AKZO NOBEL FUNCTIONAL CHEMICALS, LLC 13440 HIGHWAY 43 N. AXIS, AL 36505, Taxpayer, v. STATE OF ALABAMA DEPARTMENT OF REVENUE.	§ § § § § §	STATE OF ALABAMA ALABAMA TAX TRIBUNAL DOCKET NOS. S. 15-1278 COUNTY. 16-107

OPINION AND PRELIMINARY ORDER ON REHEARING

Akzo Nobel Functional Chemicals, LLC ("Taxpayer") manufactures chemicals at a plant located in Mobile County, Alabama. The Taxpayer petitioned the Department and Mobile County for State and Mobile County use tax refunds, respectively, for January 2011 through December 2013.[1] The petitions were filed with the Revenue Department and the Mobile County Revenue Commissioner on February 20, 2014. The petitions were deemed denied by operation of law six months after they were filed. Code of Ala. 1975, §40-2A-7(c)(3). The Taxpayer thereafter appealed to the Tribunal concerning the denial of the State petition in August 2015, and concerning the denial of the Mobile County petition in August 2016. The State and County appeals were consolidated, and a hearing was conducted on October 13, 2016. Whitney Compton and Jim Mullins represented the Taxpayer. Tyler Pritchett represented Mobile County. Assistant Counsel Duncan Crow represented the Revenue Department.

[1] The refund period stated in the Taxpayer's original State and Mobile County refund petitions was January 2012 through December 2013. The Taxpayer later filed an amended State petition showing the refund period to be January 2011 through December 2013. The State and County have not contested that the correct period is January 2011 through December 2013.

The Revenue Department continued to review documents submitted by the Taxpayer after the Taxpayer appealed to the Tribunal. It notified the Tribunal in May 2016 that it had adjusted the State refund from the amount claimed of $90,853.26 down to $28,434.17. The Tribunal entered a Final Order on May 5, 2016 granting the State refund in that amount.[2] The Taxpayer timely applied for a rehearing.

The Taxpayer submitted a Statement of Relevant Facts concerning the remaining disputed items. The Department stipulated to those facts. Additional facts are set out in the below analysis. The stipulated facts are as follows:

> Statement of Relevant Facts:
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> Akzo Nobel Functional Chemicals, LLC (hereinafter "AkzoNobel") manufactures chemicals at a plant located in LeMoyne, Alabama. At LeMoyne, AkzoNobel produces carbon disulfide, sulfuric acid, sodium hydrosulfide (NASH), sulfur chloride, and crystex.
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> SULFURIC ACID CONVERTER — THE ROBERTS COMPANY
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> AkzoNobel entered into a construction contact with The Roberts Company for Roberts to fabricate and install a new Sulfuric Acid Converter. The Converter is a circular structure approximately 22 feet in diameter and 4 stories, 45 feet high and weighs approximately 110 tons. It is bolted to concrete supports and pilings that are buried into the ground. Steel girders are attached to and support the structure and stair ways on each side of the structure. The structure is built to withstand a category 3 hurricane. It is not designed to be moved and can't be moved intact. The Roberts Company purchased all the materials used to fabricate and install the new Sulfuric Acid Converter. The Roberts Company billed on progress payments based upon the degree of completion. AkzoNobel made its final payment after the Sulfuric Acid Converter had been attached to realty and after the Sulfuric Acid Converter was tested. AkzoNobel took title to the completed Sulfuric Acid Converter after it was attached to real estate. The Taxpayer provided copies of the construction contract and all invoices to

[2] The May 5, 2016 Final Order involved only the State refund because, as indicated, the Taxpayer did not appeal the denied Mobile County petition to the Tribunal until August 2016, after the Final Order was entered. The County filed a motion to intervene in the State case in September 2016. The Tribunal treated the motion as a motion to consolidate the two cases, which was granted on October 20, 2016.

the Department. The Department of Revenue's representatives stated that the refund was denied because the Sulfuric Acid Converter was a manufacturing machine.

COOLING TOWER — OBR COOLING TOWERS

AkzoNobel entered into a construction contract with OBR Cooling Towers, Inc. to repair a cooling tower affixed to real estate at the AkzoNobel plant in LeMoyne. OBR provided, "all labor, supervision, safety supplies, materials and equipment to repair cooling tower per inspection report." AkzoNobel made a single, lump sum payment for entire contract price. The materials supplied by OBR were attached to the cooling tower when title to those materials passed to AkzoNobel. The Taxpayer provided the appropriate purchase orders and invoices to the Department. The Department's representative stated that the refund was denied because the cooling tower was manufacturing machinery.

STORM WATER SAMPLES — TC CONSTRUCTION INC.

In this case TC Construction took storm water samples. TC used $54.75 in materials to take and test the storm water samples. The tax at issue is $2.19. The Department of Revenue denied this refund because the material cost did not equal the invoice amount.

MATERIALS USED TO REPAIR AFFIXED MACHINERY — TC CONSTRUCTION

TC Construction, Inc. made many small repairs to affixed manufacturing machines. The Auditor/refund reviewer allowed a refund for the difference between machinery rate and the general rate. AkzoNobel contends that these are construction contracts. Taxpayer provided purchase orders and invoices.

DEMOLISH AND INSTALL STILL BOTTOMS, PIPING AND COLUMNS — GA WEST

AkzoNobel entered into a construction contract with GA West to demolish old and install new still bottoms, piping, and columns on existing machinery affixed to real property located at AkzoNobel's LeMoyne plant. GA West purchased and installed all the materials used on this project. The materials supplied by GA West were attached to the real property when title to those materials passed to AkzoNobel. The Taxpayer provided purchase orders and invoices to the Department of Revenue. The Department of Revenue denied the refund claims because the materials purchased by GA West were installed on manufacturing machinery.

REPLACE 250 FEET OF HANDRAIL ON MAIN STRUCTURE — GA WEST

AkzoNobel entered into a construction contract with GA West to replace approximately 250 linear feet of handrail on the main structure. AkzoNobel paid a lump sum amount to GA West after the handrail was installed and took title to the handrail after it was installed as real property. The Department of Revenue denied the refund because the handrail was attached to manufacturing machinery.

FABRICATE AND INSTALL FIBERGLASS LINE TO SXC12 SCRUBBER — BITTNER INDUSTRIES, INC.

AkzoNobel entered into a construction contract with Bittner which called for Bittner to supply all labor, material, equipment, and supervision to fabricate and install fiberglass piping that attached to the Sxc12 Scrubber. The piping is attached to the scrubber unit and is generally supported by steel framing that is approximately 20 feet in the air. The steel supports are affixed to real property. The Department's auditor, refund reviewer contends that the Bittner supplied piping is not machinery and that this was not a construction contract.

HARDWARE AND SOFTWARE ATTACHED TO GAS CHROMATOGRAPH — AGILENT

Agilent sold hardware and software that is directly connected to the Gas Chromatograph, a piece of manufacturing machinery. The Department contends that the general tax rate applies. The Taxpayer has provided a tour of the facility and photographs of the machinery.

DRY MAX SYSTEM — SD MYERS

SD Myers sold a 'dry max' unit to AkzoNobel. The 'dry max' unit is attached to the transformer.

ANALYSIS

(1) The Sulfuric Acid Converter Project.

The Taxpayer contracted for The Roberts Company ("Roberts") to remove the existing sulfuric acid converter and furnish, fabricate, and install a new converter at its Mobile County facility. Roberts thereafter purchased all of the materials and fabricated

and installed the new converter. Roberts paid the vendors for the materials, and periodically billed the Taxpayer for progress payments based on the percentage of completion.

The Taxpayer argues that it incorrectly paid use tax on the materials used by Roberts on the project because Roberts should have paid the tax due when it purchased the materials under the sales and use tax "contractor" provisions at Code of Ala. 1975, §§40-23-1(a)(10) and 40-23-60(5), respectively. Those sections are identical, and define a retail sale to include – "Sales of building materials to contractors, builders, or landowners for resale or use in the form of real estate. . . . ."

The Department contends that the converter project was not a construction project. Rather, it asserts that the converter is a machine used in manufacturing, and thus taxable at the reduced one and one-half percent use tax "machine" rate levied at Code of Ala. 1975, §40-23-61(b). The Department's March 1, 2016 Addendum To Refund Petition, at 2, reads in part as follows:

> A large portion of the refund was for a sulfuric acid converter including materials and parts attached to it provided by The Roberts Company Field Services Inc. This was determined to be a manufacturing machine because it is part of the manufacturing process. The sulfuric acid converter along with all parts and materials attached would be taxable at the machine rate.

For the contractor provision to apply, (1) the person or entity performing the work must be a contractor, (2) the materials used must be building materials, and (3) the materials must be sufficiently attached so as to become a part of realty. See generally, *Dept. of Revenue v. James A. Head & Co.*, 306 So.2d 5 (Ala. Civ. App. 1974).

Citing cases from other states, the Court in *Head* defined a "contractor" as "one who formally undertakes to do anything for another. . .," and "[a]lso, a 'contractor' is

ordinarily understood to be a person who undertakes to supply labor and materials for specific improvements under a contract with an owner or principal." *Head*, 306 So.2d at 10.

Applying the above definitions, Roberts was clearly a contractor when it contracted to furnish the labor and materials "for specific improvements under a contract," i.e., the removal of the old converter and the construction/erection of the new converter at the Taxpayer's Mobile County facility.

The Court in *Head* defined "building materials" for purposes of the contractor provision as "material used in construction work and is not limited to materials used in constructing a building with sides and covering . . . ; and to include anything essential to the completion of a building or structure of any kind for the use intended." (cites omitted) *Head*, 306 So.2d at 13. The materials purchased and used by Roberts to construct/erect the new converter were clearly building materials.

Finally, the Court in *Head* stated that tangible personal property becomes sufficiently affixed to real estate so as to become a part of realty if the follow criteria are met.

> First, annexation to the realty, either actual or constructive; second, adaptation or application to the use or purpose to which that part of the realty to which it is connected is appropriated; and third, intention to make the article a permanent accession to the freehold.

Head, 306 So.2d at 14.

The converter weighs 110 tons. It was constructed or assembled some few yards from its intended permanent location. It was then moved to that location on a special rail system built and used solely for that purpose. The converter was then attached by bolts to concrete pilings sunk into the ground. It was also attached to a

steel support structure.

The converter is a permanent part of realty by its weight and size alone.[3] As indicated, it is also attached to the realty by bolts and a steel support structure. Clearly, the third requirement for the contractor provision to apply is also satisfied.

The gist of the Department's argument is that the contractor provision cannot apply because the converter is a machine used in manufacturing and/or processing, and thus taxable at the reduced one and one-half percent rate. "The completion of the sulfuric acid converter was not in the nature of a construction contract but instead was a piece of machinery installed into the production process." Department's Brief at 3. I disagree.

The Taxpayer concedes, and I agree, that the converter is an integral part of and used in the Taxpayer's manufacturing process. Alabama law is clear, however, that if the contractor provision applies, as in this case, it is irrelevant that the structure or machine involved is subsequently used in the manufacturing or production process.

The Alabama Supreme Court's holding in *Layne Central Co. v. Curry*, 8 So.2d 839 (Ala. 1942) is directly on point. In that case, the taxpayer, Layne Central, contracted to furnish and install pump houses, pipe lines, and well connections for a company building a paper mill. The Supreme Court recognized that the pump houses, pipe lines, and well connections were to be subsequently used by the mill owner as machines used in manufacturing, which at the time were exempt from sales and use tax. It held, however, that the exemption did not apply because the taxable event under

[3] The finding that the converter is a permanent part of realty is not altered by the fact that Mobile County requires all property taxpayers to report or list all fixed assets, including machines permanently attached to realty, on the County's business personal property tax return.

the contractor provision was Layne Central's purchase of the materials used on the project.

> In the case of King & Boozer v. State, 241 Ala. 557, 3 So. 2d 572, we had a question under the Sales Tax Act of whether that tax could be laid on a contractor, under a cost-plus a fixed fee contract with the United States Government. We thought that since the Government could not be burdened with such a tax, a contractor of that sort, passing his tax on to the Government as a separate distinct item, was entitled to the same immunity. We relied upon Panhandle Oil Co. v. State of Mississippi ex rel. Knox, 277 U.S. 218, 48 S. Ct. 451, 72 L. Ed. 857, 56 A. L. R. 583, and Graves v. Texas Co., 298 U.S. 393, 56 S. Ct. 756, 80 L. Ed. 1236. But the United States Supreme Court reversed this ruling, declaring those cases no longer were authority. 314 U.S. 1, 62 S. Ct. 43, 86 L. Ed. 3. The court held that the tax was on the sale of material to the contractor, though it was bound to and did use it in building a structure for the Government, and though the amount of the tax was to be paid by the Government as a distinct item, and though the Government was immune from paying any such tax. We had previously held that the tax event is the sale to a contractor of material which is used in performing the contract, relating to a structure on real estate. He is the purchaser at a retail sale consuming the product by transferring it into another structure becoming real estate. Lone Star Cement Corp. v. State Tax Commission, 234 Ala. 465, 175 So. 399; Wood Preserving Corp. v. State Tax Commission, 235 Ala. 438, 179 So. 254.
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> But we thought that since it was for the Government, and immediately went into its ownership, its payment became a tax burden on the Government, and so it did. The United States Supreme Court said in substance, that such a situation is immaterial as respects the tax event. That the particular disposition of the property, even though transformed into a nontaxable product, does not help the purchaser; that his burden is fixed at the time of his purchase which is the taxable event, regardless of what particular use he may make of the property purchased, and becomes settled before its immunity comes into existence. His burden must not be confused with that of the owner of the finished product, though the latter must either directly or indirectly relieve him of it.
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> So here the tax event occurs while the material and even the finished product are still in the possession and control of appellant. He uses it and becomes subject to the use tax before the finished product is itself used in the manufacture of tangible personal property.

> There is another theory on which this levy was within the statute. When ownership of the pump houses, well connections and pipe-lines as completed structures was acquired by Hollingsworth and Whitney Company it was not by virtue of a retail sale as defined in section 787, supra, of personal property whose use is taxable except as exempt under section 789 (q), but by virtue of a contract to add a structure to real estate. Hollingsworth and Whitney Company did not buy machines from appellant to be used by it in manufacturing tangible personal property, exempt under section 789 (q), supra; neither did appellant manufacture tangible personal property with that material as an operating machine. Section 789 (q), supra. But the transaction under which the material constituting the ingredients of those appliances was acquired by appellant was a "sale at retail," as defined by the statute. For "sales of building materials to contractors * * * for * * * use in the form of real estate are retail sales in whatever quantity sold," Section 787 (e) of the Code, supra; (cites omitted)

Layne Central, 8 So.2d at 842 – 843.

Likewise, the materials purchased and used by Roberts to construct the converter were taxable when purchased by Roberts. The Taxpayer is thus due refunds of the State and County tax it erroneously paid on those materials. For other contractor provision cases supporting the above holding, see *Kline Iron & Steel Co. v. State of Alabama*, Docket S. 03-726 (Admin. Law Div. 7/13/2004); *State of Alabama v. Algernon Blair Industrial Contractors, Inc.*, 362 So.2d 248 (Ala. Civ. App. 1978).

(2) Repairs to Machinery.

The Taxpayer contracted with various contractors, including Bittner Industries, OBR Cooling Towers, G. A. West and Co., and T. C. Construction, among others, to perform repairs on various machines at the Taxpayer's Mobile County facility. The contractors purchased and used the materials to make the repairs. The Department contends that the Taxpayer is liable for use tax on those materials at the machine rate because the machines in issue were used by the Taxpayer to manufacture the chemicals produced at the factory.

The machines in issue are attached to the Taxpayer's facility. Revenue Reg. 810-61-.143 specifies that the repairman/contractor is liable for sales or use tax, as applicable, on the purchase of repair parts used to repair real property.

The contractors that purchased and used the parts to repair the Taxpayer's machines were also the parties that used the parts, not the Taxpayer. The contractors, and not the Taxpayer, were thus liable for the use tax due on the parts.

(3) The Gas Chromatograph.

The Taxpayer uses a gas chromatograph, and a computer and printer attached to the chromatograph, to test the various chemicals it produces. It argues that the chromatograph and attachments are an integral part of the manufacturing process, and thus qualify as a machine used in processing or manufacturing. The Taxpayer contends that the above items are similar to the testing equipment in issue in *State of Alabama v. Phifer Wire Products, Inc.*, Docket U. 85-179 (Admin. Law Div. 5/21/1986). I agree.

Phifer Wire manufactured wire and wire-related products. It used an Instron Universal Testing Instrument to test the tensile strength and elongation properties at several points during the manufacturing process. Citing the "integral function" test set out in *State v. Newbury Mfg. Co., Inc.*, 93 So.2d 400 (1957), and also the Missouri Supreme Court's decision in *Novanda Aluminum, Inc. v. Missouri Dept. of Revenue*, 599 S.W.2d 1 (1980), the Department's Administrative Law Division, now the Tax Tribunal, held that the testing machine was an integral and necessary part of the manufacturing process, and thus taxable at the reduced machine rate. Likewise, the chromatograph and attachments are a necessary part of the Taxpayer's chemical

manufacturing process, and thus taxable at the machine rate.

(4) The Dry Max Unit.

The Taxpayer claims that it is due a refund of the difference between the four percent general rate it paid on the dry max unit and the reduced one and one-half percent machine rate because the unit is attached to and a part of a transformer.

Transformers used in manufacturing are taxable at the reduced machine rate. Department Reg. 810-6-2-.101. The evidence shows that the dry max unit is attached by a hose to a transformer at the Taxpayer's plant. The unit removes oil from the transformer, removes moisture from the oil, and then returns the purified oil to the transformer. The unit is a necessary and integral part of the transformer, and thus taxable at the reduced rate.

The Revenue Department is directed to recompute and notify the Tribunal of the State and Mobile County refunds due the Taxpayer in accordance with this Order. A Final Order will then be entered in the case.

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, §40-2B-2(m).

Entered March 23, 2017.

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BILL THOMPSON
Chief Tax Tribunal Judge

bt:dr
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