

JURISDICTION: OKLAHOMA TAX COMMISSION - DECISION
CITE: 2001-07-10-028 / NOT PRECEDENTIAL
ID: P9700225 / P9700227
DATE: 07-10-01
DISPOSITION: SUSTAINED IN PART / DENIED IN PART
TAX TYPE: SALES / USE
APPEAL: NO APPEAL TAKEN

FINDINGS OF FACT AND CONCLUSIONS OF LAW

1. PROTESTANT was a sole proprietorship until June 1, 1996, when the business was incorporated under the name PROTESTANT's Inc., located at 9999 ANY STREET, BIGCITY, Oklahoma, under sales tax permit No. 9999 99. The two entities are hereafter referred to as "PROTESTANT".

2. PROTESTANT operates two business activities at its store. First, PROTESTANT sells and services truck and tractor tires and accessories including mounting and balancing the tires and fixing flat tires, among other things. This business is conducted in the front shop. Another second business is conducted in the retread shop. In the retread shop PROTESTANT will take worn out tires called "casings" or "cores" and put them through the retreading process. This process involves buffing the casing to a rough texture. Raw gum is then applied to the rough casing. The new tread or the retread is placed onto the gummed casing. At that time any scuffs or holes in the casing are repaired with tire patches. The prepared casing is then enveloped in a rubber tube and sealed in order to hold the assembled casing and retread in place. The enveloped assembly is then placed in an oven and cooked for 2.5 hours. The entire process requires at least 3 hours to perform. When the process is complete, the retreaded tire is warranted by PROTESTANT to perform properly for its intended use.

3. The retreading process is performed by PROTESTANT on casings that it owns for resale and on casings owned by its customers. The Division's Exhibit E illustrates that PROTESTANT retreaded between 50 PERCENT to 60 PERCENT of casings owned by its customers. Under PROTESTANT's warranty, a retread that failed would be replaced or an allowance would be given to the customer on the replacement depending on the tread life left on the failed tire. PROTESTANT did not collect tax on the warranty replacement or allowance.

4. The Audit Division of the Oklahoma Tax Commission, "Division" hereafter, conducted a field audit of PROTESTANT for the period of May 1, 1994, to April 30, 1997. The Division determined that additional sales and use tax were due on sales to entities that did not have a valid permit number in order to purchase tax exempt, as well as tax on trade-in allowance and warranty replacement. Also included in the audit were sales or use tax on shop supplies used by PROTESTANT. The Division also assessed sales and use tax on equipment and supplies used in the retread shop. PROTESTANT has not been issued a Manufacturer's Limited Exemption Certificate from the Tax Commission. On June 16, 1997, the Division issued the following proposed assessments, as further adjusted, for sales and use tax as follows:

1. PROTESTANT'S SOLE PROPRIETORSHIPSales Tax

Tax	\$ 12,199.01
Interest	7,375.56
Penalty	<u>1,219.92</u>
TOTAL	\$ 20,794.49

Use Tax

Tax	\$ 3,446.77
Interest	1,119.92
Penalty	<u>344.69</u>
TOTAL	\$ 4,911.38

2. PROTESTANT CORPORATIONSales Tax

Tax	\$ 6,222.07
Interest	2,329.02
Penalty	622.21
TOTAL	\$ 9,173.30

Use Tax

Tax	\$ 1,068.46
Interest	93.87
Penalty	106.85
TOTAL	\$ 1,269.18

PROTESTANT timely filed its protest to these assessments by letter of July 9, 1997. PROTESTANT claims that it is entitled to the manufacturer's exemption on the machines and supplies it uses in the retread shop. PROTESTANT also claims that it should not have to pay sales tax on wheel weights and other shop supplies used in the front shop for servicing tires since they are part of the sale of the tire.

PROTESTANT also disputes taxes assessed on sales for resale or sale for agricultural use because of improper documentation or cancellation of the permit. PROTESTANT further disputes sales tax assessed on its warranty adjustments. PROTESTANT had also protested the Division's proposed assessment for waste tire fee, however, PROTESTANT has withdrawn its protest as to that assessment.

ISSUES

1. Whether PROTESTANT is entitled to the manufacturer's limited exemption for machinery and materials used in the retread shop.
2. Whether PROTESTANT is subject to sales tax on its warranty adjustments on its retread tires.
3. Whether PROTESTANT is subject to sales and use tax on wheel weights and similar supplies used in its front shop incidental to the sale and servicing of tires.
4. Whether PROTESTANT is liable for sales or use tax on sales made to invalid permit numbers or which were not properly documented for resale or agricultural use.

CONCLUSIONS OF LAW

1. The Oklahoma Tax Commission has jurisdiction of this protest, 68 O.S. § 207.

A. Manufacturer's Exemption

2. The Oklahoma sales and use tax manufacturing exemption has undergone drastic change within the last decade. Before the audit period in this case, the manufacturing exemption at 68 O.S.1991, § 1359(A) provided:

There are hereby specifically exempted from the tax levied by this article:

Goods, wares, merchandise, and property purchased for the purpose of being used or consumed in the process of manufacturing, compounding, processing, assembling, or preparing for sale a finished article and such goods, wares, merchandise, or property become integral parts of the manufactured, compounded, processed, assembled, or prepared products or are consumed in the process of manufacturing, compounding, processing, assembling, or preparing products for resale. The term manufacturing plants shall mean those establishments primarily engaged in manufacturing or processing operations, and generally recognized as such.

The same exemption was provided for use tax pursuant to 68 O.S.1991, § 1404(d). This exemption was strictly construed by the Tax Commission against the exemption, *McDonald's Corp. v. Oklahoma Tax Commission*, 563 P.2d 635, 1977 OK 74. The Tax Commission's strict construction of the exemption was tested in the case of *Schulte Oil Co. v. Oklahoma Tax Commission*, 882 P.2d 65, 1994 OK 103.

The *Schulte* case concerned a company that remanufactured used oil field pipe. The company ("RDL") would acquire used oil field pipe that was damaged or unusable. RDL would then process this unusable pipe in an extensive remanufacturing system that produced a usable product. RDL remanufactured pipe that it had purchased for its own account as well as pipe owned by other companies. The Commission's conclusion that RDL was not "primarily engaged in manufacturing" and therefore not entitled to the manufacturing exemption, was reversed by the Supreme Court which held:

The ultimate purpose of the manufacturer's exemption is to enhance this state's competitive position in inducing industries to locate and expand in Oklahoma. The trend in manufacturing is toward the use of recyclable materials in manufactured goods. The Legislature will not be perceived to have intended the exemption to discriminate against those businesses which produce saleable goods from recycled materials by placing them in a less favorable position than those which use new materials. In conformity with the Legislature's apparent objective--that of encouraging the development of industry--and in the absence of specific provisions for dealing with the remanufacturing of used, recyclable goods, we hold that the § 1352(H) definition of "manufacturing" includes both (a) the production of new and raw material and (b) the "remanufacturing" of used and commercially valueless material by the application of machinery, labor and skill which transforms it into a marketable commodity.

3. After the *Schulte* decision, the State legislature amended Section 1359 to provide the exemption in a broader scope. The manufacturing exemption now states at 68 O.S.Supp.1999, § 1359(1) as follows:

There 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" and "manufacturing operation" at 68 O.S.Supp.1999, § 1352(9) and (10) 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.

"Manufacturing operation" means the designing, manufacturing, compounding, processing, assembling, warehousing, or preparing of articles for sale as tangible personal property. A manufacturing operation begins at the point where the materials enter the manufacturing site and ends at the point where a finished product leaves the manufacturing site. "Manufacturing operation" does not include administration, sales, distribution, transportation, site construction, or site maintenance.

The current manufacturing exemption does not limit itself to establishments primarily engaged in manufacturing and generally recognized as such. In that regard, the process used by PROTESTANT in its retread shop is a manufacturing operation as that term is defined in the Sales Tax Code. The production of retreaded tires by PROTESTANT certainly meets the Supreme Court's definition of "manufacturing" as stated above from the *Schulte* case being, "the remanufacturing of used and commercially valueless material by the application of machinery, labor and skill which transforms it into a marketable commodity." Therefore, PROTESTANT is entitled to the manufacturer's exemption for machinery and materials used in the retread shop in the manufacturing process.

B. Sales Tax On Warranty Adjustments Made By PROTESTANT On Its Retread Tires

4. PROTESTANT provides a product warranty with the sale of its retread tires. If the retread tire fails within certain tread life parameters, the retread tire is totally replaced by PROTESTANT or an allowance is given to the customer on the purchase of another retread tire based on the remaining tread life on the failed tire. If there is no tread life remaining, then no allowance is given to the customer. The manufacturer's original product warranty is defined at OAC 710:65-19-371 (a) as follows:

"Manufacturer's original product warranty" means those warranties which are provided as a condition of all sales of a product and which constitute an indistinguishable part of the product sold. For purposes of this section, a "Manufacturer's original product warranty," is included within the basis for determining sales tax, without regard for whether the charges for the warranty and for the product are separately stated.

When replacement tires are exchanged with a customer pursuant to PROTESTANT's warranty contract, only the part that is billed to the customer is subject to sales tax as provided in OAC 710:65-19-371 (c) which states:

Parts used by the manufacturer to perform original manufacturer's warranty repair or replacement, are not taxable to the manufacturer. If the parts are included in the terms of the original warranty, and are not sold/billed to the customer, sales tax will not be due upon use by the manufacturer to effect repair or replacement. Parts billed/sold to the customer are subject to sales tax.

Therefore, PROTESTANT is not subject to sales tax on its warranty adjustments of retread tires except that sales tax is due on the parts billed or sold.

C. Sales And Use Tax On Wheel Weights And Supplies

5. PROTESTANT's next claim is that wheel weights and similar supplies used in its front shop to service the sale or repair of tires should be exempt from sales tax as to PROTESTANT under the sale for resale exemption because those supplies are part of the sale of a tire. The wheel weights and supplies to service tires are not resold by PROTESTANT, rather those are items that PROTESTANT uses to perform its service. Therefore, sales and use tax should be paid by PROTESTANT for those items for which it is the user/consumer rather than a reseller.

OAC 710:65-19-368 sets out the rule as follows:

The balancing of wheels of automobiles is a service by the balancer. Receipts from such wheel balancing are not taxable. The weights used by a balancer are consumed by him and are taxable when sold to him.

Under this rule, PROTESTANT is responsible for sales tax on wheel weights and shop supplies which it uses or consumes in the conduct of its business of selling and servicing tires.

D. Sales Made To Invalid Permit Numbers

6. PROTESTANT finally protests sales and use tax on items sold to its customers without proper documentation to qualify for the exemption or to customers that did not hold valid permit numbers. However, the burden of proving a sale is not a taxable sale is on the person who made the sale, 68 O.S. § 1365(C). OAC 710:65-76(a) provides that all sales are presumed to be subject to sales tax unless specifically exempted by the Sales Tax Code. Vendors are liable for the sales tax collected as well as for the tax that should have been collected. A vendor may be relieved of this liability under OAC 710:65-7-6(b) if the vendor in good faith, timely accepts from a consumer, properly completed documentation certified by the Oklahoma Tax Commission that such consumer is exempt from the taxes levied. In terms of the exemptions for sales for resale and sales for agricultural purposes the minimum requirements to establish properly completed documentation are set out in OAC 710:65-7-6(d) as follows:

In the case of sales for resale, items set out in this paragraph are required:

- (A) A copy of the purchaser's sales tax permit, or if unavailable, the purchaser's name, address, sales tax permit number, and its date of expiration. If a copy of the sales tax permit is unavailable, and if the information provided has not been previously verified, it must be verified by either calling the Taxpayer Assistance Division or by reference to the sales tax permit list obtained pursuant to OAC 710:65-9-6;
- (B) A statement that the articles purchased are purchased for resale;
- (C) The signature of the purchaser or a person authorized to legally bind the purchaser;
- (D) Certification on the face of the invoice, bill or sales slip or by a separate document, that says the purchaser is engaged in reselling the articles purchased; and,
- (E) In cases where purchases are made on regular basis, and the certification indicates that all purchases are for resale, then subsequent purchases may be made without further certification until the expiration date of the permit.

* * *

In the case of a claimed agricultural exemption, the vendor must obtain the items of information set out in this paragraph:

- (A) A copy of the agricultural exemption permit card;
- (B) A statement that the articles purchased will be used in agricultural production;
- (C) Signature of the permit holder or a person authorized to legally bind the permit holder; and,

(D) In the circumstances defined in (i) and (ii) of this subparagraph, certification on the face of the invoice or sales ticket is required;

(i) From any person purchasing feed for horses, mules, or draft animals used directly in the production and marketing of agricultural products; or

(ii) From any person who is making purchases of materials, supplies, or equipment to be used in the construction of livestock facilities, including facilities for the production and storage of feed, pursuant to a contract with an agricultural permit holder. See 68 O.S.Supp.1995, § 1358(8) and 710-65-13-17.

PROTESTANT did not provide evidence at the hearing which would satisfy these documentation requirements. 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 Co. v. Oklahoma Tax Commission*, 570 P.2d 315 (Okla. 1977). Since the sale for resale and agricultural use exemptions are not properly documented, no further adjustments can be made, *Dunn v. Oklahoma Tax Commission*, 862 P.2d 1285, 1993 OK CIV APP 105.

7. PROTESTANT's protest to the proposed assessment should be denied in part and sustained in part.

ADDENDUM TO FINDINGS, CONCLUSIONS AND RECOMMENDATIONS

NOW on this 7th day of May, 2001, the Findings, Conclusions and Recommendations ("Findings") issued in the above styled and numbered cause on November 22, 2000, come on for reconsideration of additional findings of fact and a recommendation as to the amount of the deficiency which should be confirmed by an Order of the Tax Commission.

The Division, as directed by the Findings, adjusted the sales and use tax assessment and provided notice to Protestant. Protestant has not challenged the adjustment proposed by the Division.

Upon consideration of the Findings and the adjustment to the assessment, the undersigned finds that the following Findings of Fact should be added to and incorporated in the Findings:

1. That notice of the adjustment to the assessments was filed of record in this cause on March 8, 2001.

2. That the Division revised the sales tax assessment to an amount of \$30,032.48, consisting of tax in the amount of \$15,837.65, interest accrued through April 1, 2001, in the amount of \$12611.03, and penalty in the amount of \$1,583.80.

3. That the Division revised the use tax assessment to an amount of \$3,775.20, consisting of tax in the amount of \$1,977.98, interest accrued through April 1, 2001, in the amount of \$1,599.38, and penalty in the amount of 197.84.

4. That the aggregate amount in controversy for sales tax is \$30,032.48, and for use tax is \$3775.20.

5. That the adjustment complies with the recommendations set forth in the findings.
6. That the Protestant was provided notice of the adjustment.
7. That the Protestant did not file a response to the adjustments.

The undersigned further finds that the following Recommendation should be added to and incorporated in the Findings:

It is further DETERMINED that the aggregate amount in controversy, inclusive of any additional accrued and accruing interest, be fixed as the deficiency due and owing.

THEREFORE, the Findings, Conclusions and Recommendations issued on November 22, 2000, are amended to include and incorporate the above and foregoing findings of fact and recommendation.

DISPOSITION

It is the DETERMINATION of the undersigned OKLAHOMA TAX COMMISSION, based upon the specific facts and circumstances of this case, that the sales and use tax protest be denied in part and sustained in part as set out above.

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.