JURISDICTION: **OKLAHOMA TAX COMMISSION - DECISION**
CITE: **2001-07-10-025 / NOT PRECEDENTIAL**
ID: **P9700202**
DATE: **07-10-01**
DISPOSITION: **DENIED**
TAX TYPE: **SALES / USE**
APPEAL: **NO APPEAL TAKEN**

FINDINGS OF FACT AND CONCLUSIONS OF LAW

Upon review of the file and records, including the record of the proceeding and the exhibits received into evidence, the undersigned finds:

FINDINGS OF FACT

1. PROTESTANT is located in BIGCITY, Oklahoma, and is a privately held corporation. PROTESTANT is in the business of retail sales of graphic arts and crafts supplies and services and architectural supplies. PROTESTANT is also in the business of "reprography," which means that PROTESTANT reproduces the intellectual property of other people through a process which uses film, paper, laminates, diazo machines, and the skill and experience of PROTESTANT'S employees to produce duplicate originals of architectural or engineering blueprints which were created by architects or engineers who are customers or clients of PROTESTANT. The duplicate original blueprints are sold by PROTESTANT only to the creator of the original blueprint, which sale is subject to sales tax as a sale of tangible personal property.

2. The Audit Division of the Oklahoma Tax Commission, "Division" hereafter, conducted a field audit of PROTESTANT for the audit period of September 1, 1993, through August 31, 1996, for sales tax and use tax. On March 3, 1997, the Division issued proposed assessments for sales and use tax as follows:

Sales Tax

Tax	$ 3,572.50
Interest	1,165.15
Penalty	357.37
TOTAL	$ 5,095.02

Use Tax

Tax	$ 7,894.16
Interest	2,693.40
Penalty	789.45
TOTAL	$ 11,377.01

PROTESTANT timely filed a protest of the sales and use tax assessments on April 2, 1997.

3. In its sales tax protest, PROTESTANT submitted additional documentation and claimed that the sales which were assessed by the Division were exempt from sales tax under several applicable exemptions. After reviewing this additional documentation, the Division removed some of the items from the audit and revised its proposed assessment as follows on August 15, 1998:

Sales

Tax	$ 2,872.02
Interest	1,583.47
Penalty	287.34
TOTAL	$ 4,742.83

4. In its use tax assessment, PROTESTANT asserts that it is entitled to the manufacturing exemption for equipment, materials and supplies which PROTESTANT uses in its reprography business. PROTESTANT had applied to the Division for a Manufacturers Limited Exemption Certificate in 1991 which the Division denied at that time on the basis that PROTESTANT is not generally recognized as a manufacturer, is not primarily engaged in manufacturing, and does not mass produce tangible personal property for resale. PROTESTANT contends in this protest that its reprography business does qualify for the manufacturing exemption from use tax. The Division has not revised its proposed use tax exemption.

ISSUES

1. Whether PROTESTANT's sales of supplies to customers were exempt under the sales for resale exemption and should be removed from the sales tax assessment.

2. Whether PROTESTANT is exempt from use tax under the manufacturing exemption for its purchase of tangible personal property used in its reprography business.

CONCLUSIONS OF LAW

1. Jurisdiction over the parties and subject matter of this proceeding is vested in the Tax Commission, 68 O.S. §§ 207 and 221.

A. Sales Tax

2. A proposed assessment is presumed correct and the taxpayer bears the burden of showing that it is incorrect, and in what respect. *Enterprise Management Consultant, Inc. v. Oklahoma Tax Commission*, 768 P.2d 359 (Okla. 1988). Failure to provide evidence which is sufficient to show an adjustment to the proposed assessment is warranted will result in the denial of the protest. *Continental Oil Company v. Oklahoma Tax Commission*, 570 P.2d 315 (Okla. 1977). The burden of proving a sale is not a taxable sale is on the person who made the sale, 68 O.S. 1991, § 1365(C).

3. The standard burden of proof in administrative proceedings is "preponderance of evidence," see Oklahoma Tax Commission Order No. 91-10-17-061. "Preponderance of evidence" is evidence which is of greater weight or more convincing than the evidence which is offered in opposition to it; that is, evidence which as a whole shows that the fact sought to be proved is more probable than not. It also means evidence which is more credible and convincing to the mind or that which best accords with reason and probability.

4. PROTESTANT has the burden of proof to show in what respects the proposed assessments are incorrect pursuant to *OAC* 710:1-5-47. PROTESTANT did submit additional documentation to the Division which resulted in an adjustment to the assessment. However, PROTESTANT submitted no evidence at hearing which could prove its claim that its assessed sales were exempt from sales tax by a preponderance of the evidence.

B. Use Tax

5. The main thrust of PROTESTANT's argument at hearing concerned its contention that its reprography business, or the production of duplicate original blueprints for the customer that created the blueprint, is manufacturing. The reprography process was described by PROTESTANT in a lengthy letter introduced at hearing as Exhibit "A".

PROTESTANT's witness at hearing testified that reprography was a complex process by which articles are manufactured from prepared materials which are given new forms, qualities, properties or combinations by machines operated by trained technicians. PROTESTANT's witness contended that this manufacturing process is not altering or amending in any way the original blueprint, but taking various materials and altering them in a form that replicates the blueprint that is brought to PROTESTANT for reproduction.

The Division's witness had reviewed PROTESTANT's reprography business and concluded that it did not qualify as a manufacturer under the Sales Tax Code because PROTESTANT is providing a replication of the original blueprint on the paper they are selling to that specific customer. PROTESTANT does not have an inventory of manufactured goods held or offered for sale as a product in the classic sense of manufacturing activity. The Division concluded that PROTESTANT is not generally recognized as a manufacturer and not primarily engaged in manufacturing and does not mass produce a product to be held in inventory for sale.

6. The Oklahoma Sales Tax code provides a manufacturing exemption at 68 O.S. § 1359(1) as follows:

> These are hereby specifically exempted from the tax levied by Section 1350 et seq. Of this title:
>
> 1. Sales of goods, wares, merchandise, tangible personal property, machinery and equipment to a manufacturer for use in a manufacturing operation.

The sales tax code defines "manufacturing" at 68 O.S.Supp.1999, § 1352(9) as follows:

> "Manufacturing" means and includes the activity of converting or conditioning tangible personal property by changing the form, composition, or quality of character of some existing material or materials, by procedures commonly regarded as manufacturing, compounding, processing or assembling, into a material or materials with a different form or use. "Manufacturing" does not include extractive industrial activities such as mining, quarrying, logging, and drilling for oil, gas and water, but may include processes subsequent to extraction if such processes result in a change of the form or use of the material extracted.

This manufacturing exemption is provided for use tax pursuant to 68 O.S. § 1404(4). This exemption is strictly construed by the Tax Commission against the exemption, *McDonald's Corporation v. Oklahoma Tax Commission*, 1977 OK 74, 563 P.2d 635. The *McDonald*'s case concerned the taxpayer's claim of the manufacturing exemption for a restaurant which made hamburgers for resale. The Court found that
the taxpayer's primary effort, the success of its business venture and the essence of its operation, is the selling or merchandising of its products at retail to the consumer. Its sales are not to realize the production or manufacturer's profit, for had the hamburgers and other products remained in its possession, even for a single day, there would be no profit. The Court concluded that *McDonald*'s restaurants were not manufacturing plants because they we not "generally recognized as such" according to the exemption statute at Section 1305(p). The manufacturing exemption at Section 1359(1) no longer contains the "generally recognized" clause, however, the definition of manufacturing at Section 1357(9) requires that the procedures be commonly regarded as manufacturing. Therefore, the new manufacturing exemption does not include restaurants.

7. The present manufacturing exemption in Section 1359(1) provides a broader scope than the previous statutory language and is construed by the Supreme Court in *Schulte Oil Co., Inc. v. Oklahoma Tax Commission*, 1994 OK 103, of 882 P.2d 65, by a more inclusive interpretation in consideration of the purpose of the manufacturing exemption to enhance the State's competitive position to attract industry to Oklahoma. However, the reprographics process does not come clearly within the framework of the exemption as outlined in the applicable rules of the *Oklahoma Administrative Code*. "Reprography" is defined in Webster's New Collegiate Dictionary as: "facsimile reproduction (as by photocopying) of graphic matter."

OAC 710:65-19-259 provides that the sale of photocopies represents a taxable sale of tangible personal property, but persons operating photocopy machines are not entitled to the manufacturing exemption. *OAC* 710:65-19-260(a)(6) provides that sales of tangible personal property by commercial photographers and others for "Reproducing copies of documents, drawings, photographs, or prints by mechanical and chemical reproduction machines, blue printing and process camera equipments," is subject to sales tax. Subsection (c) of that rule further provides as follows:

> Establishments regularly engaged in processing photographic film and/or photographic paper are manufacturers of the negatives, prints and/or transparencies which result from the chemical and physical photographic process. The processing of photographic film by photographers is not considered manufacturing under this Section.

This rule contemplates that a person who mass produces photographic prints by nonprofessional photographers is a manufacturer but that a professional photographer who uses his skill to produce professional photographs for a customer is not a manufacturer.

8. *OAC* 710:65-19-260(a)(6) contemplates that reprography is not manufacturing but is a taxable sale of blue printing services or it is a photocopying process as contemplated in *OAC* 710:6519-259 and not a manufacturing process. Blue printing services have been taxable under this Rule prior to the audit period in this case and during all relevant periods in this audit. The Division has previously applied this construction of the manufacturing exemption to PROTESTANT's business for many years. In 1991, the Division's witness reviewed PROTESTANT's business when it applied for a Manufacturer's Limited Exemption Certificate and determined at that time that it was not a manufacturing operation. PROTESTANT's business has not changed in that time and the Division's interpretation of the statute remains a valid and reasonable construction under the present law and should be upheld. *Oral Roberts University v. Oklahoma Tax Commission*, 1985 OK 97, 714 P.2d 1013.

9. PROTESTANT's protest to the proposed sales and use tax exemptions should be denied.

DISPOSITION

Based on the above and foregoing findings of fact and conclusions of law, it is DETERMINED that the protest be denied.

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.