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.	'	

FINAL ORDER

The Revenue Department assessed use tax against Carlisle Engineered Products, Inc. (ATaxpayer@) for July 1995 through June 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 13, 2000. Blake Madison represented the Taxpayer. Assistant Counsel Margaret McNeill represented the Department.

ISSUES

The Taxpayer operates a manufacturing facility in Tuscaloosa, Alabama. The Taxpayer uses high pressure plastic injection molds to manufacture plastic automobile parts for various customers. The Taxpayer purchased molds and other machines, i.e. barrels and screws, used in the manufacturing process during the audit period from out-of-state vendors. This appeal involves the following issues:

(1) Is the Taxpayer liable for Alabama use tax on the molds? The Taxpayer argues that it does not owe use tax because the molds were owned by its customers;

(2) Did the molds, barrels, and screws become an ingredient or component part of the finished parts manufactured by the Taxpayer? If so, the Taxpayer purchased the machines tax-free at wholesale pursuant to Code of Ala. 1975, '40-23-60(4)(b);

(3) Was a foamer machine used by the Taxpayer on one of its contracts purchased by the tax-exempt City of Tuscaloosa Industrial Development Board (AIDB@); and,

(4) Were the molds, barrels, and screws subject to Alabama sales tax, and not use tax as assessed by the Department? This issue involves the sales and use tax Aloophole@ addressed in Bluegrass Bit Company, Inc. v. State of Alabama, U. 96-294 and S. 96-287 (Admin. Law Div. 1/16/97), and the corrective legislation (Act 97-301) in issue in Valhalla Cemetery Company, Inc. v. State of Alabama, 1999 WL 305053 (Ala.Civ.App. 1999).

FACTS

The Department assessed the Taxpayer for use tax on the use of eight molds in Alabama during the audit period. A typical transaction involving the molds was as follows:

A customer contacted the Taxpayer concerning the production of plastic automobile parts. Once the Taxpayer and the customer agreed to terms, the customer issued a purchase order for the Taxpayer to manage the mold to be used to produce the parts. The purchase order, or an attachment to the purchase order, specified that the mold would be the property of the customer.

The Taxpayer subsequently issued a purchase order to an out-of-state vendor for the mold needed to make the parts. The vendor manufactured the mold and delivered it to the Taxpayer in Alabama. The Taxpayer tested the mold to insure it was satisfactory to the customer. After the customer approved the mold, the customer issued the Taxpayer a second purchase order to produce the actual parts.

The Taxpayer=s vendor billed the Taxpayer for the mold. The Taxpayer in turn invoiced the customer for the cost of the mold, plus associated management and program costs. The Taxpayer did not pay the vendor for the mold until it was paid by the customer. The mold was tagged to show that it was owned by the customer. The Taxpayer did not depreciate the mold for income tax purposes, and disposed of the mold only after receiving permission from the customer.

The Taxpayer used barrels and screws in conjunction with the mold to manufacture the finished parts. The barrels and screws melt plastic pellets into liquid form, and then force the liquid plastic into the mold. The molds, barrels, and screws are made of tool steel, which contains titanium, chromium, and iron. Due to heating and shearing during the manufacturing process, minuscule pieces of the titanium, chromium, and iron from the machines are mixed with and become a part of the plastic. The titanium, chromium, and iron are not necessary ingredients in the plastic parts, and represent less than one percent of the finished product.

Finally, the Taxpayer used a foamer machine on one of its contracts during the audit period. The Taxpayer received a City of Tuscaloosa IDB purchase order for the foamer. The Taxpayer subsequently purchased the foamer from an out-of-state vendor.

ANALYSIS

Issue (1) - The Molds.

The Taxpayer argues that it is not liable for use tax on the molds because the molds were owned by its customers. The purchase orders issued by the Taxpayer=s customers did state that the molds would be the property of the customers. However, the Taxpayer is

still liable for use tax on its use of the molds in Alabama.

The Alabama use tax is on the use, storage, or consumption in Alabama of tangible personal property previously purchased at retail. Code of Ala. 1975, '40-23-61(a). The tax is levied on the person that uses the property in Alabama. Code of Ala. 1975, '40-23-61(d). The Alabama Supreme Court has held that use tax is owed on the use of property in Alabama even if the user did not hold technical legal title to the property. Associated Contractors v. Hamm, 172 So.2d 385 (1965).

Associated Contractors contracted with the federal government to perform construction work on a federal installation. The contract required Associated Contractors to purchase all materials necessary to complete the contract. The contract further provided that title to the property purchased by Associated Contractors Ashall pass to and vest in the government upon delivery of such property (to Associated Contractors) by the (third party) vendor.@ Associated Contractors, 172 So.2d at 387. The purchase orders used by Associated Contractors to purchase the materials also indicated that title passed to Associated Contractors when the materials were loaded for shipment, and then passed to the government Athe moment next following the moment the title passes to Associated Contractors.@ Associated Contractors, 172 So.2d at 387. The Supreme Court held that Associated Contractors= use of the materials in Alabama was a taxable use, even though technical legal title to the materials was with the government.

> AThese various provisions do not make it crystal clear as to the exact intention of the parties with respect to technical legal title. However, we are in complete agreement with the trial court in its conclusion that at least insofar as the Alabama Use Tax statute is concerned, the Associated Contractors had sufficient title, control and possession of these various materials when they came to rest in this state to invoke the statute. The

> language of the statute does not seem to indicate that the legislature intended to predicate the tax upon one who held technical legal title and no other.@

Associated Contractors, 172 So.2d at 387.

The rationale of Associated Contractors applies in this case. The Taxpayer contracted with its customers to manage the molds. The Taxpayer then purchased the molds from third-party vendors. The Taxpayer did not purchase the molds as agent for the customers. Rather, as in Associated Contractors, the Taxpayer risked its own credit and was obligated to pay its vendors for the molds. There is no evidence that the vendors could have collected from the Taxpayer=s customers if the Taxpayer had failed to pay.

The purchase orders from the Taxpayer to its vendors are not in evidence. Consequently, it is unclear when title to the molds passed from the vendors to the Taxpayer. Title generally passes when the seller (vendor) completes delivery to the buyer (Taxpayer). State v. Delta Air Lines, Inc., 356 So.2d 1205 (1978). Without evidence to the contrary, the Taxpayer obtained title when the molds were delivered by the vendor to the Taxpayer in Alabama. The use tax attached at that time. State v. Toolen, 167 So.2d 546 (1964).

In Associated Contractors, a government contracting officer approved the materials before the work was performed. If the materials were unsatisfactory, the contractor was required to make the proper adjustments with the vendor. Under those facts, the trial court concluded, and the Alabama Supreme Court affirmed, that the contractor had sufficient title to the materials in Alabama to be liable for use tax.

Likewise, in this case, the Taxpayer=s customers approved the molds before they

were used by the Taxpayer. If a customer was not satisfied with a mold, the Taxpayer would have been required to deal with the vendor and make the necessary changes. Those facts are sufficiently similar to the facts in Associated Contractors to find that the Taxpayer Ahad sufficient title, control and possession of the (molds) when they came to rest in this state to invoke the (use tax) statute.@ Associated Contractors, 172 So.2d at 387.

The Alabama sales and use taxes are complimentary. Ex parte Fleming Foods, Inc., 648 So.2d 577 (Ala. 1994), cert. denied, 115 S.Ct. 1690 (1995). Historically, the use tax has been applied to property purchased at retail outside of Alabama that is subsequently used, stored, or consumed in Alabama.[1] Use tax applies if the retail sale would have been subject to Alabama sales tax had it occurred in Alabama. State of Alabama v. Hanna Steel Corp., 158 So.2d 906 (1963).

The Taxpayer would have owed Alabama sales tax if it had purchased the molds

[1]Technically, the use tax is on the use, storage, or consumption of all property in Alabama previously purchased at retail, regardless of where the retail sale occurred. That property on which Alabama sales tax was paid is then exempted from the use tax. Code of Ala. 1975, '40-23-62(1), as amended in 1997 by Act 97-301. For a detailed discussion of the relationship between the Alabama sales and use taxes, see Bluegrass Bit Company, Inc. v. State of Alabama, U. 96-294 and S. 96-287 (Admin. Law Div. 1/16/97); and Act 97-301, which closed the Aloophole@ discussed in Bluegrass Bit.

from Alabama vendors. The Taxpayer paid its vendors the Asales price@ for the molds on which the use tax is levied. Code of Ala. 1975, '40-23-61(a). It follows that the Taxpayer, as the purchaser and user of the molds, owes Alabama use tax on its use of the molds in Alabama.

Although the Taxpayer has not raised this contention, it could be argued that the Taxpayer purchased the molds for resale to its customers. In that case, the purchases would have been at wholesale, and the use tax would not apply. Code of Ala. 1975, '40-23-60(4)a.

Under the facts, however, the Taxpayer was not reselling the molds to its customers. The initial purchase order from the customer to the Taxpayer was for the Taxpayer to manage the molds for the customer, not sell the molds to the customer. The lump-sum amount paid by the customer included the Taxpayer=s cost of the mold, and also the Taxpayer=s operating and other management costs associated with the mold.

In any case, if the Taxpayer had resold the molds, it would owe Alabama sales tax on the lump-sum amount paid by the customers.[2] As indicated, that lump-sum amount was

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[2]The retail sales would not have been non-taxable casual or isolated sales because the Taxpayer was regularly engaged in contracting with its customers to manufacture plastic automobile parts. If those transactions included the re-sale of the molds to the customers, the Taxpayer would have been regularly engaged in the business of making retail sales, and thus liable for sales tax on those sales. See, Code of Ala. 1975, '40-23-

greater than the Taxpayer=s cost of the molds on which the Department assessed use tax. The Taxpayer would thus owe more tax on the transactions, not less.

This holding applies only to the specific facts of this case. It is not intended to apply to a situation where an out-of-state customer gives or loans a machine to an Alabama manufacturer for use in manufacturing an item for the customer. The Department is not in this case and to my knowledge has never attempted to tax the use of property in Alabama that was not purchased by and never owned by the user. This case is different because the Taxpayer (1) purchased and paid the vendors for the molds, (2) had title to the molds in Alabama, at least to the same extent the contractor had title to the subject materials in Associated Contractors, and (3) used the molds in Alabama.

Issue (2) - The Ingredient or Component Part Issue.

It is undisputed that microscopic pieces of the molds, barrels, and screws were sheared away during the manufacturing process, and became a part of the plastic parts manufactured by the Taxpayer. It is also undisputed that those microscopic pieces did not provide a necessary ingredient in the finished product.

2(1).

Code of Ala. 1975, '40-23-60(4)(b) provides that tangible personal property that becomes an ingredient or component part of an item manufactured for sale can be purchased by the manufacturer tax-free at wholesale. How that statute should be construed was recently addressed in Alexander City Casting Co., Inc. v. State of Alabama, S. 99-467 (Admin. Law Div. 2/25/00).[3]

The issue in Alexander City Casting was whether a mica and silica coating used in the manufacture of castings became an ingredient or component part of the castings. After reviewing the Alabama appellate court cases involving the issue, the Administrative Law Division held as follows:

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[3]Alexander City Casting involved the sales tax ingredient or component part statute. Code of Ala. 1975, '40-23-1(a)(9)b. This case involves the use tax statute. The sales and use tax statutes were different before 1997. See, Stauffer Chemical v. State, Dept. of Revenue, 628 So.2d 897 (1993). However, both statutes were amended in 1997 by Act 97-648, and are now identical. Act 97-648 was retroactive to all open tax periods. Consequently, the post-1997 version of the statute addressed in Alexander City Casting applies in this case.

AHow should the current statute be interpreted? Other than removing intent as a factor and specifying that depreciable equipment does not qualify, the current version of '40-23-1(a)(9)b. is in substance identical to the pre-1981 statute. Consequently, the last Supreme Court opinion interpreting the pre-1981 statute, Robertson and Associates, should control.

AAs discussed, Robertson and Associates held that the test was Awhether the manufacturer . . . used the material . . . with the intent and purpose of making it an ingredient or component part of the (finished product); or, conversely, was its presence in the finished product merely incidental to its primary function.@ Robertson & Associates, 361 So.2d at 1073. While both the 1981 and 1997 amendments to '40-23-1(a)(9)b. eliminated intent as a factor, the remainder of the Robertson & Associates test is still valid. That 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.

AIn Robertson & Associates, the Supreme Court noted that the oxygen in U.S. Steel and the carbon electrodes in Abex provided necessary ingredients to the finished products. It then found that the ammonium nitrate in issue was not a necessary ingredient, but rather was only incidentally in the coal, and thus did not qualify as an ingredient or component part.

AIn addition to U.S. Steel and Abex, in every other Alabama case in which the ingredient or component part provision was held to apply, the materials in issue provided a necessary ingredient in the finished product. In Southern Kraft, the materials in issue provided necessary ingredients in the finished Kraft paper. In General Oils, the fuel oil contributed sulfur necessary for the production of the finished products. In Alabama Metallurgical, the carbon electrodes supplied carbon as a necessary ingredient in the finished product. Only in Robertson & Associates did the material in issue not provide a necessary ingredient in the finished product. The Supreme Court thus concluded that the ingredient or component part provision did not apply.

ALikewise, the coating in issue does not provide a necessary ingredient in the finished castings. The sole function and purpose of the coating is to aid in the manufacturing process. The presence of the coating on or in the finished casting is only incidental to that function. Indeed, the Taxpayer attempts to remove as much of the coating from the finished casting as practicable for cosmetic reasons. Requiring the Taxpayer to pay tax on the coating will not result in double taxation because the Taxpayer is

> not reselling the coating to its customers. Rather, the coating should be taxed at the reduced 1**2** percent Amachine@ rate levied at Code of Ala. 1975, '40-23-2(3).
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> AThe above holding complies with the purpose of the ingredient and component part provision. Manufacturers are allowed to purchase the ingredient or component parts of a final product tax-free to prevent double taxation. The rationale is that the value of all component parts will be included in the finished product, and that sales (or use) tax will be collected on that total value when the finished product is sold at retail. On the other hand, materials used in the manufacturing process are taxed when purchased by the manufacturer because the value of those materials is not included in the finished product.
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> AThe hard question arises when a material is necessary to the manufacturing process and also remains in the finished product. In those cases, the test in Alabama for determining whether the materials can be purchased tax-free is whether the materials become a Asubstantial ingredient or component part of the finished product . . .@ Southern Kraft, 8 So.2d at 889, 890, or whether the materials Apresence in the finished product (is) merely incidental to its primary function@ Robertson & Associates, 361 So.2d at 1073.
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> AThe coating in issue does not add value to the casting, and thus does not become a Asubstantial@ part of the casting. Rather, its presence on or in the casting is only incidental to its use in the manufacturing process. As in Robertson & Associates, to allow the Taxpayer to purchase the coating at wholesale would result in the Taxpayer avoiding tax on the coating altogether.@

Alexander City Casting, S. 99-467 at 6-9.

The rationale of Alexander City Casting applies in this case. The titanium, chromium, and iron particles from the molds, barrels, and screws are only incidentally mixed with the plastic, and are not a substantial or necessary ingredient in the finished parts. The machines thus do not become an ingredient or component part of the finished products within the scope of '40-23-60(4)(b). Rather, they should be taxed at the reduced 1**2** percent Amachine@ rate levied at Code of Ala. 1975, '40-23-61(b).

The Taxpayer argues in a well-written supplemental brief that the 1981 amendment to the sales tax statute entirely eliminated the test set out in Robertson and Associates.[4] That is, by eliminating the manufacturer=s intent as a factor, a material can only incidentally become a part of the final product and still qualify as an ingredient or component part. The Taxpayer=s argument is plausible and almost persuasive. But the 1981 amendment only eliminated the manufacturer=s intent as a factor. It did not express the legislature=s intent that materials that do not provide a necessary ingredient in the finished product should be included in the scope of the statute. As discussed in Alexander City Casting, Alabama=s appellate court=s have never applied the ingredient or component part provision to a material that was not a necessary ingredient in the finished product.

The ingredient or component part statute is in substance an exclusion from

[4]The 1981 amendment changed the sales tax ingredient or component part statute, but not the use tax statute. However, as discussed in footnote 3, infra, the use tax statute was amended and conformed to the sales tax statute in 1997 by Act 97-648. Both statutes are now identical.

taxation.[5] Consequently, it must be strictly construed, and any ambiguity must be resolved against the exclusion and for the Department. Bean Dredging Corp. v. State of Alabama, 454 So.2d 1009 (1984).

Accepting the Taxpayer=s argument would also lead to a nonsensical result. In such cases, the courts must look to the overall purpose of the statute to determine the legislature=s intent. Blue Cross and Blue Shield of Ala., Inc. v. Nielsen, 116 F.3d 1406 (1997); Weill v. State ex rel. Gaillard, 34 So.2d 132 (1948); Abramson v. Hand, 155 So.

[5]It could be argued that the ingredient or component part statute is technically not an exclusion from taxation. However, only by defining the purchase of an ingredient and component part as a wholesale sale at '40-23-60(4)a. is the purchase excluded from the definition of a taxable retail sale at Code of Ala.1975, '40-23-60(5). Further, the ingredient or component part provision is generally referred to as an exclusion or exemption from taxation. See, R. Pomp & O. Oldman, State and Local Taxation '7-33 (3rd Ed. Revised 2000)(AConceptually, the ingredient or component exemption is akin to the sale (purchase) for resale exemption. Both exempt a subset of business inputs.@)

590 (1934).

The overall purpose for the ingredient or component part provision is to avoid double taxation. Manufacturers are allowed to purchase component parts tax-free because the value of the component is added to the final product, and sales tax is collected on the final product, including the component, when the product is sold at retail. In that respect, the ingredient or component part exemption is similar to the sale for resale exemption. See again, R. Pomp & O. Oldman, State and Local Taxation ¶7-33 (3rd Ed. Revised 2000). Manufacturers can purchase component parts tax-free because they are in substance reselling the components as a part of the finished product.

It would be absurd to find that the large metal molds, barrels, and screws in issue are being resold as component parts of the small plastic automobile parts. The microscopic pieces of those machines that are mixed with the plastic do not add value to the final product. If the Taxpayer=s interpretation is accepted, the Taxpayer would be allowed to purchase and use those machines tax-free. As found by the Alabama Supreme Court in Robertson & Associates, A[t]o allow the purchase of these explosive materials to be classified as >wholesale sales= contravenes the legislative intent to prevent double taxation; instead, such interpretation avoids the (sales or use) tax altogether.@ Robertson & Associates, 361 So.2d 1074.

Issue (3) - The Foamer Machine.

The Taxpayer argues that it does not owe use tax on the foamer machine because the machine was purchased by the exempt City of Tuscaloosa IDB. In support of that claim, the Taxpayer offered a purchase order for the machine from the Tuscaloosa IDB.

The Taxpayer subsequently purchased the foamer from an out-of-state vendor, and used it to complete its contract with the customer.

Code of Ala. 1975, '11-54-96 exempts purchases by an IDB from Alabama sales and use tax. However, for the exemption to apply, the purchase must be made in the name of the Board, the Board=s credit must be obligated, and the purchase must be paid for by the Board with funds belonging to the Board. State v. Marmon Industries, Inc., 456 So.2d 798 (1984); Champion International Corp. v. State, 405 So.2d 932 (1980). See also, Dept. Reg. 810-6-3-.33.

The burden of proving that a sale is an exempt sale to an IDB is on the taxpayer claiming the exemption. Champion International Corp., 405 So.2d at 934. The Taxpayer failed to carry that burden in this case. It could be argued that because the Taxpayer received a Tuscaloosa IDB purchase order for the foamer, it was ordered in the name of the IDB. However, the Taxpayer subsequently ordered the foamer from the out-of-state seller in its own name. There is no evidence that the Board=s credit was obligated, or that the machine was paid for with funds belonging to the Board. Consequently, the IDB exemption does not apply. The Department properly included the foamer machine in the use tax assessment.

Issue (4) - Bluegrass Bit and Valhalla Cemetery.

The Alabama Legislature amended Code of Ala. 1975, '40-23-62(1) by Act 97-301, effective May 7, 1997. That Act closed the Aloophole@ addressed in Bluegrass Bit Company, Inc. v. State of Alabama, U. 96-294 and S. 96-287 (Admin. Law Div. 1/16/97),

and was retroactive to all open periods. Various taxpayers challenged the constitutionality of the retroactive application of Act 97-301. The Taxpayer argues that if the retroactive application of Act 97-301 is unconstitutional, the molds, barrels, and screws purchased before the effective date of the Act would be exempt from use tax under the pre-Act 97-301 version of the statute. An explanation of the Bluegrass Bit Aloophole,@ the effect of Act 97-301, and the constitutional challenges to that Act, will help the reader understand this issue.

A sale of tangible personal property closed in Alabama is subject to Alabama sales tax. Code of Ala. 1975, '40-23-2(1). Before Act 97-301, '40-23-62(1) exempted from Alabama use tax all property subject to Alabama sales tax. Consequently, if an out-of-state seller without nexus with Alabama sold property at retail to a customer in Alabama (the property was delivered by the seller, a common carrier, or the Postal Service into Alabama, or the sale was otherwise closed in Alabama), the transaction would have been subject to Alabama sales tax, and thus exempt from Alabama use tax. However, because the Department is not authorized to collect sales tax from the purchaser, and also could not assess the seller because the seller lacked nexus with Alabama, the transaction was in effect tax-free. This loophole was pointed out in Bluegrass Bit.[6]

As discussed, to close the loophole, the Alabama Legislature amended '40-23-62(1) by Act 97-301, effective May 7, 1997, but retroactive to all open periods. Under the

[6]The Administrative Law Division had pointed out the loophole in two cases before Bluegrass Bit. See, State v. Rawhide Erection, U. 84-194 (Admin. Law Div. 11/14/85), and State v. Rush Hospital, U. 88-193 (Admin. Law Div. 11/12/93). Rawhide Erection was affirmed on appeal by the Montgomery County Circuit Court, and was not appealed further. Rush Hospital was not appealed.

amended statute, property used, stored, or consumed in Alabama is exempt from use tax only if Alabama sales tax is actually paid on the property.

Valhalla Cemetery and others contested the retroactive application of Act 97-301 in Montgomery County Circuit Court, claiming it was unconstitutional. The Circuit Court agreed. The Alabama Court of Civil Appeals reversed, holding that the retroactive provision was constitutional. Valhalla Cemetery Company, Inc. v. State of Alabama, 1999 WL 305053 (Ala.Civ.App. 1999). The Alabama Supreme Court denied certiorari on November 5, 1999. The U.S. Supreme Court also denied certiorari on March 20, 2000. Consequently, the retroactive application of Act 97-301 is constitutional, and applies in this case.

The molds, screws, barrels, and foamer machine in issue were delivered by the out-of-state vendors to the Taxpayer in Alabama. The sales were thus closed in Alabama, and subject to Alabama sales tax. However, the Taxpayer failed to pay sales tax when it purchased the machines. Consequently, the Taxpayer=s use of the machines in Alabama was not exempt from use tax pursuant to '40-23-62(1), as amended.

The final assessment is affirmed. Judgment is entered against the Taxpayer for $23,466.52, plus applicable interest from the date of the final assessment, October 4, 1999.

This Final Order may be appealed to circuit court within 30 days pursuant to Code of Ala. 1975, '40-2A-9(g).

Entered April 17, 2000.

BILL THOMPSON
Chief Administrative Law Judge