CARLISLE ENGINEERED PRODUCTS, INC. 1401 Industrial Park Drive Tuscaloosa, AL 35401,	'	STATE OF ALABAMA DEPARTMENT OF REVENUE ADMINISTRATIVE LAW DIVISION
Taxpayer,	'	DOCKET NO. U. 99-524
v.	'	
STATE OF ALABAMA DEPARTMENT OF REVENUE.	'	

OPINION AND PRELIMINARY ORDER
ON TAXPAYER=S APPLICATION FOR REHEARING

The Final Order entered in this case on April 17, 2000 held that (1) the Taxpayer was liable for use tax on molds it used in Alabama; (2) the molds, and also barrels and screws used by the Taxpayer in conjunction with the molds in its manufacturing process, did not become an ingredient or component part of the Taxpayer=s final product, and thus were not purchased at wholesale pursuant to Code of Ala. 1975, '40-23-60(4)b.; and (3) the Taxpayer is liable for use tax on its purchase and use of a foamer machine. The Taxpayer timely applied for a rehearing, arguing that all three issues were erroneously decided.

The Final Order is affirmed concerning issues (1) and (3) above. However, I now agree that the molds, barrels, and screws became ingredient or component parts pursuant to '40-23-60(4)b.

The purpose for an ingredient or component part provision is to avoid double taxation. Robertson and Associates (Ala.), Inc. v. Boswell, 361 So.2d 1070 (1978). A manufacturer is allowed to purchase component parts tax-free because the components become part of the final product, and tax is collected when the product is sold at retail. In effect, the components are being resold as part of the final product.

A machine or other product used in manufacturing that only incidentally becomes a part of the final product should not qualify as an exempt component part because the machine or product is not being resold.[1] If manufacturers are allowed to purchase such machines and other products tax-free, sales or use tax will never be paid on the item. ATo allow the purchase of (property that only incidentally becomes part of the final product) to be classified as >wholesale sales= contravenes the legislative intent to prevent double

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[1]Professor Richard Pomp, a leading commentator on state and local tax issues, argues that all machines and other items (business inputs) used to manufacture consumer goods should be exempt under an ideal sales tax system because business inputs constitute a cost to the manufacturer that is included, either directly or indirectly, in the retail price of the final product, and thereby taxed when the product is sold. Pomp contends that taxing business inputs results in an improper Apyramiding@ of taxes. See, R. Pomp & O. Oldman, State and Local Taxation '6-20 (3rd Ed. Revised 2000). However, Alabama does not have an ideal sales tax system, and machines used in manufacturing are specifically taxed at a reduced 12 percent rate. See, Code of Ala. 1975, ''40-23-2(3) (sales tax) and 40-23-61(b) (use tax).

taxation; instead, such interpretation avoids the tax altogether.@ Robertson and Associates, 361 So.2d at 1074.[2]

However, after Robertson and Associates, the 1981 Legislature amended the sales tax ingredient or component part provision at '40-23-1(a)(9)b. to include the following language - A. . . whether or not such tangible personal property or product used in manufacturing or compounding a finished product is used with the intent that it becomes a component of the finished product; . . .@ The use tax ingredient or component part provision in issue in this case, Code of Ala. 1975, '40-23-60(4)b., was not amended in 1981. However, the sales tax and the use tax statutes were both amended by Act 97-648

[2]Courts in numerous states have construed the ingredient and component part provision to require that the property must become a substantial and/or necessary ingredient or serve a primary purpose in the finished product. Property that only incidentally remains in the final product does not qualify. Lackawanna Leather Company v. Department of Revenue, No. S-98-1121 (Neb. 3/31/00); Kaiser Steel Corp. v. State Bd. of Equalization, 593 P.2d 864 (Cal. 1979); American Distilling Co. v. Department of Revenue, 368 N.E.2d 541 (Ill. 1977).

in 1997. They are now identical, and include the language quoted above. The 1997 amendment applied to all open years. Consequently, the 1997 version of ' 40-23-62(4)b. applies to the entire period in issue in this case.

How should the above quoted phrase be construed? I initially held that the phrase only eliminated intent as a factor, and that the remainder of the Robertson and Associates test was still valid. AThat is, material does not become an ingredient or component part within the scope of the statute if its presence in the finished product is not necessary and is only incidental to its primary function.@ Carlisle Engineered Products, Inc. v. State of Alabama, S. 99-524 (Admin. Law Div. Final Order 4/17/00), at 9, quoting Alexander City Casting Company, Inc. v. State of Alabama, S. 99-467 (Admin. Law Div. 2/25/00), at 6.

I now concede that my initial holding was wrong. First, the phrase refers to Asuch tangible personal property (that becomes an ingredient or component part) . . . used in manufacturing . . . a finished product.@ The phrase thus envisions that a machine used in manufacturing may also become an ingredient or component part.[3] Second, if property becomes a substantial and necessary ingredient, I can think of no instance in which the manufacturer would not intend that it remain in the finished product. Consequently, by specifying that property may become an ingredient or component part, even if the manufacturer did not intend that it remain in the final product, the Legislature could only have intended that property that does not become a substantial and necessary ingredient and only incidentally remains in the final product still qualifies as an exempt ingredient or

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[3]As discussed, *infra*, only machines and other items that cannot be depreciated qualify for the exclusion.

component part.

The statute as written emasculates Alabama=s sales and use tax system because it allows manufacturers to escape tax on otherwise taxable machines, supplies, etc. used in manufacturing. The molds, barrels, and screws in issue are used exclusively for manufacturing, and only microscopic shards of the machines incidentally enter into the final product. It cannot reasonably be argued that the machines are being resold as component parts of the small plastic parts sold by the Taxpayer. Yet the Taxpayer is being allowed to purchase and use the machines tax-free, and thus escape tax on the machines altogether. But an objective analysis of the statute as written leads to that conclusion. The statute contains a nonsensical Aloophole,@ but the Taxpayer is correct that it can only be fixed by the Legislature, if it so desires.

The ingredient or component part exclusion is limited because it does not include Acapital equipment, machinery, tools, or product@ that is subject to income tax depreciation. That limitation does not apply in this case because the Taxpayer did not depreciate the molds, barrels, or screws.[4]

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[4]The Taxpayer could not depreciate the molds because it did not have technical legal title to the molds. The Taxpayer claims it also did not depreciate the barrels and

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screws, but rather claimed them as a regular expense. That claim was not disputed by the Department.

The Department is directed to recompute the Taxpayer=s liability by removing the molds, barrels, and screws from the measure of the assessment. A Final Order on Application for Rehearing will then be entered for the adjusted amount due.

This Opinion and Preliminary Order on Taxpayer=s Application for Rehearing is not an appealable Order, the Final Order on Application for Rehearing, when entered, may be appealed to circuit court within 30 days pursuant to Code of Ala. 1975, ' 40-2A-9(g).

Entered August 28, 2000.

BILL THOMPSON
Chief Administrative Law Judge