JURISDICTION: **OKLAHOMA TAX COMMISSION - DECISION**
CITE: **99-02-08-006 / NOT PRECEDENTIAL**
ID: **P9600322**
DATE: **02-08-99**
DISPOSITION: **SUSTAINED**
TAX TYPE: **SALES / USE**
APPEAL: **NO APPEAL TAKEN**

FINDINGS OF FACT AND CONCLUSIONS OF LAW

Upon review of the file and records, the undersigned finds:

A. The parties stipulate to the following:

BACKGROUND

1. THE COMPANY, is a corporation, that, among other things publishes a newspaper, produces a web site, and publishes printed products for third parties.

2. Among the newspapers published by THE COMPANY, is THE ***XYZ NEWSPAPER***, produced daily and distributed chiefly to residents of the City of XYZ.

3. The web site produced by THE COMPANY, publishes the same information as that in THE ***XYZ NEWSPAPER***.

4. Among the publications produced by THE COMPANY, for third parties is THE ***3RD PARTY PUBLICATION***. Under a written contract with THE ***3RD PARTY PUBLICATION***, THE COMPANY is required to produce THE ***3RD PARTY PUBLICATION*** in two forms:

a. Pre-labeled newspapers that THE COMPANY, delivers to the United States Post Office.

b. Unlabeled newspapers that THE COMPANY, delivers to THE ***3RD PARTY PUBLICATION***.

THE XYZ NEWSPAPER'S PUBLICATION PROCESS

5. THE XYZ NEWSPAPER's publication process includes one or more of the following sequential phases:

a. Gather news
b. Input data
c. Manipulate Data
d. Create negative/transfer to website
e. Create plates
f. Print and cut
g. Insert material/affix labels
h. Baling
i. Deliver
j. Distribute

6. **Data Input**. After news has been gathered, the next phase is to put the information into the process. This is accomplished in one of two ways: electronically or physically. The tools used to effect the data input (text and images) are basically the same whether the input is electronic or physical and include the use of:

a. Computers - portable/desktop
b. Facsimile
c. Scanners
d. Copy machines

7. **Data Manipulation**. When placed in the process, the data is thereafter manipulated, ***i.e.***, edited and paginated either electronically or physically.

a. Electronic pagination is the process by which software configures the text and images previously entered and edited so that they fit on one or more electronic pages.

b. Physical pagination is the process of manipulating text and images on paper by cutting and pasting so they fit on form pages.

8. **Create negative/transfer to website**. Negatives are created of the electronic or physical pages and the electronic pages are also electronically transferred to web site disc drives.

a. Electronic negative. Software and hardware convert the electronically paginated pages into photographic negatives.

b. Manual negative. The text and images pasted on a flat page form are photographed to create photographic negatives.

c. Transfer to website. The electronically created pages are transferred to disc

drives at the website where software makes these pages viewable by web users.

9. **Create plates**. The negatives whether produced electronically or physically are used to create off-set printing plates that are placed on cylinders in the printing press.

10. **Print and cut**. When all of the plates have been affixed to the cylinders on the printing press, paper is fed into the press and the images on the plates are printed on the paper which is then cut and folded. The cut and folded papers are either baled for delivery or further processed.

11. **Inserting/Labeling**. Unless baled for delivery, the cut and folded papers are further processed using one or more of the following machines:

a. Inserter. This machine inserts pre-printed material into the cut and folded papers.

b. Labeler. This machine takes a single sheet of addresses, six-across, cuts out a six by one inch address, applies glue to the back side and affixes one to each cut and folded paper.

12. **Baling**. The cut and folded papers with or without inserts and with or without labels are baled.

13. **Delivery**. Baled papers are then delivered to the local post office, to THE ***3RD PARTY PUBLICATION***, to newsstands, or to drop zones for pickup by news carriers.

14. **Distribution**. The product is distributed to the ultimate consumer either directly (***e.g. THE 3RD PARTY PUBLICATION***) or through the mails, newspaper carriers, or newsstands.

TAX AUDIT

15. After conducting an audit, the Oklahoma Tax Commission proposed sales and use tax assessments against THE ***XYZ NEWSPAPER***.

16. THE ***XYZ NEWSPAPER*** protested the proposed assessment as to:

a. Sales tax assessment on:

(1) a XXXXXXX copier purchased January 8, 1996, for $5,995.00, from A LOCAL Business Equipment COMPANY. The XXXXXXX copier is used in the data input phase. Text, including advertising, and images are reduced on the copier so they fit in an appropriate place when pasted on the page form.

(2) a laser fax purchased July 28, 1995, for $1,767.00, from ANONYMOUS,INC. Text and images are received by the fax machine that are then scanned into the computer to be manipulated by software and ultimately to appear in whole or in part on a page of the newspaper. Other facsimile transmissions are either reduced or enlarged by the XXXXXXX copier to be pasted on the page form.

(3) film and related items purchased April 10, 1993 through January 25, 1996, from the YYY COMPANY for $3,137.86. These supplies are consumed in making the negatives of the electronic or physically paginated pages or consumed in the process of taking photographs subsequently used in the newspaper.

(4) toners purchased from April 8, 1993 to September 18, 1995, for $1,449.40 from ZZZ Supply. These supplies are consumed by the XXXXXXX copier and the fax machine during the data input phase and,

(5) developers for the various photographic equipment purchased from July 20, 1993 to September 26, 1995, from QQQ for $1,077.08.

(b) Use tax assessment on:

(1) film purchased from July 18, 1994 to September 15, 1995, from RRR Camera for $1,140.86 used in the input phase.

(2) a portable computer purchased November 27, 1995, from SSS for $100.00, is used to input data in the same fashion as the desktop computers used in the main office. The portable computer is used sometimes in the main office and sometimes on location. However, the information in the input into the computer is electronically handled in the same fashion as that input by the desktop computers.

(3) a labeling machine purchased for $18,850.00, on September 27, 1995, by THE ***XYZ NEWSPAPER*** from TTT, a vendor in ANOTHER STATE. The labeler was purchased solely so that THE ***XYZ NEWSPAPER*** could meet the requirements of THE ***3RD PARTY PUBLICATION*** contract.

(4) CERTAIN SOFTWARE purchased on January 26, 1996 for $295.00 from VVV, a Washington vendor.

(5) two Internet programs purchased October 19, 1995, and November 9, 1995, from UUU, an OUT-OF-STATE vendor, for $390.00. This software and the CERTAIN SOFTWARE enable web users to access THE ***XYZ NEWSPAPER's*** electronic web pages.

(6) film and developers purchased April 15, 1993 through January 26, 1996, from GGG, a New York vendor, for $23,030.61.

17. Copy and Fax Machines

a. Before many items are submitted for publication, they must be placed in a form that can be electronically scanned and/or edited. The laser fax and copy machines are used to convert particular items into a workable format.

b. The laser fax machine is used approximately 85% in the publication process and 15% for other purposes such as general office facsimile transmissions.

c. The copy machine is used in approximately 75% in the publication process and 25% for other purposes such as general office copying.

ISSUE

It is undisputed that Protestant is a manufacturer and produces for sale or resale a newspaper, a web site and other printed products for third parties. The issue is whether the disputed items were used or consumed in the manufacturing process, and became integral parts of the manufactured products or were incorporated into, and used directly in, the process of manufacturing.

CONCLUSIONS OF LAW

1. Jurisdiction over the parties and subject matter of this proceeding is vested in the Tax Commission. 68 O.S. 1991, § 207.

2. The sale of tangible personal property in the State of Oklahoma, unless otherwise exempted by the provisions of the Oklahoma Sales Tax Code, is subject to an excise tax of four and one-half percent (4.5%) of the gross receipts or gross proceeds of the sale. 68 O.S. 1991, § 1354(1)(A). See, 68 O.S. 1991, § 1352(L). Likewise, an excise tax of four and one-half percent (4.5%) is levied on the purchase price of any tangible personal property which is purchased outside of Oklahoma and brought into Oklahoma for storage, use, or other consumption. 68 O.S. 1991, § 1402. See, ***Phillips v. Oklahoma Tax Commission***, 577 P.2d 1278 (Okl. 1978).

3. Exempt from the levy of sales tax is the sale of "[g]oods, wares, merchandise, and property purchased for the purpose of being used or consumed in the process of manufacturing . . . for sale a finished article and [which] . . . become integral parts of the manufactured . . . products or are consumed in the process of manufacturing . . . products for resale". 68 O.S. 1991, § 1359(A). In addition, the "[s]ale of machinery and equipment purchased and used in the operation of manufacturing plants" is exempt from the levy of sales tax provided "such machinery and equipment is incorporated into, and is directly used in, the process of manufacturing property for sale or resale". 68 O.S. 1991, § 1359(C). Such articles of tangible personal property are also exempt from the levy of use tax. 68 O.S. 1991, § 1404(d) and (e).

4. As a general rule, statutes exempting property from taxation are to be applied circumspectly and are to be strictly construed against the allowance of an exemption. *Bert Smith Road Machinery Co. v. Oklahoma Tax Commission*, 563 P.2d 641 (Okl. 1977); *Phillips Petroleum Co. v. Oklahoma Tax Commission*, 542 P.2d 1303 (Okl. 1975). The language of an exemption statute may not be construed so as to give it an effect which is not intended. *Protest of Hyde*, 188 Okl. 413, 110 P.2d 292 (1941). To be entitled to an exemption, the taxpayer has the burden of proving that the transaction falls squarely within the exemption. *Bert Smith*, supra.

5. "Manufacturing" is defined to mean and include "every operation commencing with the first production stage of any article of tangible personal property and ending with the completion of tangible personal property having the physical properties which it has when transferred by the manufacturer to another." 68 O.S. 1991, § 1352(H). Manufacturing is "the production of articles for use from raw or prepared materials by giving these materials new forms, qualities, properties or combinations, whether by hand labor or machine." Rule 710:65-13-150 of the *Oklahoma Administrative Code.* "[T]he process of manufacturing has taken place whenever labor is bestowed upon an article which results in its assuming a new form, possessing new qualities or new combinations. *Id.*

6. The Oklahoma Supreme Court has concluded that the manufacturing exemption "should receive a practical construction - - one that would not allow a manufacturing operation that is in fact but one continuous and integrated production process to be chopped up into distinct and discrete segments." ***Schulte Oil Co., Inc. v. Oklahoma Tax Commission***, 882 P.2d 65, 74 (Okl. 1994). See, ***United Design Corp. v. Oklahoma Tax Commission***, 942 P.2d 725, 727 (Okl. 1997). In ***Schulte***, the Court held that "machinery which is synchronized into the manufacturing operation in a manner that makes it necessary to the production of the finished product is `directly used in' the manufacturing process." In ***United Design***, the Court held that the integrated production process includes "any necessary [operations] adjunct to production" as well as operations "putting the product into marketable form."

7. Here, the items in dispute are exempt from the levies of sales and use taxes pursuant to Sections 1359 or 1404(d) and (e) since such items are used or consumed in the manufacturing process, become integral parts of the manufactured products or are incorporated into, and used directly in, the process of manufacturing. The copier, laser fax and computer are used in a manner similar to the master molds which were determined to be exempt in ***United Design***, in that these items are directly used in creating the text and images which are physically or electronically manipulated to produce the negatives which in turn are used to create the off-set printing plates. The film, developers and related items are consumed in the process of creating the negatives or the images which are further manipulated in the production process. The toner is consumed in the operation of the copier and laser fax. Each of these items is either "necessary to the production of the finished product", ***Schulte***; or "necessary [operations] adjunct to production", ***United Design***. Additionally, the labeling machine, CERTAIN SOFTWARE and internet programs perform

operations necessary for "putting the manufactured products into marketable form", ***United Design***, and are therefore exempt.

8. Protestant's protest to the proposed assessment of sales and use tax on the items in dispute should be sustained.

DISPOSITION

Based on the above and foregoing findings of fact and conclusions of law, it WAS DETERMINED that the protest THE COMPANY be sustained.

OKLAHOMA TAX COMMISSION

CAVEAT: This decision was **NOT** deemed precedential by the Commission. This means that the legal conclusions are not 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.