

Rule 2007-5
REDUCED SALES TAX RATE FOR NATURAL GAS OR ELECTRICITY USED
DIRECTLY IN THE MANUFACTURING PROCESS

This rule is promulgated by the Director of the Department of Finance and Administration to administer the provisions of Act 185 of 2007 pursuant to the authority of Ark. Code Ann. § 26-52-319(e) as enacted by Act 185 of 2007. This rule is promulgated pursuant to the provisions of § 25-14-204 of the Administrative Procedure Act regarding rules.

A. General Information:

1. Beginning July 1, 2007, sales of natural gas and electricity to a manufacturer for use directly in the manufacturing process will be taxed as follows:
 - a. From July 1, 2007 through June 30, 2008 the state tax rate will be four and one-half percent (4.5%).
 - b. Beginning July 1, 2008, and continuing thereafter, the state tax rate will be four percent (4%).¹
2. Natural gas and electricity that is sold for any purpose other than for use directly in manufacturing will continue to be taxed at the state tax rate of six percent (6%).
3. Although Act 185 of 2007 reduced the state tax rate on natural gas and electricity used directly in manufacturing, Act 185 did not affect the local tax rate on natural gas and electricity used in manufacturing. The collection of local tax on sales of natural gas and electricity for all purposes should continue at the rate levied by the local government.

B. Definitions: For purposes of this rule, the following definitions apply:

1. "DFA" shall mean the Sales and Use Tax section of the Department of Finance and Administration.
2. "Manufacturer" shall mean a person or entity classified within sectors 31 through 33 of the North American Industry Classification System, as in effect on January 1, 2007.
3. "Meter certification" shall mean the process for a manufacturer to register with DFA, provide information regarding each natural gas and electricity meter, and obtain a certificate from DFA that lists each meter and the percentage of each meter's billing that may be purchased at the reduced rate.
4. "Mixed use meter" shall mean a meter that supplies natural gas or electricity, part of which is used directly in the manufacturing process (taxed at reduced rate) and part of which is used for other purposes (taxed at full state rate).

¹ Act 185 of 2007 reduced the statutory state tax rate on natural gas and electricity used directly in manufacturing to the rate of 4.375% beginning July 1, 2007 and to the rate of 3.875% beginning July 1, 2008. Act 185 of 2007 did not affect the constitutional levy (by Amendment 75 to the Arkansas Constitution) of state tax at the rate of one-eighth of one percent (0.125%) on all taxable sales of property and services. The aggregate of the state tax rate levied by Act 185 of 2007 and the constitutional rate result in the 4.5% and the 4% rates, respectively.

5. "Reduced rate" shall mean the rate of state tax that is levied on sales of natural gas or electricity that is sold to a manufacturer for use directly in the actual manufacturing process.
6. "Separately metered" or "separate meter" shall mean that each meter used to purchase natural gas or electricity shall be used solely to purchase either (i) natural gas or electricity used directly in the manufacturing process, or (ii) natural gas or electricity used for other purposes.
7. "Used directly in the actual manufacturing process" shall mean that the natural gas or electricity is used either:
 - a. to power machinery and equipment or provide energy used in the actual production or assembly of the manufactured product, or
 - b. to power machinery and equipment or provide energy that supports the actual production or assembly of the finished product, including heating or air conditioning the manufacturing facility where production and assembling occur; temporary cooling/chilling areas at the beginning or at the end of the process which are needed to enhance, maintain, and protect the integrity of the product; providing lighting for the manufacturing process that occurs either inside or outside a building or other structure including parking lots and grounds; providing restroom facilities, maintenance facilities, break facilities, pollution control equipment, and offices for personnel of the manufacturing facility whose activities directly support the manufacturing operations; and other functions in support of the production and assembly of the finished product. "Personnel whose activities directly support the manufacturing operations" include plant manager(s), plant maintenance personnel, work place safety personnel, human resources personnel, and engineering personnel. Personnel whose activities do not directly support the manufacturing operations include sales personnel, general accounting, payroll, and legal personnel, and warehousing personnel.

For purposes of the "used directly" requirement, the manufacturing process shall include processes beginning at the point where raw materials are first moved from raw material storage to begin manufacturing or processing of those materials into items of tangible personal property and ending when production and packaging of the finished manufactured goods is completed.

Natural gas or electricity used in storage and warehousing facilities, material handling facilities used before raw materials are moved toward the point of manufacturing, and general office facilities, are not used directly in the actual manufacturing process.

C. Registration and Certification:

1. A manufacturer must register with DFA to purchase natural gas or electricity at the reduced rate using Form ET185A and provide information to DFA at that time regarding each manufacturing use of natural gas or electricity at each meter (see section (C)(2) for information required). A manufacturer who operates manufacturing facilities at more than one physical location must make a separate application for each location. The signature on the application (Form ET185A) will certify that all the information provided is true and correct information regarding qualification for the reduced rate. DFA will issue a certificate to the

manufacturer that will certify the percentage available for reduced rate at each meter (Form ET185RR).

2. Information Required.
 - a. Separate Meters. The manufacturer shall prepare a list that includes each separate meter that supplies natural gas or electricity that is used solely in the manufacturing process.
 - b. Mixed use meters. When gas or electricity is furnished through one meter, and a portion of the gas or electricity is subject to the full tax rate while another portion of the gas or electricity is eligible for the reduced tax rate, a reasonable formula shall be used by the manufacturer to apportion the gas or electricity between that eligible for the reduced rate and that not eligible. The formula or method used in determining the percentage eligible for the reduced rate does not have to be pre-approved by DFA. However, the formula or method used does have to reasonably reflect the percentage of manufacturing use to total use. The manufacturer shall provide with the application a narrative explanation of the formula or method employed to determine the percentage of manufacturing use. The manufacturer may calculate the apportionment through the use of the manufacturer's own knowledgeable employees or the use of an outside firm. The manufacturer shall prepare a list that includes each mixed use meter and the percentage that is subject to the reduced rate at each meter. The manufacturer shall maintain all records necessary to support the apportionment percentages for review upon audit by DFA.
3. DFA will accept the certification provided by the manufacturer and issue a certificate to the manufacturer that lists each meter for which the reduced rate is available and the percentage of that meter's billing that is taxed at the reduced rate (Form ET185RR).
4. The manufacturer shall maintain the supporting documents (worksheets) used to calculate the percentage for mixed use meters for the period of time that tax records are required to be kept. The worksheets and the calculation of the percentage subject to the reduced rate are subject to audit and assessment of any unpaid tax resulting from incorrect calculation or certification of the percentage.
5. Purchases made after July 1, 2007 but before the manufacturer registers and obtains a meter certification from DFA are taxable at the full state tax rate of six percent (6%). If the manufacturer subsequently registers and obtains a meter certification, the manufacturer may file a request for refund with DFA for the overpayment that includes documentation regarding the calculation of the overpayment (see section F).

D. Recertification.

1. Recertification is required at each location:
 - a. When there is a substantial change in the manufacturer's operation that would affect energy usage at any, or all, meters. A substantial change is a change resulting in greater than a twenty percent (20%) change in the percentage of total energy usage that results from additions or replacement of machinery or equipment, taking machinery or equipment out of service, or changes in business processes altering the usage percentages.

For purposes of this requirement, a twenty percent (20%) change means that the current percentage of natural gas used directly in manufacturing, or the current percentage of electricity used directly in manufacturing, is 20% greater or less than the percentage of natural gas or electricity, respectively, that was used directly in manufacturing at the time of the original certification.

Example: At the time of the original certification, manufacturer used 60% of the natural gas it purchases directly in manufacturing. Due to a change in its operations, manufacturer's use of natural gas directly in manufacturing increases to 72% or greater, or decreases to 48% or less [$60 \times .20 = 12$; $60 + 12 = 72$; $60 - 12 = 48$]. This represents a 20% or greater change and manufacturer is required to recertify.

- b. At the end of any thirty-six (36) months in which no recertification has occurred. Each certificate will contain an expiration date that is thirty-six months from the date of the certificate. If, during the effective period of the certificate, the manufacturer recertifies due to a substantial change in operation or usage, a replacement certificate will be issued that expires thirty-six (36) months from the date of the replacement certificate. DFA will notify each manufacturer prior to the end of any thirty-six month period for which recertification is required. If applicable, recertification can be accomplished by a statement that no changes have occurred since the date of the last certification.
2. A manufacturer may adjust any portion, or all, of its certification percentage at any time.

E. Calculating and Remitting Tax.

1. The tax on all sales of natural gas or electricity to manufacturers shall be calculated and remitted as follows:
 - a. Apply the four and one-half percent (4.5%) [four percent (4%) after July 1, 2008] state tax rate to:
 - i. Sales of natural gas or electricity from separate meters certified for use solely in manufacturing; and
 - ii. Sales of the percentage of natural gas or electricity sold from each mixed use meter that is certified for the reduced rate on the certificate issued to the manufacturer by DFA.
 - b. Apply the six percent (6%) state tax rate to sales of natural gas and electricity from separate meters not used in manufacturing and to the percentage of natural gas or electricity from mixed use meters that is not taxed at the reduced rate.
 - c. Apply the local tax to all sales from all meters.
2. Direct Pay Permit Holders. Manufacturers who have direct pay permits and wish to remit tax directly on purchases of natural gas or electricity should calculate and remit the tax according to the method in section E(1).
3. Seller Collects Tax. Manufacturers who either do not have direct pay permits or do not wish to remit tax on utilities on their direct pay report must determine whether each seller of natural gas or electricity is able to apportion the billing for each mixed use meter by applying the two different state tax rates to sales from each mixed use meter.

- a. The manufacturer must provide any seller of natural gas or electricity who is able to apportion the billing for mixed use meters with the certificate that lists the percentage of the sale from each meter that is subject to the reduced rate (Form ET185RR).
- b. The manufacturer has the following options regarding purchases of natural gas or electricity from a seller who is not able to apportion the billing:
 - i. Obtain (or use if already permitted) a direct pay permit (that can be used to remit the tax due on all purchases or only on purchases of natural gas or electricity used directly in manufacturing) and remit the tax directly to DFA; or
 - ii. Pay the full state tax rate of six percent (6%) to the seller and file a request for refund with DFA for the overpayment that includes documentation regarding the calculation of the overpayment.

F. Refund Process.

- 1. Manufacturers who pay tax at the full state rate on natural gas or electricity used directly in manufacturing may request a refund of the overpayment directly from DFA (Form ET185F). The refund cannot be obtained from the seller. The following documentation must be included with the request for refund:
 - a. The name and address of the manufacturer, and permit number if manufacturer has a permit;
 - b. The time period for which the refund is claimed, including the date(s) the tax was paid to the seller;
 - c. The type of utility purchased – natural gas or electricity;
 - d. Schedules or worksheets used to calculate the amount of the refund; and
 - e. Any other information relative to the payment as may be required by DFA.
- 2. DFA shall determine the amount of the refund, if any, and shall issue the refund to the manufacturer.
- 3. Any manufacturer whose claim for refund is denied, in whole or in part, shall be entitled to the remedies available under the Arkansas Tax Procedure Act, Ark. Code Ann. § 26-18-101 et seq., to contest the denial of the refund.

G. Existing Exemptions.

All existing statutory exemptions from sales and use tax for natural gas or electricity used in manufacturing or other purposes continue to apply.

Issued this _____ day of _____, 2008.

Richard A. Weiss
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 Administration

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 Administration