

ONA CORPORATION §  
d/b/a Onan Corporation §  
646 James Record Road §  
Huntsville, Alabama 35824-1520, §

Taxpayer. §

v. §

STATE OF ALABAMA §  
DEPARTMENT OF REVENUE. §

STATE OF ALABAMA  
DEPARTMENT OF REVENUE  
ADMINISTRATIVE LAW DIVISION

DOCKET NO. U. 90-315

OPINION AND PRELIMINARY ORDER

The Revenue Department assessed sales and use tax against Ona Corporation, d/b/a Onan Corporation ("Taxpayer"), for the period July 1985 through June 1988. The Taxpayer appealed to the Administrative Law Division and the case was submitted on a joint stipulation of facts. Jacquelin Hagel represented the Taxpayer. Assistant counsel Wade Hope represented the Department.

The issue in this case is whether coolants used by the Taxpayer in its manufacturing process should be taxed at the reduced 1½% "machine" rate levied at Code of Ala. 1975, §§40-23-2(3) (sales tax) and 40-23-61(b) (use tax).

The facts are undisputed.

The Taxpayer manufactures diesel engines at its facility in Huntsville, Alabama. The Revenue Department issued the Taxpayer a permit pursuant to Code of Ala. 1975, §40-23-31, commonly known as a Regulation A permit, which allows the Taxpayer to purchase tangible personal property tax-free and then report and remit tax directly to the Department on that portion of the property used for a taxable purpose.

The Taxpayer purchased coolants tax-free for use in its manufacturing process during the period in question. The Taxpayer remitted tax to the Department on the coolants at the reduced 1½% "machine" rate. The Department audited the Taxpayer and taxed the coolants at the general 4% rate. The Taxpayer appealed to the Administrative Law Division.

The coolants are used by the Taxpayer as follows: The Taxpayer manufactures engine parts that must be cut to specific measurements. To assist in the cutting process, a continuous stream of coolants is pumped directly on the cutting tools and the metal being cut. The coolants reduce the heat resulting from the cutting process, remove minute particles from the cutting area, and in effect prolong the cutting tools' effective life. The coolants are customarily and necessarily used in the Taxpayer's manufacturing process. Code of Ala. 1975, §40-23-2(3) levies a reduced 1½% sales tax on certain "machines" used in manufacturing. A corresponding use tax "machine" rate is set out at Code of Ala. 1975, §40-23-61(b). Section 40-23-2(3) levies the reduced rate as follows:

(3) Upon every person, firm or corporation engaged or continuing within this state in the business of selling at retail machines used in mining, quarrying, compounding, processing, and manufacturing of tangible personal property an amount equal to one and one-half percent of the gross proceeds of the sale of such machines; provided, that the term "machines," as herein used, shall include machinery which is used for mining, quarrying, compounding, processing, or manufacturing tangible personal property, and the parts of such machines, attachments and replacements therefor, which are made or manufactured for use on or in the operation of such machines and which are necessary to the operation of such machines and are customarily so used.

The "machine" rate provision has been construed numerous times by Alabama's courts. In State v. Newbury Manufacturing Company, 93 So.2d 400 (Ala. 1957), the issue was whether sand and steel shot

used in the taxpayer's manufacturing process should be taxed at the reduced rate. The sand was used to form core molds and the shot was used to clean the cast-iron fittings taken from the molds. The court found that the sand and shot served an independent function in the manufacturing process and was thus entitled to the reduced rate, as follows:

The term "machines, attachments and replacements" in this connection have been given a broad meaning. State v. Wilputte Coke Oven Corp., 251 Ala. 271, 37 So.2d 197; State v. Alabama Gas Corp., 258 Ala. 356, 62 So.2d 454; State v. Calumet & Hecla Consol, Cooper Co., 259 Ala. 225, 66 So.2d 726; State v. Taylor, 262 Ala. 639, So.2d 628. Their status is not controlled by the material of which they are composed, but by the office they serve in the process. If the article in question performs an integral function in the procedure by which the tangible personal property is produced, we think it is a part and parcel of the machinery used in its production. It is not controlled by the fact that in its use it wears out its valuable properties in that connection. Many parts of machinery wear out and have to be replaced.

On the other hand, if a product, such as grease or fuel is useful only as an aid, though vital in enabling the machine or some part of it to operate, but not itself performing a distinct function in the operation, it does not come within the exception.

The "sand" and "steel shot" here in question have an independent function in the operation. That is not simply as an aid to some other part in the performance of its service. The question is not controlled by whether it is necessary to the operation of a machine - grease and fuel are that, but they perform no specific function in the operation. It is sometimes said to depend upon whether the article has a direct part in the processing program. (cites omitted).

So.2d 354 (Ala. 1968), the Supreme Court, citing Newbury, held that paper bags used in processing dolomite into finished magnesium metal was an integral, essential, and functional part of the manufacturing process, and thus should be taxed at the reduced rate. See also, Robertson and Assocs. v. Boswell, 361 So.2d 1070 (Ala. 1978) (explosives used to mine coal granted reduced rate); State v. Selma Foundry and Mach. Co., 160 So.2d 1 (Ala. 1963) (saw sharpeners, grinders, etc. used to recondition machines denied reduced rate).

Do the coolants in issue serve an integral, essential, and independent function in the Taxpayer's manufacturing process within the context of the above statutes and cases? I do not believe that they do.

Unlike the sand and shot in Newbury and the bags in Calumet and Hecla, the coolants in issue do not serve a direct, independent function in the manufacture of the engine parts. Rather, the coolant's primary function is to cool and thereby prolong the useful life of the cutting tools used to cut the parts. The coolants are necessary to the process, but they do not cause a change in the property being manufactured, and in that respect are akin to grease and lubricants, which are taxable at the general 4% rate. See, Newbury, at page 402. Materials used primarily to operate or maintain plant machinery are not entitled to the reduced rate. Alabama Power Company v. State, 103 So.2d 780 (Ala. 1958).

The Legislature granted the reduced rate specifically for "machines", and not for all tangible personal property used in the manufacturing process. I do not believe that the Legislature intended that liquid coolants used to cool cutting tools should be treated as "machines" used in the manufacturing process. The coolants help in the manufacturing process, but they are not "machines".

The above considered, the assessments in issue are affirmed. The Department adjusted the Taxpayer's liability after entry of the assessments. The Department also concedes that a refund is due for the subject period relating to safety shoes. See paragraph 7 of stipulation. The Department is directed to recompute the Taxpayer's liability in accordance with the stipulation and the above holding, and thereafter inform the Administrative Law Division of the adjusted amount due. A Final Order will then be entered which may be appealed to circuit court within 30 days pursuant to Code of Ala. 1975, §40-2A-9(g).

Entered on February 10, 1995.

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BILL THOMPSON  
Chief Administrative Law Judge

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