BLUEGRASS BIT COMPANY, INC. 107 Mildred Street Greenville, Alabama 36037-0427,	§	STATE OF ALABAMA DEPARTMENT OF REVENUE ADMINISTRATIVE LAW DIVISION
DEMOLITION TECHNOLOGIES, INC. 107 Mildred Street Greenville, Alabama 36037-0427,	§	DOCKET NOS.U. 96-294 S. 96-287
Taxpayers,	§	
v.	§	
STATE OF ALABAMA DEPARTMENT OF REVENUE.	§	

OPINION AND PRELIMINARY ORDER

Bluegrass Bit Company, Inc. ("Bluegrass") and Demolition Technologies, Inc. ("Demo Tech") are sister corporations located in Greenville, Alabama. The Department assessed Bluegrass for State and Butler County use tax for January 1990 through March 1995. The Department also assessed Demo Tech for State use tax for November 1991 through March 1995, and State sales tax, City of Greenville sales and use tax, and Butler County sales and use tax for January 1991 through March 1995. Both companies (together "Taxpayers") appealed to the Administrative Law Division pursuant to Code of Ala. 1975, §40-2A-7(b)(5)a. The appeals were consolidated, and a hearing was conducted on October 9, 1996. Will Sellers represented the Taxpayers. Assistant Counsel Margaret McNeill represented the Department.

This case involves the following issues:

(1) The Taxpayers purchased materials from out-of-state vendors. The materials were delivered into Alabama by the vendor or by common carrier and subsequently used by the Taxpayers in Alabama. The primary issue is whether those materials were subject

to Alabama use tax, as assessed by the Department, or Alabama sales tax, and thus exempt from use tax, as argued by the Taxpayers.

(2) Should materials (Bristar) and machines used to break or cut concrete, rock, etc. be taxed at the reduced 1½ percent "machine" rate levied at Code of Ala. 1975, §40-23-2(3) (sales tax). That issue turns on whether the Bristar and machines were used in "processing" or "quarrying";

(3) Is sales tax owed on Demo Tech invoices that show a "ship to" address as Bluegrass in Alabama, although, according to Demo Tech, the materials were actually delivered by common carrier outside of Alabama;

(4) Should Demo Tech be excused from sales tax on materials sold to and used by Bluegrass on a City of Courtland Industrial Development Board ("IDB") project because the general contractor on the project informed Demo Tech that the project was exempt; and

(5) Should the penalties in issue be waived.

Demo Tech

Demo Tech sells Bristar, an expanding grout used to break concrete. Demo Tech sells to customers throughout the United States, but primarily to Bluegrass for use in its concrete removal business. Demo Tech delivers the Bristar to its customers by common carrier.

The Department assessed sales tax at the general rate on the Bristar sold to Demo Tech's customers in Alabama. Demo Tech argues that the Bristar should be taxed at the 1½ percent "machine" rate because it is used to "process" or "quarry" concrete.

The Department also taxed some Bristar invoices that indicated

the "ship to" destination as Bluegrass in Alabama. Demo Tech argues that those sales should not be taxed because the Bristar was actually delivered to a jobsite in Texas. Nicholas Jenkins, Demo Tech's managing director, testified that for the sake of simplicity, the invoices showed the same "ship to" and "bill to" address as Bluegrass in Alabama, but that the Texas destination was on the bottom of each invoice.

Demo Tech also sold Bristar tax-free to Bluegrass for use on a project for the Courtland Industrial Development Board. Demo Tech concedes that those sales were taxable, but argues that it should be relieved of liability because the general contractor on the project informed Demo Tech that the project was exempt.

Finally, the Department assessed use tax against Demo Tech on supplies purchased from out-of-state vendors. The supplies were delivered to Demo Tech in Alabama either by the vendors or by common carrier. As discussed below, Demo Tech argues that sales tax was due on the supplies, not use tax.

Bluegrass

Bluegrass manufactures machines that it uses to cut concrete, rock, etc. The parts and materials used to manufacture the machines are purchased from out-of-state vendors and delivered into Alabama by either the vendor or by common carrier.

The Department assessed use tax at the general rate on the machine parts and other materials purchased from the out-of-state vendors. Bluegrass argues that sales tax should have been assessed, not use tax, but that if the materials are taxed at all,

they should be taxed at the reduced 1½ percent "machine" rate levied at Code of Ala. 1975, §40-23-2(3). Bluegrass contends that the machines are used in "processing" and/or "quarrying" rock and concrete.

Bluegrass also contracts to cut or break and remove concrete, rock, and other items. Bluegrass uses its cutting machines and the Bristar purchased from Demo Tech to complete the contracts. During the period in issue, Bluegrass contracted (1) to salvage and replace concrete blocks from an old dam, (2) remove concrete from an old power plant in Manhattan (the blocks were recycled as asphalt), (3) remove radioactive concrete from a nuclear power plant (the blocks were stored for safety purposes), and (4) cut wire at another nuclear power plant (the metal was recycled).

Issue I - Were the materials purchased from out-of-state vendors subject to Alabama sales tax or use tax?

The Department assessed State and local use tax against both Taxpayers on the supplies and materials purchased from out-of-state vendors. The materials were in all cases delivered into Alabama either by the vendor or by common carrier. The Taxpayers argue that the sales were closed in Alabama and that sales tax was due, in which case the items were exempt from use tax. I agree.

The Alabama sales tax and use tax are complementary. Ex parte Fleming Foods of Alabama, Inc., 648 So.2d 577 (Ala. 1994), *cert. denied,* _____ U.S. _____, 115 S.Ct. 1690 (1995). Sales tax is

levied on retail sales closed in Alabama. Code of Ala. 1975, §40-23-2. Use tax is levied on all property purchased at retail that is subsequently used, stored, or consumed in Alabama. Code of Ala. 1975, §40-23-61. However, property subject to Alabama sales tax is specifically exempted from use tax. Code of Ala. 1975, §40-23-62(1).[1] Consequently, the Alabama Supreme Court has held that sales tax applies to retail sales closed in Alabama, whereas use tax applies to property purchased at retail outside of Alabama that is subsequently used, stored, or consumed in Alabama. State v. Marmon Industries, Inc., 456 So.2d 798 (Ala. 1984); State v. Dees, 333 So.2d 818 (Ala.Civ.App. 1976), *cert. denied,* 333 So.2d 821 (1976).

In Dees, the Department assessed use tax on the sale of an airplane in Alabama. The Court of Civil Appeals held that the sale was subject to sales tax, and thus exempt from use tax, because the sale was closed in Alabama.

> The Supreme Court of Alabama in the case of *Layne Central Co. v. Curry*, 243 Ala. 165, 8 So.2d 839, said that the above provision of Section 789 (now §40-23-62(1)) means that the use tax does not apply to sales effected within the State of Alabama, but only to sales effected in interstate commerce. That statement was repeated and reinforced by further amplifications by the court in the decision of *Paramount-Richards Theatres v. State*, 256 Ala. 515, 55 So.2d 812. In that decision the court said:

[1]Section 40-23-62(1) exempts from use tax all "Property, the gross proceeds of sales of which are required to be included in the measure of the (sales) tax imposed by the provisions of article 1 of this chapter."

> Alabama is one of the states which has adopted two separate acts for the purpose of imposing a tax upon, or with respect to, or measured by, the retail sale of tangible personal property . . . .
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> The Sales Tax Act applies to retail sales within the state. The Use Tax Act is designed to apply only to sales (or purchases) made in interstate commerce, or sales (or purchases) made outside of the state of goods thereafter brought into the state for use by the purchaser.
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> Though Adams Aircraft is a Mississippi Corporation, does not maintain a place of business in Alabama and is not licensed under the provisions of the Sales Tax Act, it nevertheless, at least on the occasion of this transaction, engaged in the business of selling an airplane in this state at retail to a resident of the state. By doing so it fell squarely within the terms of the Sales Tax Act and specifically, Section 753 of Title 51. The sale of property at retail within the state of Alabama being subject to sales tax, its use or consumption is exempt from the provisions of the Use Tax Act.
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> Construing the Sales Tax Act in para materia with the Use Tax Act, the sale was subject to sales tax. The use or consumption of the property was exempt from use tax.

Dees, 333 So.2d at 820.

Whether Alabama use tax or sales tax is due on a transaction depends on where the sale occurs. The Uniform Commercial Code ("UCC") defines "sale" as "the passing of title from the seller to the buyer for a price." Code of Ala. 1975, §7-2-106(1). Title passes when the seller completes delivery of the sale item, unless otherwise explicitly agreed. Code of Ala. 1975, §7-2-401(2). See

generally, Oxmoor Press, Inc. v. State, 500 So.2d 1098 (Ala.Civ.App. 1986).

Alabama's courts generally applied the above UCC definitions for sales tax purposes prior to 1986. See, State v. Delta Air Lines, Inc., 356 So.2d 1209 (Ala.Civ.App. 1978), *cert denied*, 356 So.2d 1208 (Ala. 1978). However, the definitions were specifically adopted for sales tax purposes by Act 86-536 in 1986. That Act amended the sales tax definition of "sale" at §40-23-1(a)(5) to provide that a sale occurs "when and where title is transferred by the seller or seller's agent to the purchaser or purchaser's agent, ..." As stated, title is transferred under §7-2-401(2) when the seller completes delivery. The Act also designated that a common carrier or the United States Postal Service shall be deemed as agent of the seller.[2]

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[2]The practical effect of deeming the Post Office and all common carriers as agents of the seller is that sales by an Alabama retailer that are delivered by mail or common carrier to the purchaser outside of Alabama are now closed outside of Alabama, and thus
not subject to Alabama tax. Conversely, the sale of items by an out-of-state retailer that are delivered into Alabama by mail or common carrier are closed upon delivery in Alabama.

Act 86-536 was enacted in response to the Administrative Law Division's decision in Oxmoor Press, supra. Oxmoor Press was located in Alabama and sold telephone books that were mailed to South Central Bell's customers outside of Alabama. I ruled that Oxmoor owed Alabama sales tax because the sales were closed in Alabama when Oxmoor delivered the books to the Post Office in Alabama, citing §7-2-401(2) as to when title transfers. Oxmoor Press appealed. While the appeal was pending, the Legislature passed Act 86-536, making the Post Office the agent of the seller, which made the sales by Oxmoor closed outside of Alabama.

Ironically, the Court of Civil Appeals reversed, not based on

In this case, the property purchased by the Taxpayers from the out-of-state vendors was delivered into Alabama either by the vendor or by common carrier. Consequently, the sales were closed in Alabama when the vendor or the vendor's agent, the common carrier, completed delivery in Alabama. The sales were thus subject to Alabama sales tax, and exempt from Alabama use tax.

The same result was reached in two prior cases decided by the Administrative Law Division, State v. Rawhide Erection Co., Inc., U. 84-194 (Admin. Law Div. 11/14/85) and State v. Rush Hospital/Butler, Inc., U. 88-193 (Admin. Law Div. 11/12/93).

The Rawhide Erection decision reads in part as follows:

> In the present case there is no question that the sales in issue were completed within Alabama. In each case the

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Act 86-536, but because Oxmoor presented new evidence in the de novo circuit court appeal that South Central Bell and Oxmoor had "otherwise explicitly agreed" that the sales would be closed outside of Alabama. Applying the "unless otherwise explicitly agreed" exception in §7-2-401(2), the Court ruled that the sales were closed outside of Alabama and that Alabama sales tax was not due.

> structural steel was delivered by the vendor to the Taxpayer at the Alabama job sites. Under Code of Alabama 1975, §7-2-106, a sale occurs with the transfer of title. Code of Alabama 1975, §7-2-401 provides that title transfers with the physical delivery of the goods. Accordingly, the sales in question occurred within Alabama, when the steel was delivered by the vendors to the Taxpayer at the job sites. The Revenue Department does not dispute that fact. That being the case, the transactions in issue cannot be subject to either state or local use tax.

Rawhide Erection, U. 84-194 at 3.

The Rush Hospital decision reads in part as follows:

> Under both §7-2-106(1) and §40-23-1(a)(5), a sale occurs when and where title passes from the seller to the buyer. Under both §7-2-401(2) and §40-23-1(a)(5), title passes and thus a sale is closed at the time and place the seller completes physical delivery of the goods. Oxmoor Press, Inc. v. State, 500 So.2d 1098; Department of Revenue v. Dixie Tool and Die Company, 537 So.2d 921.
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> In this case, Rush/Meridian (and the third-party suppliers) delivered the materials in issue to the Taxpayer in Alabama. The retail sales thus were closed upon delivery within Alabama and sales tax is applicable, not use tax. Consequently, the use tax assessments in issue were erroneously entered and must be dismissed.

Rush Hospital, U. 88-193 at 5.

The Department appealed Rawhide Erection to Montgomery County Circuit Court, and Judge Phelps affirmed, CV-86-175-PH. The Department elected not to appeal to the Court of Civil Appeals. The Department also elected not to appeal Rush Hospital to circuit court.

I discussed in Rush Hospital that Alabama's sales and use tax statutes, as presently construed, contain a loophole because in some cases property sold at retail in Alabama and also used in

Alabama would not be subject to either Alabama sales tax or use tax. That situation occurs when an out-of-state retailer without nexus with Alabama makes a retail sale closed in Alabama, i.e., its only contact with Alabama is that its goods are delivered into Alabama by mail or common carrier. Alabama sales tax would be due, but the out-of-state retailer could not be taxed because of lack of nexus.[3] Sales tax could not be assessed against the Alabama

[3]Nexus is established for Due Process Clause purposes if the out-of-state retailer avails itself of a state's economic market. However, for Commerce Clause purposes, the retailer must have some substantial physical presence in the state. A retailer whose only contact with a state is that it delivers its goods into the state by mail or common carrier does not have nexus with and thus cannot be taxed by the state. See generally, National Bellas Hess, Inc. v. Dept. of Revenue, 87 S.Ct. 1389 (1967); Quill Corp. v. North Dakota, 112 S.Ct. 1912 (1992); Philip Crosby Assoc., Inc. v. State,

purchaser because there is no provision to assess and collect sales tax directly against the purchaser. Use tax also could not be assessed against the purchaser because the sale was closed in Alabama, making the property exempt from use tax.

I suggested in Rush Hospital that the loophole could be closed by holding that a sale by an out-of-state seller without nexus with Alabama is not subject to Alabama sales tax, in which case the §40-23-62(1) exemption would not apply and use tax could be collected from the purchaser. On review, I no longer believe that statement is correct. A retail sale closed in Alabama is subject to Alabama sales tax, and thus exempt from use tax, even if the sales tax cannot be collected from the out-of-state seller because of lack of nexus. Consequently, the loophole can be closed only if the Legislature sees fit to amend the use tax exemption, §40-23-62(1).

If the out-of-state vendors in this case repeatedly delivered their products into Alabama in their own trucks, or if they otherwise had a sufficient physical presence in Alabama to establish nexus, the Department could have assessed them for the Alabama sales tax due on the materials. But if the vendors did not have sufficient contacts with Alabama to establish nexus, the

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U. 96-143 (Admin. Law Div. 12/4/96).

loophole would apply and tax could not have been collected on either the sale or the use of the property in the State.

Based on the above, the Department's stated policy that use tax is due if the seller's business is located outside of Alabama is incorrect. Where the sale is closed is determinative of whether sales tax or use tax is due, not where the seller's business is located. Consequently, the use tax assessed against both Taxpayers in this case is dismissed.

Issue 2 - The "machine" rate.

Because use tax is not due, the "machine" rate issue concerns only the sales tax assessed against Demo Tech. Specifically, should the Bristar sold by Demo Tech in Alabama be taxed at the 1½ percent "machine" rate levied at §40-23-2(3).

Demo Tech claims that the Bristar is a "machine" used in "processing" and/or "quarrying" the concrete. I disagree.

I agree that Bristar is a "machine" in the same sense that the explosives used in mining were considered machines in Robertson and Assoc., Inc. v. Boswell, 361 So.2d 1070 (1978), and that the sand and steel shot used to make cast iron fittings were deemed machines in State v. Newberry Mfg. Co., 93 So.2d 400 (1957). However, the Bristar is not used in "processing" or "quarrying" as those terms are used in §40-23-2(3). The Alabama Supreme Court has held that "the word 'process' is synonymous with the expressions

'preparation for market' and 'to convert into marketable form.'" Southern Natural Gas Co. v. State, 73 So.2d 731, 735 (1953).

Bristar is used to break or crack concrete so that it can be removed. It does not prepare the concrete for market or convert it into marketable form. After being removed, the concrete may later be recycled as asphalt or some other product, but that is subsequent to and unrelated to the function served by the Bristar, i.e. the cracking of the concrete for removal purposes. The later recycling of the concrete, if it is recycled at all, is only incidental to the primary function of removing it. There is also no evidence that the Bristar is used to crack concrete for recycling purposes after it has been removed.

"Quarrying" as used in §40-23-2(3) has not been defined by Alabama's courts. Consequently, the generally accepted definition of the term must be used. The American Heritage Dictionary, 2nd Edition, defines "quarry" as "An open excavation or pit from which stone is obtained . . . ." "Quarrying" is defined as "To obtain (stone) from a quarry . . . ."

The Bristar is not used to crack stone for removal from a quarry. Rather, it is used to crack concrete. The removal of concrete is not "quarrying."

Base on the above, the Department properly assessed State and local sales tax on the Bristar sold by Demo Tech in Alabama at the four percent general State rate and the applicable general local

tax rates.

Issue 3 - The "ship to" invoices.

The Department taxed certain Bristar invoices that showed "ship to" Bluegrass in Alabama. Demo Tech claims that the "ship to" designation showed Bluegrass in Alabama for convenience purposes only. It argues that the Bristar was actually shipped to a Bluegrass jobsite in Texas by common carrier. According to Demo Tech's witness, the out-of-state designation was shown on the bottom of each invoice. Unfortunately, none of those invoices were submitted into evidence.

The burden is on Demo Tech to establish that the sales were outside of Alabama, and thus not subject to Alabama tax. See, Code of Ala. 1975, §40-2A-7(b)(5)(c) ("burden of proof shall be on the taxpayer to prove such (final) assessment is incorrect").

Demo Tech is allowed 21 days from this Opinion and Preliminary Order to resubmit the disputed invoices to the Department for review. If the invoices clearly establish that the materials were delivered via common carrier outside of Alabama, the Department should delete the invoices from the assessments. Otherwise, the tax will be affirmed.

Issue 4 - Sales to the Courtland IDB.

Demo Tech concedes that the materials sold to Bluegrass for use on the Courtland IDB project were subject to Alabama sales tax. It claims, however, that it should be relieved of the tax because

the project's general manager erroneously informed it that the project was exempt. I disagree.

The Department cannot be estopped from collecting a tax due because a taxpayer was given an incorrect interpretation of the law or incorrect information by a Department employee. Maddox Tractor and Equipment Co. v. State, 69 So.2d 426 (1953). Consequently, certainly the Department cannot be estopped from collecting tax due because a third party gave a taxpayer bad advice.

Issue 5 - Waiver of penalties.

The Taxpayers argue that the penalties included in the assessments should be waived for reasonable cause as provided at Code of Ala. 1975, §40-2A-11(h). I am unclear why the penalties were assessed in the first place. The Department is directed to explain what the different penalties are for, and in what amounts.

In summary, the Taxpayers should provide the Department with the invoices discussed in Issue 3 above within 21 days from this Opinion and Preliminary Order. The Department should review the invoices to determine if the materials were delivered outside of Alabama, and thus not taxable. The Department should then recompute the Taxpayers' adjusted liabilities in accordance with this Opinion and Preliminary Order, including the penalty amounts and why they were entered. A Final Order will be entered upon receipt of the above information by the Administrative Law Division.

This Opinion and Preliminary Order is not an appealable Order. The Final Order, when entered, may be appealed to circuit court within 30 days pursuant to Code of Ala. 1975, §40-2A-9(g).

Entered January 16, 1997.

BILL THOMPSON
Chief Administrative Law Judge