JURISDICTION:	**OKLAHOMA TAX COMMISSION DECISION**
CITE:	**86-10-02-01 / NON-PRECEDENTIAL**
ID:	**P-85-134**
DATE:	**OCTOBER 2, 1986**
DISPOSITION:	**DENIED**
TAX TYPE:	**SALES**
APPEAL:	**NO APPEAL TAKEN**

FINDINGS OF FACT AND CONCLUSIONS OF LAW

The above styled cause comes on for consideration, pursuant to assignment regularly made to ALJ by the Oklahoma Tax Commission, and hearing had on April 22, 1986, at which hearing counsel for PROTESTANT, appeared not and the Sales and Use Tax Division appeared by ASSISTANT GENERAL COUNSEL. The notice of hearing was mailed by certified mail, return receipt requested, to Protestant by the undersigned and Protestant received said notice, as evidenced by the return receipt. Counsel for PROTESTANT was three-times called in open court on the date of hearing. The following exhibits were offered by the Sales and Use Tax Section of the Business Tax Division and were received into evidence:

1. Sales Tax Report for the months of June, 1982 through October, 1984, prepared by AUDITOR and dated January 7, 1985. Attached thereto are the auditor's workpapers.

2. Protestant's accounts receivable ledger.

3. Copy of Lease Agreement between Protestant and COMPANY with attachments.

4. Letter of Protest dated January 17, 1985. Attached thereto proposed assessment of the Sales and Use Tax Division dated January 11, 1985 and letter enclosing Affidavit from President of COMPANY alleging COMPANY was a manufacturer.

5. Letter from the Sales and Use Tax Division granting a Ninety (90) day extension of time in which to protest the proposed assessment, dated January 30, 1985.

6. Offer of settlement from Protestant, by letter dated February 22, 1985.

7. Letter from the Sales and Use Tax Division rejecting settlement, dated March 22, 1985.

An opening statement was made by ASSISTANT GENERAL COUNSEL on behalf of the Sales and Use Tax Division. ASSISTANT DIRECTOR, Audit, Sales and Use Tax Division, testified on behalf of the Division. Closing argument was then made by ASSISTANT GENERAL COUNSEL for the Sales and Use Tax Division and the case was submitted to the

undersigned for Findings, Conclusions and Recommendations to the Oklahoma Tax Commission.

STATEMENT OF FACTS

Protestant, a corporation, has its principal place of business in CITY, New York. A field audit of the Protestant's Federal Income Tax Return, lease agreements, accounts receivable ledger and records and files for the months of June, 1982 through October, 1984 revealed that the Protestant was receiving monthly rental payments from COMPANY of BIG CITY, Oklahoma upon the lease of two (2) Oil Country Lathes. Protestant, however, was not charging, collecting or remitting Sales Tax on the monthly rental payments. The accounts receivable ledger of the Protestant confirms that it was receiving monthly rental payments from COMPANY and indicates the amounts so received.

On January 11, 1985, the Division issued a proposed assessment for additional sales tax, penalty and interest, in the amount of Eight Thousand Nine Hundred Fifty-one Dollars and Ninety-nine Cents ($8,951.99).

On January 17, 1985, the Division received a letter from the Protestant requesting a Ninety (90) day extension of time in which to protest the imposition of sales tax on machinery rented within the State of Oklahoma. The letter continues, "Your office has been furnished with an Affidavit from COMPANY indicating that the machinery leased is being used exclusively in the manufacturing process only. The fact that they do not always purchase the pipe which is used in the manufacturing process is the question concerned herein. I cannot understand how your law differentiates between the manufacturer who purchases the pipe and the manufacturer who does not purchase the pipe. They both do the same thing, they manufacture, they thread the pipe. The machines that we are renting them are completely productive."

On January 30, 1965, the Division by letter granted the Protestant's request for a Ninety (90) day extension of time in which to Protest.

On February 22, 1985, the Protestant by letter proposed a settlement offer to the Division. The important part of this letter begins in the third paragraph, where it states, "Please try to understand that the representation made to us by our lessor has been that the machines were to be used in the 'manufacture of oil country pipe.' If you indicated that COMPANY is not a manufacturer, then we have been completely misled as to the sales tax and there is no way that we can recover any monies from our lessor. The law here in New York State would have recognized COMPANY as a pipe manufacturer in spite of the fact that he is involved in some sub-contracting activities. All that we ask of you is some understanding to this situation."

On March 22, 1985, the Division by letter acknowledged receipt of the Protestant's letter of February 22, 1985. The Division's letter rejected the Protestant's settlement offer and reiterated the Division's position as to the tax consequences of the transaction. The letter also stated that the Protestant's file would remain open until the expiration of the Ninety (90) day extension period, at which time the Division would accept the Protestant's correspondence as a formal protest.

No further correspondence was exchanged and the file was forwarded to the Legal Division of the Oklahoma Tax Commission to be set down for a hearing.

ISSUES AND CONTENTIONS

The issue in this case is whether the two (2) Oil Country Lathes which were leased by the Protestant to COMPANY were employed in a manufacturing process thereby exempting the monthly rental payments from sales tax.

In addition, an issue not raised by the Protestant in its letter of Protest was discussed during the hearing, to-wit: whether use tax should have been assessed against COMPANY upon the purchase price of the property brought into the state rather than sales tax against the Protestant upon the gross receipts of gross proceeds received from the lease.

The Protestant in its letter of protest contended that the two (2) Oil Country Lathes were being used exclusively in the manufacturing process and therefore the monthly rental payments were exempt from sales tax. It argued that COMPANY was a manufacturer and therefore the machinery it leased to COMPANY was used in the manufacturing process.

The Sales and Use Tax Division contended that the manufacturing exemption did not apply since the machinery was not directly used in the process of manufacturing property subject to taxation.

The Division argued that the machinery leased to COMPANY was used to provide a service to the customers of COMPANY and was not used to manufacture property subject to sales tax. The Division further asserted that COMPANY was primarily engaged in providing a service to its customers and not primarily engaged in a manufacturing or processing operation.

DISCUSSION OF APPLICABLE LAW

Title 68 O.S. 1981, § 1354 levies an excise tax of three and one-fourth percent (3¼%) of the gross receipts or gross proceeds of each sales, not otherwise exempted in the Oklahoma Sales Tax Code.

Sale is defined in Title 68 O.S. 1981, § 1352(L) to mean the transfer of either title or possession of tangible personal property for a valuable consideration regardless of the manner, method, instrumentality, or device by which the transfer is accomplished in this state, including but not limited to the exchange, barter, lease, or rental of tangible personal property resulting in the transfer of the title to or possession of the property.

Title 68 O.S. 1981, § 1359 provides an exemption from the tax levied in the Oklahoma Sales Tax Code for Manufacturers. This case turns upon the language of Subsection (c) of Section 1359 which provides:

> "Sale of machinery and equipment purchased and used by persons establishing new manufacturing plants in Oklahoma, and machinery and equipment purchased and used by persons in the operation of manufacturing plants already established in Oklahoma. This exemption shall not apply unless such machinery and equipment is incorporated into, and is directly used in, the process of manufacturing property subject to taxation under this article. The term 'manufacturing plants' shall mean those establishments primarily engaged in manufacturing or processing operations and generally recognized as such." (Emphasis added.)

In Bert Smith Road Machinery Company, Inc. v. Oklahoma Tax Commission, 563 P.2d 641 (1977), relied upon by the Division, the taxpayer had sold a mobile asphalt plant to McConnell Construction which at the time of the purchase was a contractor and not a manufacturer. The asphalt plant was delivered by the taxpayer to a highway construction site where at the time McConnell was in the process of paving a state highway under a state contract.

In Bert Smith, supra, it was not contended that the mobile asphalt plant was not a manufacturing plant. However, it was contended that McConnell did not fall within the manufacturing exemption, because McConnell was not generally recognized as a manufacturer but as a contractor and because, at the time the asphalt plant was purchased McConnell was not acting as a seller of asphalt, but as a contractor using asphalt in its own construction business.

The Supreme Court of Oklahoma, at page 643, held:

> "We agree with the Commission that McConnell Construction is primarily a highway contractor and not a manufacturer. The equipment was used primarily in building of road and not in the manufacturing of property subject to taxation. Even though McConnell Construction made occasional casual sales, they were not primarily engaged in manufacturing nor generally recognized as such."

In the present protest, COMPANY used the two (2) Oil Country Lathes which it leased from the Protestant to thread pipe. Most of the pipe which was threaded by COMPANY, if not all, was owned by its customers. As such, the two (2) Oil Country Lathes were used primarily to provide the service of threading pipe. COMPANY was selling its service of threading pipe by use of the two (2) Oil Country Lathes. It was not selling property subject to taxation under the Oklahoma Sales Tax Code.

Further, COMPANY was primarily a service oriented company and not primarily a manufacturer. Therefore, even if COMPANY made occasional sales of threaded pipe, such sales would not transform COMPANY into a manufacturer of such pipe. See, Dairy Queen of Oklahoma, Inc. v. Oklahoma Tax Commission, 205 Okl. 473, 238 P.2d 800 (1951).

There remains to be decided the issue discussed during the hearing, to-wit: whether use tax should have been assessed against COMPANY upon the purchase price of the property

brought into the state rather than sales tax against the Protestant upon the gross receipts or gross proceeds received from the lease.

Title 68 O.S. 1981, § 1354(Q) levies a sales tax upon the gross receipts or gross proceeds from the rental or lease of tangible personal property.

Sale is defined in Title 68 O.S. 1981, § 1352(L) to mean the transfer of either title or possession of tangible personal property for a valuable consideration regardless of the manner, method, instrumentality, or device by which the transfer is accomplished in this state, including but not limited to the exchange, barter, lease or rental of tangible personal property resulting in the transfer of the title to or possession of the property.

Black's Law Dictionary 800 (rev. 5th ed. 1979), defines a lease, when used with reference to tangible personal property, to mean a contract by which one owning such property grants to another the right to possess, use and enjoy it for specified period of time in exchange for periodic payment of a stipulated price, referred to as rent.

As defined, title to property under a lease is never transferred, only the right to possess, use and enjoy it for a specified period is transferred. Therefore, under a lease, possession is transferred for the period specified in the lease contract upon the payment of the stipulated price or rent.

In this protest, the lease contract between the Protestant and COMPANY called for COMPANY to pay the stipulated price or rent on a monthly basis. The two (2) Oil Country Lathes were used by COMPANY at its principal business location in BIG CITY, Oklahoma. Therefore, upon each payment of rent, possession was transferred to COMPANY and since such property was located within the State of Oklahoma, transfer of possession was accomplished in this state.

CONCLUSIONS

Based upon the above and foregoing findings of fact and applicable law relevant thereto, the undersigned concludes as follows:

(1) That the Oklahoma Tax Commission has jurisdiction in this case.

(2) That the two (2) Oil Country Lathes leased to COMPANY were used primarily to provide a service of threading pipe and were not used primarily to manufacture property subject to taxation under the Oklahoma Sales Tax Code.

(3) That COMPANY was primarily a service oriented company and not primarily a manufacturer and as such occasional sales of threaded pipe would not transform COMPANY into a manufacturer.

(4) That upon each payment of rent under the lease, possession was transferred to COMPANY for a specified period of time and since the two (2) Oil Country Lathes were located in Oklahoma, transfer of possession was accomplished in this state.

(5) That the gross receipts or gross proceeds from the rental or lease of the two (2) Oil Country Lathes was subject to the levy of sales tax.

(6) That the assessment of additional sales tax, penalty and interest in the amount of Eight Thousand Nine Hundred Fifty-one Dollars and Ninety-nine Cents ($8,951.99) for the months of June, 1982 through October, 1984, is correct, and that the Protestant should be required to pay such amount of money plus interest accruing at eighteen percent (18%) per annum until paid.

(7) That the protest should be denied and the total amount of the assessment sustained.

DISPOSITION

It is the ORDER of the OKLAHOMA TAX COMMISSION that the protest of PROTESTANT be denied, that the assessment of the Sales and Use Tax Division be sustained, and that the PROTESTANT be required to pay the amount of additional sales tax and penalty for the months of June, 1982 through October, 1984, plus interest assessed and accrued from the due date until paid.

OKLAHOMA TAX COMMISSION

CAVEAT: This decision was NOT deemed precedential by the Commission. This means that the legal conclusions are generally applicable or are limited in time and/or effect. Non-precedential decisions are not considered binding upon the Commission. Thus, similar issues may be determined on a case-by-case basis.