JURISDICTION: OKLAHOMA TAX COMMISSION
CITE: 2005-05-10-23
ID: P-04-059-K
DATE: MAY 10, 2005
DISPOSITION: DENIED
TAX TYPE: USE
APPEAL: NONE TAKEN

FINDINGS OF FACT AND CONCLUSIONS OF LAW

STATEMENT OF THE CASE

A field audit of Protestant's books and records for the period of January 1, 1999 through December 31, 2003, was conducted by the Division. As a result of the audit, the Division by letter dated March 22, 2004, caused to be issued against Protestant a proposed use tax assessment. Protestant timely protested the proposed assessment by letter received April 19, 2004. Protestant did not request a hearing in the letter of protest.

On May 11, 2004, the Division forwarded its file to the Office of the Administrative Law Judges (ALJ's Office) for further proceedings consistent with the Uniform Tax Procedure Code[1] and the Rules of Practice and Procedure Before the Oklahoma Tax Commission[2]. The case was docketed as Case No. P-04-059-K and assigned to ALJ, Administrative Law Judge.[3]

A pre-hearing conference was scheduled in this cause for July 7, 2004, by *Notice of Prehearing Conference* issued May 18, 2004.[4] By *Motion* filed June 18, 2004, the Division requested a continuance of the pre-hearing Conference. The Division's *Motion* was granted and the pre-hearing Conference was rescheduled for July 13, 2004. The conference was held with the representatives of the parties in attendance. Pursuant to the pre-hearing conference, a *Prehearing Conference Order and Notice of Alternative Hearing Date*[5] was issued whereby this cause was scheduled to be submitted for decision by the filing of a stipulation of facts and briefs[6] or, in the event the parties were unable to stipulate to a full and complete factual record, the filing of pre-trial briefs and a hearing scheduled for November 3, 2004.[7] By memorandum filed October 29, 2004,

1 68 O.S. 2001, § 201 et seq.

2 Rules 710:1-5-20 through 710:1-5-47 of the Oklahoma Administrative Code ("OAC").

3 See, OAC, 710:1-5-22 and 710:1-5-30.

4 OAC, 710:1-5-28.

5 OAC, 710:1-5-28(b).

6 OAC, 710:1-5-38.

7 OAC, 710:1-5-29.

the Division advised the ALJ's Office that the parties had conferred and wished to proceed by stipulated facts with briefs and requested the hearing scheduled for November 3, 2004, be stricken.

A *Joint Stipulation of Facts* was filed by the parties on December 2, 2004. Protestant failed to file a brief pursuant to the *Prehearing Conference Order*. The Division filed a *Brief* on January 25, 2005, whereupon the record in this cause was closed and the matter was considered submitted for decision.[8]

FINDINGS OF FACT

Upon review of the file and records, including the *Joint Stipulation of Facts* and the Division's *Brief*, the undersigned finds:

A. The parties stipulate to the following:

Protestant produces dental prosthetic plates, bridgework and artificial teeth for the patients of dentists, and is located in ANYTOWN, Oklahoma.

During the period January 1, 1999 through December 31, 2003, Protestant purchased numerous supplies [from] out of state vendors without use tax being charged by those vendors, nor with Protestant remitting tax as a consumer user. Exhibit A to the Joint Stipulation of Facts.[9]

The Division performed a field audit upon Protestant for the above period. By agreement between Protestant and the Division, an error rate projection method, using a sample period of January 1, 2001 through December 31, 2003, was used for the audit of use tax. Exhibit B to the Stipulation of Facts.[10]

As a result of the audit, the Division by letter dated March 22, 2004 issued a proposed assessment of use tax against Protestant for the period January 1, 1999 through December 31, 2003 in the amounts of $7,800.73 for tax, $3,387.30 for interest (through May 15, 2004), and $780.11, for a total of $11,968.14.[11] Exhibit C to the Stipulation of Facts.[12]

By letter dated April 19, 2004, Protestant protested the proposed assessment thereby placing the entire amount in controversy. Protestant asserts two issues in the protest letter: (1) the supplies

8 OAC, 710:1-5-39(a).

9 Copies of out-of-state purchase invoices without tax. The Auditor's notes indicate that the purchase invoices are a sampling of the purchase invoices reviewed for the audit period.

10 Copy of the audit workpapers.

11 Footnote 1 original to the Stipulation of Facts. The footnote provides: "Protestant was audited and assessed use tax in 1986, and was assigned the use tax permit number ######."

12 Copy of the letter of assessment.

purchased by it upon which use tax was assessed are raw materials which constitute the major cost and part of the items manufactured by it, and are therefore exempt from use tax; and (2) to the extent the dentists to whom the dental appliances are sold pay use tax [sic] on them, the Division is collecting use tax twice on the same materials. Exhibit D to the Stipulation of Facts.[13]

In a subsequent letter dated June 12, 2004, Protestant made two additional assertions: (1) that the audit did not take into consideration out of state sales and related costs and purchases, and (2) that the materials used in the fashioning of the dental [sic] prosthetics are exempt as dental prosthetics from Oklahoma sales and use tax, under terms of 68 O.S. § 1357.6(A). Exhibit E to the Stipulation of Facts.[14]

Protestant does not hold an Oklahoma Manufacturer's Sales Tax Exemption Certificate.

B. Additional findings:

That the amount in controversy is $11,095.07, the amount assessed less the amount of the thirty (30) day delinquent penalty ($780.11) and the amount of interest included in the assessment for the period of April 17, 2004 through May 15, 2004 ($92.96).[15]

ISSUE AND CONTENTIONS

Four issues are presented for decision. The first issue is whether the tangible personal property purchased by Protestant is exempt from use tax under 68 O.S. Supp. 1999, § 1404(4), by reason of 68 O.S. Supp. 1998, § 1359(1), since the property is used in, and becomes an intricate part of, the products (artificial teeth, crowns, bridges and partials) manufactured by Protestant and sold to dentists. The second issue is whether the Division erred in assessing use tax on the tangible personal property purchased by Protestant to the extent that the same property when sold by Protestant to a dentist is subject to sales or use tax. The third issue is whether the Division erred in assessing use tax on the tangible personal property purchased by Protestant to the extent that the property was used in making products that were sold to out-of-state dentists. The fourth issue is whether the tangible personal property purchased by Protestant is exempt from use tax under 68 O.S. Supp. 1999, § 1404(4), by reason of 68 O.S. 1991, § 1357.6(A), since the property is used in, and becomes an intricate part of, the products (prosthetic devices) made by Protestant and sold to dentists.

13 Copy of the letter of protest.

14 Copy of letter. Attached to the letter as Attachment A is Protestant's "Out of State Sales Calculations." Protestant calculates that the total tax assessed should be reduced by the amount of $970.00.

15 The Division records show that Protestant payment under protest of $11,188.03 was posted on April 16, 2004. The records also show that Protestant is due a credit of $92.96 on the payment.

CONCLUSIONS OF LAW

1. Jurisdiction over the parties and the subject matter of this proceeding is vested in the Tax Commission. 68 O.S. 2001, § 221(D).

2. Use tax is levied and shall be paid by every person storing, using or otherwise consuming within the state, tangible personal property purchased or brought into the state at the rate of four and one-half percent (4.5%) of the purchase price of such property. 68 O.S. 2001, § 1402. "Use tax" is defined to mean "an excise tax charged on the sale of tangible personal property purchased from outside of Oklahoma and brought into the state for consumption or use". *OAC*, 710:65-21-2. The Oklahoma user or consumer of tangible personal property bought outside the state and brought into the state for storage, use or consumption is required to accrue, report and remit the use tax directly to the Tax Commission where the vendor of the property does not maintain a place of business in this state and has not voluntarily agreed to collect the use tax. OAC, 710:65-21-3 and 710:65-21-4. Use taxes are meant to be complementary and supplementary to sales taxes, ***Phillips v. Oklahoma Tax Commission***, 1978 OK 34, 577 P.2d 1278; and are designed to prevent consumers from escaping sales tax by going outside of the state and purchasing property and bringing it into the state for use or consumption, ***Southeastern, Inc. v. Oklahoma Tax Commission***, 1960 OK 97, 351 P.2d 739.

3. Exempted from the levy of use tax is "the use of tangible personal property now specifically exempted from taxation under [the] Oklahoma Sales Tax Code", 68 O.S. 2001, § 1351 et seq. 68 O.S. 2001, § 1404(4).

4. In particular to this proceeding, and at all times relevant herein, the Oklahoma Sales Tax Code specifically exempted the following from the levy of sales tax:

> [s]ales of goods, wares, merchandise, tangible personal property, machinery and equipment to a manufacturer for use in a manufacturing operation"; 68 O.S. Supp. 1998, § 1359(1), provided: (1) the articles designed, manufactured, compounded, processed, assembled, warehoused, or prepared <u>for sale</u> are tangible personal property, 68 O.S. Supp. 1998, § 1352(10); (2) the form, composition, or quality of character of the tangible personal property is changed by an activity of converting or conditioning the tangible personal property; (3) the activity of converting or conditioning the tangible personal property employs procedures commonly regarded as manufacturing, compounding, processing or assembling; (3) the form or use of the tangible personal property is different as a result of the procedures, 68 O.S. Supp. 1998, § 1352(9); and the manufacturer has a manufacturer exemption permit and furnishes proof of eligibility for the exemption to the vendor at the time of the sale, 68 O.S. Supp. 1998, § 1359.2(A) and (B);[16]

16 Emphasis added.

and

> sales of * * * medical appliances, medical devices and other medical equipment including but not limited to prosthetic devices,[17] * ** when administered or distributed by a practitioner,[18] * * * who is authorized by law to administer or distribute such items or when purchased or leased by or on behalf of an individual for use by such individual under a prescription or work order of a practitioner who is authorized by law to prescribe such items and when the cost of such items is reimbursable to the practitioner, supplier or the individual under the Medicare or Medicaid Program, 68 O.S. 1991, § 1357.6(A).

5. The Tax Commission with respect to its general duty to administer and enforce the provisions of the state tax laws,[19]promulgated the following rule with respect to dentists, dental laboratories, and dental supply houses, which rule provides in pertinent part:

> (a) **Dentists**. Dentists primarily render services and incidentally use tangible personal property in connection therewith. The gross receipts of dentists derived from these sources are not subject to the sales tax.
>
> (b) **Dental supply houses**. Dental supply houses who sell tangible personal property such as platinum, gold, silver or cement for filling, artificial teeth or other such materials to a dentist for use in the performance of the dentist's services are making sales within the Sales and Use Tax Code and must collect, report and remit tax based on the gross receipts received from such sales. This is true whether the dental supply house sells material to a dentist whose services are rendered directly to a patient, or to a dental laboratory that uses the material in producing plates, bridge-work, artificial teeth or prosthetic devices on prescription of the dentist for the dentist to use in connection with rendering dental services.
>
> (c) **Dental laboratories**. Dental laboratories that purchase tangible personal property to produce plates, bridge-work, artificial teeth, prosthetic devices and the like must pay tax when the material is

17 "Prosthetic device" is defined to mean "a device which replaces a missing part or function of the human body and shall include any supplies physically connected to such device." 68 O.S. § 1357.6(C).

18 "Practitioner" is defined to mean "a physician, osteopathic physician, surgeon, podiatrist, chiropractor, optometrist, pharmacist, psychologist, ophthalmologist, nurse practitioner, audiologist or hearing aid dealer or fitter who is licensed by the state as required by law." 68 O.S. 1357.6(B).

19 68 O.S. § 203.

> purchased and must not charge tax to the dentist when the finished product is transferred to the dentist.[20]

6. As a general rule, statutes exempting property from taxation are to be strictly construed against the allowance of an exemption. ***Autumn House v. Oklahoma Tax Commission***, 1991 OK 73, 814 P.2d 1036; ***Matter of Wal-Mart Stores, Inc.***, 1991 OK CIV APP 73, 817 P.2d 1281; ***Bert Smith Road Machinery Co. v. Oklahoma Tax Commission***, 1977 OK 75, 563 P.2d 641. Claims of exemption from taxation must be plainly and unmistakably supported by express grant. ***In re Noble's Estate v. State ex rel. Oklahoma Tax Commission***, 1938 OK 324, 80 P.2d 243. An exemption cannot exist by implication and any doubt is fatal to the claim of exemption. ***Phillips Petroleum Co. v. Oklahoma Tax Commission***, 1975 OK 146, 542 P.2d 1303; ***Oklahoma City v. Shields***, 1908 OK 195, 22 Okla. 265, 100 P. 559. The burden of proving the existence of an exemption is on the one claiming the exemption to show it falls squarely within the specific language of the exemption. ***Austin, Nichols & Co. v. Oklahoma County Bd. of Tax-Roll Corrections***, 1978 OK 65, 578 P.2d 1200.

7. Rules promulgated pursuant to the Administrative Procedures Act[21], are presumed to be valid until declared otherwise by a district court of this state or the Supreme Court. 75 O.S. 1991, § 306(C). They are valid and binding on the persons they affect, have the force of law and are prima facie evidence of the proper interpretation of the matter to which they refer. 75 O.S. 1991, § 308.2(C).

Great weight is accorded an agency's construction of a statute when the administrative interpretation is made contemporaneously with the enactment of the statute and the construction is longstanding and continuous by the agency charge with its execution. ***Schulte Oil Co., Inc. v. Oklahoma Tax Commission***, 1994 OK 103, 882 P.2d 65 (1995). Where the Legislature is made repeatedly aware of the operation of the statute according to the construction placed upon it by an agency and the Legislature has not expressed its disapproval with the agency's construction, the Legislature silence may be regarded as acquiescence in the agency's construction, ***R.R. Tway, Inc. v. Oklahoma Tax Commission***, 1995 OK 129, 910 P.2d 972 (1995); and the agency's construction is given controlling weight and will not be disregarded except in cases of serious doubt, ***Cox v. Dawson***, 1996 OK 11, 911 P.2d 272 (1996).

The rules and regulations of an administrative agency which implement the provisions of a statute are valid unless they are beyond the scope of the statute, are in conflict with the statute or are unreasonable. See, ***Arkansas Louisiana Gas Co. v. Travis***, 1984 OK 33, 682 P.2d 225 (1984); ***Boydston v. State***, 1954 OK 327, 277 P.2d 138 (1954). Agency rules need not be specifically authorized by statute, but must generally reflect the intent of the Legislature as expressed in the statute. ***Jarboe Sales Company v. Oklahoma Alcoholic Beverage Laws Enforcement Commission***, 2003 OK CIV APP 23, 65 P.3d 289 (2003). As a general rule, it is presumed that administrative rules and regulations are fair and reasonable, and that the complaining party has the

20 OAC, 710:65-19-71.

21 75 O.S. 1991, § 250 et seq., § 301 et seq.

burden of proving the contrary by competent and convincing evidence. ***State ex rel. Hart v. Parham***, 1966 OK 9, 412 P.2d 142 (1966).

8. A proposed assessment is presumed correct and the taxpayer bears the burden of showing that it is incorrect, and in what respect. *OAC*, 710:1-5-47. *See*, ***Enterprise Management Consultants, Inc. v. State ex rel. Oklahoma Tax Commission***, 1988 OK 91, 768 P.2d 359. In administrative proceedings, the burden of proof standard is "preponderance of evidence." Black's Law Dictionary, 1064 (5th ed. 1979). *See*, *Oklahoma Tax Commission Order No.* 91-10-17-061. "Preponderance of evidence" means "[E]vidence 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." *Id.* It is also defined to mean "evidence which is more credible and convincing to the mind ... [T]hat which best accords with reason and probability." *Id.*

9. In ***Crutcher Dental Supply Co., Inc. v. Rabren***[22], the Supreme Court of the State of Alabama had before it taxpayer's action to declare illegal and void a regulation adopted by the Commissioner of Revenue of the State of Alabama, which regulation is identical to Rule 710:65-19-71 adopted by the Oklahoma Tax Commission. Taxpayer, a dental supply house, sold certain materials to dental laboratories and dentists who used the materials in making or manufacturing dental appliances or prostheses such as artificial teeth for the patients of the dentists. The effect of the regulation under attack was to impose on taxpayer the liability to collect from its customers and to remit to the state the amount of sales tax imposed on the "retail sales" of material sold by taxpayer to its customers, the dentists and laboratories. Taxpayer argued that the sales made to dentists and laboratories were "wholesale sales" because the materials are used in the manufacture of dental prostheses and become an ingredient or component part of the prostheses, and not "retail sales", and thus, taxpayer was not liable to collect and remit to the state the tax imposed on the sales.[23]

In ***Crutcher***, *supra* at 417, the Court held "the sales by taxpayer to laboratories and dentists are not wholesale sales because the articles manufactured by the laboratories and dentists are not manufactured `for sale,' as the words `for sale' are used in the sales tax statutes." The Court reasoned that "dentists are not engaged in merchandising, and that the supplying of prostheses is incidental to the professional service rendered by the dentist to the patient" and that "[dental] laboratories [are] an extension of the arm of the dentist or an extension of his office, and the laboratories are in the same position as the dentists who makes a set of artificial teeth for the individual patient". *Id.*, at 419. The Court also found that "the use of material by dentists and laboratories in making the prostheses is a consumption incident to rendering professional service

22 286 Ala. 686, 246 So.2d 415 (1971).

23 In Alabama, the tax is imposed on "retail sales" as opposed to "wholesale sales". "Wholesale sales" are defined to include a sale of tangible personal property to a manufacturer which enters into and becomes an ingredient or component part of the products which he manufactures or compounds for sale. "Retail sales" are defined as all sales except those defined as wholesale sales and also means the use or consumption of any tangible personal property by anyone who purchases same at wholesale except property which enters into and becomes an ingredient or component part of products manufactured or compounded for sale. Id., at 416-417.

and not a manufacture for sale any more than the preparation and production of a deed or a will or a lengthy brief by a lawyer for a client would be a manufacture of the instrument for sale." *Id.*

10. With respect to the first issue, the undersigned finds that the opinion of the Supreme Court of Alabama in ***Crutcher***, *supra*, is applicable in this case and should be found to be controlling. Like the Alabama statute, a "manufacturing operation" is defined as "the designing, manufacturing, compounding, processing, assembling, warehousing, or preparing of articles for sale as tangible personal property" by the Oklahoma Sales Tax Code[24]. (Emphasis added). The tangible personal property purchased by Protestant in this case was not purchased for the purpose of use in manufacturing or preparing prostheses "for sale",[25] but was purchased for the purpose of use or consumption incident to rendering its professional services in providing the prostheses. Further, assuming arguendo that Protestant was a manufacturer of prostheses, Protestant has not been issued a manufacturer exemption permit. *See*, 68 O.S. Supp. 1998, § 1359.2(A) and ***Apache Corporation v. Oklahoma Tax Commission***, 2004 OK 48, 98 P.3d 1061, ¶ 11. Accordingly, the tangible personal property purchased by Protestant is not exempt from use tax under 68 O.S. Supp. 1999, § 1404(4), by reason of 68 O.S. Supp. 1998, § 1359(1).

11. With respect to the second issue, Protestant's proposition is without merit. First, the tangible personal property used or consumed to produce plates, bridge-work, artificial teeth, prosthetic devices and the like is not subject to tax when the finished product is transferred to a dentist. OAC, 710:65-19-71(c). Second, even if the tangible personal property was subject to tax when the finished product was transferred to a dentist, "there is no limit to the number of times a particular article of merchandise may be subject to a sales tax so long as the article remains in the stream of commerce and goes through the regular channels of trade." ***General Tire Co. v. Oklahoma Tax Commission***, 1941 OK 120, 188 Okla. 607, 112 P.2d 407. Accordingly, the Division did not err in assessing use tax against Protestant on the tangible personal property purchased by Protestant outside the State of Oklahoma and brought into the state for storage, use or consumption.

12. With respect to the third issue, Protestant failed to present any evidence that it sold any products to out-of-state dentists. *See*, *OAC*, 710:1-5-47; ***Enterprise Management Consultants, Inc. v. State ex rel. Oklahoma Tax Commission***, 1988 OK 91, 768 P.2d 359. Accordingly, the Division did not err in assessing use tax against Protestant on the tangible personal property purchased by Protestant outside the State of Oklahoma and brought into the state for storage, use or consumption.

13. With respect to the fourth issue, Protestant's proposition that Section 1357.6(A) exempts the tangible personal property at issue from taxation is misplaced. First, Protestant purchased tangible personal property used or consumed in producing prostheses, not the prostheses. Second, Protestant did not present any evidence to show the prostheses were furnished to a Medicare or Medicaid program recipient and the cost of the prostheses was reimbursed by Medicare or Medicaid. Accordingly, the tangible personal property purchased by Protestant is not exempt from use tax under 68 O.S. Supp. 1999, § 1404(4), by reason of 68 O.S. 1991, § 1357.6(A).

24 68 O.S. 2001, § 1350 et seq., in particular 68 O.S. Supp. 1998, § 1352(10).

25 See, OAC, 710:65-19-71(c).

14. Protestant's protest to the proposed use tax assessment should be denied.

DISPOSITION

Based on the above and foregoing findings of fact and conclusions of law, it is ORDERED that the use tax protest of Protestant, DENTAL COMPANY., be denied. It is further ORDERED that the amount in controversy should be fixed as the deficiency due and owing.

OKLAHOMA TAX COMMISSION