or a modification of the original protest that is likewise subject to the sixty (60) day time limitation.

The interpretation of statutes by an administrative agency, while not conclusive, is highly persuasive. *Aluminum Co. of America v. Weiss*, 329 Ark. 225, 946 S.W.2d 695 (1997). An administrative agency's interpretation of a statute or its own rules will not be overruled unless it is clearly wrong. *Arkansas Dep't. of Human Servs. v. Hillsboro Manor Nursing*, 304 Ark. 476, 803 S.W.2d 891 (1991). The Arkansas Supreme Court has recognized that administrative agencies are often required to interpret statutes and rules. *Walnut Grove School*

*Distr. No. 6 of Boone County v. County Board of Education*, 204 Ark. 354, 162 S.W.2d 64 (1942).

Based on the relevant statute and rule, I am unable to find that the Department's interpretation is clearly wrong. In light of the presented arguments, Ark. Code Ann. § 26-18-404 (Repl. 2020) and Arkansas Gross Receipts Tax Rule GR-81.2(A) (with associated time limitations) bars consideration of the additional invoices protested for the first time during the administrative hearing. This determination appears to resolve those invoices discussed under the category of "new construction." Consequently, those invoices shall not be further analyzed within this decision and detailed testimony regarding the transactions has been removed.

## **B. Assessment of Protested Items**

### **1. New Construction and [REDACTED]**

Subject to the applicability of an exemption, a deduction, or a credit, use tax is imposed on sales of tangible personal property or specifically enumerated taxable services (meaning those services subject to Arkansas sales tax) made by out-of-state vendors/sellers to in-state purchasers. Ark. Code Ann. §§ 26-53-102(25) and 26-53-106 (Repl. 2020). When services are exempted from Arkansas sale tax, those services are likewise exempted from the Arkansas Compensating Use Tax. Ark. Code Ann. § 26-53-112(2) (Repl. 2020). Generally, the services of initial installation, alteration, addition, replacement, and repair of electrical appliances and devices, machinery of all kinds, mechanical tools, and shop equipment are taxable. Ark. Code Ann. § 26-52-301(3)(B)(i) (Repl. 2020).

#### **i. [REDACTED] Services**

With regard to this type of item, the Department's Representative stated that the associated invoices do not state what services were performed, preventing verification that the services were part of the new construction. The Taxpayer's Representative asserted that the invoices were associated with the conclusion of the new construction project and should qualify for the exclusion under Arkansas Gross Receipts Tax Rule GR-9.17(C)(2). Arkansas Gross Receipts Tax Rule GR-9.17(C)(2) provides an exclusion for certain services, stating"

**Initial Installation in New Construction.** The service of initial installation of flooring, motors, electrical appliances or devices, household appliances, or machinery in a newly constructed or substantially modified building or other improvement or structure affixed to real estate is not taxable. Individuals or businesses that provide labor to install flooring, motors, electrical appliances or devices, household appliances, or machinery in new construction are acting as contractors and are not providing taxable services. The contractor should either pay tax to the supplier on the materials and equipment used in the installation, or self-assess tax as a withdrawal from inventory (stock) on the purchase price of all materials.

While the related invoices do appear to predate the full operation of the plant, the associated invoices do not explicitly state what was done during the relevant transactions. Additionally, neither the Procurement Manager nor the Engineer were able to state what services were performed in relation to the invoices. Their testimony essentially was that the invoices must have involved something related to the activation of the new parts of the plant. No testimony was provided from the individuals who actually performed the underlying services. The uncertainty regarding these transactions prevents me from verifying that these services were associated with the "initial installation" of a motor, appliance, or device with a newly constructed or substantially modified real estate improvement. The record does not preponderate in favor of the application



of the claimed exclusion. Consequently, the Taxpayer has not established its entitlement to a refund for the invoices protested within this category.

## **2. Nonmechanical and Passive Structures Affixed to Real Estate**

As stated above, the services of initial installation, alteration, addition, replacement, and repair of electrical appliances and devices, machinery of all kinds, mechanical tools, and shop equipment are generally taxable. Ark. Code Ann. § 26-52-301(3)(B)(i) (Repl. 2020). Further, Arkansas Compensating (Use) Tax also generally applies to the privilege of storing, using, distributing, or consuming tangible personal property and taxable services within the State of Arkansas that were purchased outside this state. Enumerated taxable services remain taxable regardless of whether the serviced items are affixed to real estate. *Department of Finance & Administration v. Otis Elevator*, 271 Ark. 442, 609 S.W.2d 41 (1980).

The Arkansas Supreme Court has explained that all of the machines and devices that are interconnected to accomplish a single purpose must be analyzed as a single machine. *S H & J Drilling Corp. v Qualls*, 268 Ark. 71, 593 S.W.2d 178 (1980), and *Southern Steel & Wire Co. v. Wooten*, 276 Ark. 37, 631 S.W.2d 835 (1982). Further, Arkansas Gross Receipts Tax Rule GR-55(D)(3) provides as follows:

When individual machines or machinery are interconnected in order to accomplish a single function and the function of each such individual machine is not complete before the adjacent machines begin to function, the result is a new single identifiable machine. The machinery purchased to replace this resulting existing machine must satisfy the requirements of GR-55(D)(2) above and the exemption is not available for the replacement of only some of the individual machines that now form component parts of the aforementioned machine. . . .

Further, this Office and judicial courts have generally treated ladders, platforms, and stairways that merely provide access to manufacturing machinery (but do not function as component parts of the machinery) as separate components from the associated machinery. See Docket Nos. 18-342, see also *Southwestern Portland Cement Co. v. Lindley*, 67 Ohio St.2d 417, 423, 424 N.E.2d 304, 308 (1981); *Schweitzer-Maudit Intern., Inc. v. Director, Div. of Taxation*, 2013 WL 1798900 (N.J. App. Div. 2013).

Additionally, Ark. Code Ann. § 26-52-301(3)(B)(vii)(a) (Repl. 2020) provides the following:

Additionally, the gross receipts tax levied in this section shall not apply to the initial installation, alteration, addition, cleaning, refinishing, replacement, or repair of nonmechanical, passive, or manually operated components of buildings or other improvements or structures affixed to real estate, including, but not limited to, the following:

- (1) Walls;
- (2) Ceilings;
- (3) Doors;
- (4) Locks;
- (5) Windows;
- (6) Glass;
- (7) Heat and air ducts;
- (8) Roofs;
- (9) Wiring;
- (10) Breakers;
- (11) Breaker boxes;
- (12) Electrical switches and receptacles;
- (13) Light fixtures;
- (14) Pipes;
- (15) Plumbing fixtures;
- (16) Fire and security alarms;
- (17) Intercoms;
- (18) Sprinkler systems;
- (19) Parking lots;
- (20) Fences;
- (21) Gates;
- (22) Fireplaces; and

(23) Similar components which become a part of real estate after installation, except flooring.

When a sale involves both taxable and nontaxable transactions, the items must be separately stated or the entire charge is subject to tax. *Weiss v. Best Enterprises, Inc.*, 323 Ark. 712, 917 S.W. 2d 543 (1996); *see also* Arkansas Gross Receipts Tax Rule GR-93. Further, contractors are generally deemed to be the end user of any materials purchased for contracts related to real estate. Ark. Code Ann. §§ 26-52-301(3)(B)(vii)(b) (Repl. 2020) and 26-52-307(a) (Repl. 2020). Arkansas Gross Receipts Tax Rule GR-21(A)(3) defines a contractor as “any person who contracts or undertakes to construct, manage or supervise the construction, erection, alteration or repair of any building or other improvement or structure affixed to real estate, including any of their component parts.”

The Arkansas Supreme Court has defined a fixture as property annexed to real estate (either land or to another component of real estate) for use in connection therewith and so arranged that it cannot be removed without injury to the real estate, such that it also becomes a component of the real estate. *Atkins Pickle Co., Inc. v. Burrough-Uerling-Brasuell Consulting Engineers, Inc.*, 271 Ark. 897, 903, 611 S.W.2d 775,778 (App. 1981); *see also* *Continental Gin Co. v. Clement*, 176 Ark. 864, 4 S.W.2d 901, 902 (1928); *Choate v. Kimball*, 56 Ark. 55, 19 S.W. 108, 109 (1892).

The Arkansas Supreme Court has summarized the relevant case law as creating a three-part test for the determination of a real estate fixture, stating as follows:

As was stated in *Choate v. Kimball*, 56 Ark. 55, 19 S.W. 108 (1892), the test for determining whether items are fixtures is: (1) whether the items are annexed to the realty; (2) whether the items are appropriate and adapted to the use or purpose of that part of the realty to which the items are connected; and (3) whether the party making the annexation intended to make it permanent.

*McIlroy Bank & Trust Fayetteville v. Federal Land Bank of St. Louis*, 266 Ark. 481, 484, 585 S.W.2d 947, 949 (1979). The intent of the parties is the primary factor to rely on when determining if a fixture has occurred. *Bank of Mulberry v. Hawkins*, 178 Ark. 504, 10 S.W.2d 898, 899 (1928); and *Continental Gin Co.*, 176 Ark. 864, 4 S.W. 2d at 902.

The Department's Representative asserted that the Taxpayer has failed to prove that the items within this category do not function as component parts of machinery. The Taxpayer's Representative asserted that the items within this category are passive, nonmechanical real estate fixtures, not components of machinery.

**i. Handrails, Stairs, Platforms, and the [REDACTED] Stairs**

The Department's Representative asserted that the handrails, stairs, and platforms are component parts of the associated machinery and pipelines. The Taxpayer's Representative asserted that the handrails, stairs, and platforms are not components parts of the associated machinery and represent passive, nonmechanical components of real estate.

Here, [REDACTED] indicate that the Taxpayer purchased the stairs and platforms without any labor cost. A purchase of stairs and platforms by themselves would represent a purchase of tangible personal property, generally taxable. This reading of the invoices was

confirmed by the Procurement Manager even though he could not remember purchases of stairs or platforms by themselves, but he did not dismiss whether such an event occurred. The Procurement Manager simply characterized such an event as being rare. Based on the submitted evidence, I simply do not know if the Taxpayer purchased the associated platforms and stairs for installation by its employees or some other contractor. Consequently, the Department's denial of the refund claims with respect to these items is appropriate.

██████████ (describing an ██████████ however, describes a handrail modification with substantial labor cost, use of a welding machine, and use of various tools. This transaction appears to be properly described as the purchase of a service, not a purchase of tangible personal property. Further, as noted above, this Office would not consider this item as a component part of the cooler as it does not participate within the functioning of the associated machine. Based upon the provided photo (displaying a handrail bolted to the concrete floor in front of a roughly six-foot pipe), the handrail is affixed to real estate and appears to be customized and adapted for its intended purpose. Additionally, the Procurement Manager testified that, under OSHA requirements, the handrail must remain so long as the protected machinery remains (which appears to include a very large pipe that is unlikely to be removed without significantly affecting the associated structure). The presented evidence supports a finding that the handrail is intended to be a permanent real estate fixture. As a result of these findings, the Department improperly denied the Taxpayer's refund claim with respect to this transaction.

**ii.** ██████████

The Department's Representative stated that the Taxpayer has not proven entitlement to any exemption or that the transaction is anything other than a repair. The Taxpayer's Representative stated that this item was a passive component of a real estate fixture.

Here, the record demonstrates that the [REDACTED] are component parts of [REDACTED] or between the manufacturing process and storage after completion of the manufacturing process. The [REDACTED] would also qualify as tangible personal property that is generally taxable. While the Taxpayer has argued that the piping is actually a real estate fixture, this Office has consistently treated piping within or between machinery for the conveyance of steam or products as component parts of the associated machinery, not separate passive, nonmechanical components real estate. As a component of machinery that may be utilized after completion of the manufacturing process to convey product to storage, the [REDACTED] purchases typically would be taxable. The [REDACTED] would qualify as taxable repair parts. Consequently, the Department correctly denied the Taxpayer's refund claim with respect to these items.

### **3. Nontaxable Services**

Additionally, Ark. Code Ann. § 26-52-301(3)(D)(i)(b) (Repl. 2020) provides that the provision of cleaning and janitorial work is taxable. Arkansas Gross Receipts Tax Rule GR-9.4 was promulgated for enforcement of that code section and provides the following, in pertinent part:

- A. Gross receipts tax applies to the service of providing cleaning or janitorial work. Ark. Code Ann. § 26-52-301(3)(D)(i). For purposes of this rule, cleaning services are defined as services to rid the interior

or exterior of any building, dwelling, or other structure of dirt, impurities, or extraneous matter. Generally, the service of cleaning streets, sidewalks, driveways, or other areas that are not part of the interior or exterior of a building is not taxable. However, see GR-9.7 regarding the taxable service of cleaning parking lots and gutters.

B. The service of cleaning motor vehicles, aircraft, farm machinery and implements, motors of all kinds, tires and batteries, boats, electrical appliances and devices, furniture, rugs, flooring, upholstery, household appliances, televisions and radio, jewelry, watches and clocks, [REDACTED] instruments, medical and surgical instruments, machinery of all kinds, bicycles, office machines and equipment, shoes, tin and sheetmetal, mechanical tools, and shop equipment is subject to tax. Ark. Code Ann. § 26-52-301(3)(B)(i).

D. The cleaning of nonmechanical, passive, or manually operated components of buildings or other improvements or structures affixed to real estate is not taxable, except when the cleaning is considered cleaning or janitorial work.

Example 1: If a painter must clean a wall in preparation to paint, the cleaning of the wall is not taxable. However, if the wall is cleaned but not painted, or if the painter hires a third party to clean the wall prior to painting, the service of cleaning the wall is a taxable cleaning or janitorial service.

Example 2: Cleaning performed by a contractor during construction or upon completion of a construction contract is not taxable if performed by the contractor. However, if the contractor hires a third party to perform the cleaning, the service of cleaning is a taxable cleaning or janitorial service. . . .

As stated above, the installation, alteration, replacement, and repair of components of machinery is generally taxable.

With respect to “sales price” subjected to taxation under Ark. Code Ann. § 26-53-102 (Repl. 2020), various challenges have been made to sever the taxable portion of a sale’s proceeds from otherwise nontaxable sales or services. Following a long line of decisions beginning with *Ferguson v. Cook*, 215 Ark. 373, 220 S.W.2d 808 (1949), the Arkansas Supreme Court declined to create a divisible sales tax. In *Ragland v. Miller Trane Service Agency, Inc.*, 274 Ark. 227, 623 S.W.2d 520 (1981), a taxpayer argued that a “package of services” (i.e.

inspections, maintenance, and repairs) were severable into taxable maintenance and repairs and nontaxable services (the taxpayer sought to allocate seventy-five percent (75%) of the total charge to nontaxable services) but the Arkansas Supreme Court held that the cost of inspections could not be deducted from the total amount of consideration paid to the taxpayer for the taxable maintenance and repairs. Consequently, any otherwise nontaxable services that are performed as a component part of a taxable service are likewise taxable.

“Lawn care and landscaping services” are also specifically enumerated taxable services. Ark. Code Ann. § 26-52-301(3)(D)(i)(f) (Repl. 2020). Landscaping is defined as “the installation, preservation, or enhancement of ground covering by planting trees, bushes and shrubbery, grass, flowers, and other types of decorative plants . . . .” Ark. Code Ann. § 26-52-301(3)(D)(ii)(a) (Repl. 2020). Landscaping services are interpreted by the Department in its promulgated rule to mean as follows:

“Landscaping” means the installation, preservation or enhancement of ground covering by planting trees, bushes, shrubbery, grass, flowers and other types of decorative plants. “Landscaping” does not include site preparation, cutting and filling, leveling, tree trimming or tree removal, or clearing a site of bushes and trees. “Landscaping” does include sodding, seeding and planting, as well as installing items such as landscape timbers, edging, planters, or similar items. Landscaping performed on highway easements and right-of-ways is taxable. **Landscaping is taxable whether it is done for decorative purposes or non-decorative purposes such as erosion or sediment control.**

Arkansas Gross Receipts Tax Rules GR-9.2(C)(1) (emphasis supplied).

#### **i. Clerical Services**

The Department’s Representative noted that the associated company typically provides taxable cleaning services. The Taxpayer’s Representative



asserted that provided services were temporary workers for filing paperwork and inputting data in computers.

Here, the Department has explained that [REDACTED] generally provides janitorial services; however, the Taxpayer has asserted that company provides several services. Most of the associated invoices bill for clerical services upon the same invoice of admittedly taxable labor, involving such activities as landscaping services. Both the Auditor and the Procurement Manager indicated that this vendor is typically performs taxable landscaping services. Additionally, the Procurement Manager acknowledged that the purchase of clerical services from [REDACTED] is atypical and the Taxpayer contracts with other employment companies for temporary labor. The invoices were coded to maintenance labor, which would also typically represent taxable services. At this point, the only evidence that supports a finding that the associated services were not charges associated with the provision of other taxable services is the testimony of the Procurement Manager. The record does not preponderate in favor of a finding that the alleged services were not taxable. Consequently, the denial of the refund claim with respect to this category is sustained.

#### **ii. Warehouse Support Services**

The Department's Representative noted that the associated company is typically associated with the provision of taxable cleaning services. The Taxpayer's Representative asserted that provided services were pulling and delivering parts and supplies from their warehouse.

For the same reasons that the refund claim denial was sustained under the clerical service category, the denial of this category is likewise sustained.

**iii. [REDACTED] Services**

The Department's Representative noted that the associated invoices failed to provide a breakout the services performed, preventing the Department from discerning what services were done. The Taxpayer's Representative stated that the only performed services were consulting activities.

Here, the associated invoices describe the associated services as [REDACTED]. Contrary to those descriptions, the Procurement Manager testified this category only involved consulting and creation of a preventative maintenance program. He further testified that no repairs were performed by the engineer. The associated invoices describe potentially taxable services including plant support, startup, and "work." The only support for the characterization of these transactions as consulting services would be the Procurement Manager's testimony.

The Department's assertion that the submitted evidence does not preponderate in favor of a finding that the Taxpayer has proven entitlement to its refund (by establishing that no taxable services occurred) is persuasive. The associated invoices present significant ambiguity regarding the taxability of the underlying services and the Procurement Manager's testimony standing alone (in light of the invoice descriptions lacking any mention of a preventive maintenance program and, at times, appearing to contradict that characterization) do not preponderate in favor of a finding that the associated services were nontaxable. Consequently, the Taxpayer has not established entitlement to a refund claim by a preponderance of the evidence with respect to this category.

**iv. [REDACTED] Services**

The Department's Representative stated that the Taxpayer's Engineer described this transaction as tank construction. The Taxpayer's Representative stated that this transaction involved the filling of a tank to check for leaks, characterized as a nontaxable service.

Here, the invoice for the associated service discusses the filling of an [REDACTED] tank, including charges for the associated equipment and labor. Additionally, the Engineer confirmed that this transaction involves the filling of a [REDACTED] to test for leaks and not a repair. That statement was confirmed by an email from the vendor. The Engineer also testified that the [REDACTED] [REDACTED] [REDACTED] [REDACTED] preventing application of Arkansas Gross Receipts Tax Rule GR-9.17 (which addresses certain services to exempt, directly used manufacturing and equipment).

The Engineer discussed [REDACTED] [REDACTED] [REDACTED] implying some of the tank components are machines involved in the movement of fluid into and out of the tank. Additionally, some type of sensors would also be anticipated components of the tank. Consequently, the evidence does not preponderate in favor of a finding that [REDACTED] would qualify as a passive, nonmechanical fixture of real estate. As a machine, services thereto remain taxable regardless of whether the associated devices or machines are affixed to real property. *Dept. of Finance and Admin. v. Otis Elevator Comp.*, 271 Ark. 442, 609 S.W.2d 41 (1980).

The decision in this matter depends on whether the transaction involved a taxable initial installation, alteration, addition, cleaning, refinishing,

replacement, or repair of a component of machinery or an electrical device. See Ark. Code Ann. § 26-52-301 (Repl. 2020). The related transaction (involving the filling and flushing of a tank) would not qualify as an installation, addition, cleaning, refinishing, or replacement of a component of machinery or an electrical device. Additionally, the record demonstrates that a repair was not performed during this service.

American Heritage College Dictionary defines “alteration” or “alter” as to modify, change, or make different. American Heritage College Dictionary 39 (3rd Ed. 1997). It does not appear that the filling and emptying of water (neither a fuel or coolant for the associated machinery) within a tank prior to its operation would qualify as an “alteration.”

Based on the above analysis, the invoice associated with this category would not represent the performance of a taxable service. Consequently, the Department improperly denied the Taxpayer’s refund with respect to this category.

#### **v. Erosion Control Services**

The Department’s Representative stated that this transaction involved taxable landscaping activities. It is uncertain if this category of items remains in contention between the parties. If it is in contention, Arkansas Gross Receipts Tax Rules GR-9.2(C)(1) explicitly includes erosion control as taxable landscaping. Consequently, the Taxpayer has not proven entitlement to a refund with respect to this category of items.

### **4. Quality Control Machinery and Equipment**

**i.** [REDACTED]

As stated above, purchases of tangible personal property for storage, use, or consumption within Arkansas are generally taxable. Ark. Code Ann. § 26-52-402(c)(2)(B)(iii) (Repl. 2020) provides an exemption for “[t]esting equipment to measure the quality of the finished product at any stage of the manufacturing process . . .” The Department is granted authority to promulgate rules for the enforcement of that exemption. Ark. Code Ann. § 26-52-105 (Repl. 2020). Arkansas Gross Receipts Tax Rule GR-55(I) provides the following guidance:

**TESTING EQUIPMENT.** Testing equipment that is used to measure the quality of the manufactured article of commerce and otherwise meets the requirements for exemption as manufacturing machinery and equipment is exempt from tax. **The equipment is exempt if it is used to test any portion of the product from the point when manufacturing begins.** Testing equipment that tests the raw materials prior to the beginning of manufacturing is not exempt. Testing equipment that tests items other than the product, or its component parts, is not exempt. For example, equipment that tests whether the manufacturing machinery is functioning properly is not exempt as testing equipment.

The Department’s Representative stated that this item does not actually test anything. The Taxpayer’s Representative asserted that this item was involved in the acquisition of samples.

Here, it is evident that the [REDACTED] does not test the Taxpayer’s product and only allows removal of the product from manufacturing process. Only equipment that actually tests the Taxpayer’s product qualifies for the exemption under Arkansas Gross Receipts Tax Rule GR-55(I) and Ark. Code Ann. § 26-52-402(c)(2)(B)(iii) (Repl. 2020). Since the [REDACTED] does not meet the requirements of the claimed exemption, the Taxpayer’s refund claim with respect to that item was properly denied.

## **5. Remaining Transactions**

To the extent that other matters (which were not conceded by either party) were discussed or presented at the Administrative Hearing and are not specifically addressed by this Administrative Decision, the Taxpayer failed to: (1) establish entitlement to a tax exemption by a preponderance of the evidence; or (2) prove entitlement to a refund.

### **DECISION AND ORDER**

The refund denial is sustained after the adjustments required by the above analysis. 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](mailto: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.<sup>34</sup>

OFFICE OF HEARINGS & APPEALS

A handwritten signature in blue ink, appearing to read 'T. Evans', is written over a horizontal line.

TODD EVANS  
ADMINISTRATIVE LAW JUDGE

DATED: September 23, 2021

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<sup>34</sup> See *Board of Trustees of Univ. of Arkansas v. Andrews*, 2018 Ark. 12.