ROBINSON IRON CORPORATION P.O. Box 1119 Alexander City, AL 35011-1119,	'	STATE OF ALABAMA DEPARTMENT OF REVENUE ADMINISTRATIVE LAW DIVISION
Taxpayer,	'	DOCKET NO. S. 99-486
v.	'	
STATE OF ALABAMA DEPARTMENT OF REVENUE.	'	

OPINION AND PRELIMINARY ORDER

The Revenue Department assessed sales tax against Robinson Iron Corporation (ATaxpayer@) for March 1995 through February 1998. The Taxpayer appealed to the Administrative Law Division pursuant to Code of Ala. 1975, '40-2A-7(b)(5)a. A hearing was conducted on January 27, 2000. Robert Walthall represented the Taxpayer. Assistant Counsel Wade Hope represented the Department.

ISSUE

The Taxpayer manufactures custom-designed ornamental iron castings at its facility in Alexander City, Alabama. The Taxpayer contracts to either (1) furnish a customer with the castings, or (2) furnish and install the castings as specified by the contract. The contracts are for a lump-sum amount. The Taxpayer uses patterns to manufacture the castings. The issue in this case is whether the Taxpayer sold the patterns at retail to its customers during the subject period, and thus owes Alabama sales tax on those sales.

FACTS

A pattern is required to produce an iron casting. Consequently, the Taxpayer either purchases a pattern from a supplier or manufactures a pattern using raw materials. The patterns are custom-designed to fit the specifications of each job. The Taxpayer purchased

patterns and pattern materials tax-free during the period in issue using its Alabama sales tax number.

The Taxpayer never negotiates with a customer concerning patterns, and the use or cost of patterns is never addressed in the contract between the parties. The Taxpayer never transfers a pattern to a customer, nor has a customer ever requested a pattern. The Taxpayer stores used patterns in its pattern storage area, and periodically destroys old patterns to make room for new ones.

While a contract is on-going, the Taxpayer issues the customer a monthly Aprogress@ invoice for the work performed on the contract during the month. The monthly invoice allows the Taxpayer to receive periodic payments on the lump-sum contract while the project is in progress. On one of the contracts in issue, the Taxpayer=s customer also required the Taxpayer to issue a bill of sale with each invoice.

The Taxpayer usually encloses a Aschedule of values@ with the invoice. The schedule of values itemizes the various charges included in the invoice, and specifies the percentage of completion of the various items listed. The itemized charges include, for example, mock-ups, shop finishing and fabrication, structural steel, disassembly, patterns or pattern work, etc. The amount listed for patterns on a schedule of values is an estimate based on the cost of the pattern or pattern materials, and also labor, overhead, and profit associated with the pattern.

Concerning the transactions in issue, the finished castings were delivered to the customer or the project location either in one of the Taxpayer=s trucks or by common carrier. If the contract was a furnish and install contract, the Taxpayer also installed the

castings. All of the castings were delivered outside of Alabama, except the castings involved in one furnish only contract in which the Taxpayer delivered the castings to the customer in Montgomery, Alabama.

The Department audited the Taxpayer and determined that the Taxpayer sold the patterns at retail.[1] The Department accordingly assessed the sales tax in issue based on the pattern amounts included on the invoices and schedules of value. If a pattern amount was not specified, the Department estimated the percentage of the lump-sum contract attributable to patterns.

The Taxpayer argues that it did not sell the patterns, and thus does not owe sales tax on the pattern charges. The Taxpayer concedes that it owes sales tax on its cost of the patterns and pattern materials it purchased tax-free during the audit period.

ANALYSIS

ASale@ is defined for Alabama sales tax purposes at Code of Ala. 1975, '40-23-1(a)(5) to include:

> A. . . every closed transaction constituting a sale. Provided, however, a transaction shall not be closed or a sale completed until the time and place when and where title is transferred by the seller or the seller=s agent to the purchaser or purchaser=s agent, and for the purpose of determining transfer of title, a common carrier or the U.S. Postal Service shall be deemed to be the agent of the seller, . . .@

[1]The Department made other audit changes that are not contested by the Taxpayer.

The Taxpayer did not sell the patterns in issue to its customers. The sale of patterns was never negotiated by the parties or addressed in the contracts between the parties. The Taxpayer retained possession of the patterns, and title was never transferred to the customers.

The fact that a pattern amount was sometimes included as an itemized charge on the monthly invoices and schedules of value does not establish that the patterns were being sold. Those documents also listed items such as shop finishing and fabrication and mock-ups that the Taxpayer certainly was not selling at retail. Substance over form governs in tax matters. Dept. of Revenue v. Acker, 636 So.2d 470 (Ala.Civ.App. 1994). AThe substance of the underlying transaction must control, not how it is recorded on a corporation=s books.@ Pechiney Corp. v. State, F. 96-106 (Admin. Law Div. 1/16/97), citing Magnolia Methane v. State, 676 So.2d 341 (Ala. 1996); see also, Macol Corp. v. State, U. 96-266 (Admin. Law Div. 1/29/97). In substance, the Taxpayer did not sell the patterns to its customers.

One of the contracts in issue involved the renovation of the South Carolina State House in Columbia, South Carolina. Concerning that contract, the customer required the Taxpayer to issue a bill of sale in addition to its normal invoice and schedule of values. The bill of sale stated that A[u]pon receipt of payment, material will belong to Caddell Construction Co., Inc., and the State of South Carolina.@ A charge for patterns was sometimes included on the bill of sale. However, as with the other contracts, the parties never negotiated concerning the patterns, the Taxpayer retained possession of the patterns, and neither Caddell nor the State of South Carolina ever requested the patterns.

Arguably, the Amaterials@ referred to on the bill of sale were the castings and other materials actually installed on the State House, not the patterns used by the Taxpayer in Alabama to make the castings. Viewing the South Carolina transaction as a whole, the Taxpayer did not sell the patterns to the customer.

This case can be distinguished from State v. Mobile Stove and Pulley Mfg. Co., Inc., 52 So.2d 693 (Ala. 1950). In that case, the taxpayer was an iron foundry that used patterns to produce castings. The foundry negotiated separately for the sale of the patterns and the sale of the castings, and quoted separate prices for the patterns and castings. The foundry also separately billed the customers for the patterns and castings, and shipped the patterns to its customers, either with the castings or at a later date. The Alabama Supreme Court held that the foundry sold the patterns to its customers. AThe sale of the patterns here taxed and the sale of the castings constitute separate and distinct transactions.@ Mobile Pulley and Stove, 52 So.2d at 698.

None of the facts in Mobile Stove and Pulley that led the Supreme Court to find that the patterns had been sold are present in this case. As discussed, the Taxpayer never negotiated with its customers for the sale of patterns, and never quoted a price for the patterns. The Taxpayer included a pattern amount on its invoices and accompanying schedules of value only to keep the customer informed as to the jobs progress. No sale occurred because title never passed. The Supreme Court recognized in Mobile Stove and Pulley that the customers could have purchased the castings without also purchasing the patterns. That is what occurred in this case.

The Department has several regulations concerning patterns. Reg. 810-6-1-.93

states that pattern makers that sell patterns to others can purchase the pattern materials tax-free at wholesale. That regulation is correct, but does not apply in this case because the Taxpayer did not sell the patterns to its customers.

Regs. 810-6-2.-.48 and 810-6-2-.59 both correctly provide that a foundry that purchases patterns or pattern materials to make castings owes tax when it purchases the items at the 1**2** percent Amachine@ rate.[2] See, Code of Ala. 1975, '40-23-2(3). Those regulations apply in this case. The Taxpayer should have paid the 1**2** percent tax when it purchased the patterns and pattern materials from its vendors.

Reg. 810-6-2-.46 is entitled AManufacturer=s Use of Patterns.@ Paragraphs (1) and (2) of that regulation are consistent with Regs. 810-6-2-.48 and 810-6-2-.59 in that patterns should be purchased at the reduced 1**2** percent Amachine@ rate. Paragraph (3), however, provides that patterns are taxable when purchased, even if Athe patterns may pass to the manufacturer=s customer after use.@ That statement is wrong if the pattern is sold to the customer. In that case, the manufacturer would purchase the pattern at wholesale, and later pay sales tax on the retail selling price of the pattern. See footnote 2, infra. Paragraph (3) does not apply in this case because the patterns in issue were never transferred to the Taxpayer=s customers.

Based on the above, the Taxpayer did not sell the patterns in issue, and thus does

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[2]Those regulations presume, however, that the foundry is not reselling the patterns. If the foundry sold the patterns, the foundry would purchase the pattern or pattern materials tax-free at wholesale, and later charge sales tax on the gross proceeds received for the pattern. Again, that did not occur in this case.

not owe sales tax on the pattern charges assessed by the Department, with one exception. An overview of how the Taxpayer should pay sales tax is necessary to explain that exception.

If the Taxpayer contracts to furnish and install the castings, the Taxpayer owes sales tax on its cost of the materials used on the contract pursuant to the sales tax Acontractor@ provision. Code of Ala. 1975, '40-23-1(a)(10).[3] The Acontractor@ provision applies when, as in this case, a contractor fabricates a custom-designed product that subsequently becomes a part of realty. State, Department of Revenue v. Montgomery Woodworks, Inc., 389 So.2d 510 (1980); Department of Revenue v. James A. Head & Co., Inc., 306 So.2d 5 (1974); Rabren v. United States Steel Corp., 240 So.2d 358 (1970); State v. Acker, 233 So.2d 514 (1970); and State v. Air Conditioning Engineers, Inc., 174 So.2d 315 (1965). See also, Dept. Reg. 810-6-1-.27.

The taxable sale occurs under the Acontractor@ provision when the contractor purchases the building materials from its vendor. However, if the contractor also on occasion sells the materials at retail, as does the Taxpayer in this case, the contractor is allowed to purchase all materials at wholesale. The contractor then reports and pays sales tax on its wholesale cost of those materials withdrawn from inventory and used on a furnish and install contract either inside or outside of Alabama. The contractor does not resell the materials used on a furnish and install contract, and thus does not owe additional Alabama

[3]The Acontractor@ statute reads - ASales of building materials to contractors, builders, or landowners for resale or use in the form of real estate are retail sales in whatever quantity sold.@

tax on the materials, regardless of how or where they are delivered or installed.

If the Taxpayer contracts to furnish castings only, the Acontractor@ provision does not apply because the Taxpayer does not install or attach the castings to realty. Rather, in that case the Taxpayer is selling the castings at retail. However, Alabama sales tax is owed on only those retail sales closed in Alabama.

A sale is closed when and where title passes. Title passes, unless otherwise specifically agreed, where the seller completes performance with respect to delivery of the goods. A common carrier is deemed to be the agent of the seller. Section 40-23-1(a)(5). If goods are delivered by the seller or by common carrier, the sale is closed when and where delivery is completed to the purchaser. Consequently, when the Taxpayer delivers furnish only materials in its own truck or by common carrier to a customer outside of Alabama, the sale is closed outside of Alabama, and no Alabama tax is due.[4] All but one of the Taxpayer=s furnish only sales in issue fit that category.

The one exception is the furnish only sale of castings delivered by the Taxpayer to the customer in Montgomery, Alabama. That sale was closed in Alabama. The Taxpayer

[4]The Taxpayer is now paying Alabama sales tax on furnish only sales if the castings are delivered in a Taxpayer truck outside of Alabama. As discussed, however, Alabama sales tax is not due on those sales because they are closed outside of Alabama.

owed Alabama sales tax on the gross proceeds derived from the sale.

AGross proceeds@ is defined as Athe value proceeding or accruing from the sale of tangible personal property . . . without any deduction on account of the cost of the property sold, the cost of the materials used, labor or service costs, interest paid . . . or any other expenses whatsoever . . .@ Code of Ala. 1975, '40-23-1(a)(6). The Taxpayer thus owed Alabama sales tax on the sale closed in Alabama based on the full contract amount, without deducting labor, overhead, patterns or other costs that may have been itemized on an invoice or schedule of values.[5] In that respect, the Taxpayer owes sales tax on the pattern charges relating to the sale because the pattern charges were a component of the taxable gross proceeds received by the Taxpayer.

The record is unclear as to how the Taxpayer reported and paid sales tax during the audit period, or what audit adjustments the Department made that were not contested by the Taxpayer. Consequently, this Order addresses only the issue of whether the Taxpayer owes tax on the pattern charges. The assessment should also be adjusted to include the tax due on the Taxpayer=s cost of the patterns and pattern materials incorrectly purchased tax-free during the audit period.

The Department is directed to delete all of the pattern charges from the final

[5]Although not in issue in this appeal, the Taxpayer may also have owed Montgomery County and City of Montgomery sales tax on the sale closed in Montgomery. That issue turns on whether the Taxpayer had sufficient nexus to be subject to taxation in those jurisdictions. Suffice it to say that the nexus question as it relates to local sales and use taxes in Alabama is an evolving issue. See, Yelverton=s v. Jefferson County, 742 So.2d 1221 (Ala. 1999). For the leading case on nexus involving interstate transactions, see Quill Corporation v. North Dakota, 112 S.Ct. 1904 (1992).

assessment in issue, except the pattern charge relating to the sale closed in Alabama.[6] The Taxpayer or the Taxpayer=s CPA should also provide the Department with records or other information sufficient for the Department to compute the tax due on the patterns and pattern materials purchased by the Taxpayer tax-free during the audit period. The Department should notify the Administrative Law Division of the Taxpayer=s adjusted liability. A Final Order will then be entered.

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

Entered March 27, 2000.

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BILL THOMPSON
Chief Administrative Law Judge

BT:dr
cc: J. Wade Hope, Esq.
Robert C. Walthall, Esq.
James Browder

[6]This assumes that the Taxpayer paid Alabama sales tax on all gross proceeds derived from the sale in Alabama except the pattern charge. If the Taxpayer failed to pay any tax on the sale, the Department should include the tax due in the final assessment.