HUNTER SECURITY, INC. P.O. BOX 1320 DAPHNE, AL 36526-1320,	§	STATE OF ALABAMA DEPARTMENT OF REVENUE ADMINISTRATIVE LAW DIVISION
Taxpayer,	§	DOCKET NO. S. 05-1309
v.	§	
STATE OF ALABAMA DEPARTMENT OF REVENUE.	§	

FINAL ORDER

The Revenue Department assessed Hunter Security, Inc. ("Taxpayer") for State sales tax for October 2001 through October 2004. 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 June 20, 2006. CPA C. E. Johnson represented the Taxpayer. Assistant Counsel Duncan Crow represented the Department.

The Taxpayer is a licensed contractor located in Daphne, Alabama. It furnishes and installs fire alarm and security systems to individuals and businesses in the area. The systems are custom designed to fit the customer's needs. The Taxpayer pays the applicable sales or use tax when it purchases the components and other materials used to complete a job.

The Taxpayer sometimes contracts directly with the property owner. The Taxpayer then designs and installs the component parts of the system. The Department concedes that in those cases, the system constitutes an attachment to real property, and that tax is due on only the Taxpayer's cost of the materials.

The Taxpayer sometimes also subcontracts with an electrical contractor. In those cases, the Taxpayer designs the system and furnishes the various components of the system, i.e., smoke and heat detectors, control panels, batteries, etc. The electrical

contractor partially installs some of the components provided by the Taxpayer. The Taxpayer oversees the contractor's work and completes the installation of those items. It also installs the remaining components, programs the system, and has the finished job certified.

The Department determined that because the electrical contractors installed some of the components provided by the Taxpayer, the Taxpayer was selling the items to the contractors at retail. The Department examiner testified as follows:

> Ms. Brunelle: Yes, sir. Except the - - as far as if they're selling to the electrician, the electrician is buying the system and then installing it themselves, except the final tie-in was our understanding. The final box and the final tie-in and the certification was done by Hunter. But the rest of them - - all of the smoke detectors and pull boxes and all were sold to the electrician. The electrician bought them from them and installed them, and they had Hunter come back in and do a final tie-in. We treated that as a retail sale.

T. at 18 – 19.

The Taxpayer argues that it does not sell the system components at retail. Rather, it contends that it provides the components and other materials as part of its contract to provide a finished addition to real property, and that it owes tax on only its cost of the materials used. The Taxpayer's CPA explained:

> Mr. Johnson: We're not selling those to the contractor. They're providing a complete system under contract.
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> * * *
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> The Court: The electrician issues purchase orders to ya'll for materials?
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> Mr. Johnson: For a complete system. They don't say we want to order thirty smoke detectors and a final panel. We want you to design the system. We want you to furnish the materials. We want you to supervise the job. We want you to do the installation of the panels, the line amplifiers, the battery.

* * *

> Mr. Johnson: Now the electricians will hang one end of the smoke detectors. It's just a wall ornament at that point in time. It remains personal - - tangible personal property until it's incorporated into the real estate, and I think the regulations cover that. Hunter Security attaches the other end of that into the central control panel. They test every single device. They do all of the programming. The actual attachment of one end of the field device - - what do you tell them the average time is?
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> Mr. Hunter: Including everything, they figure a quarter of an hour. That's drive time, breaks, moving the ladders. You know, whatever they have to do to hang that device they figure a quarter an hour.
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> The Court: Who hangs this device? I'm getting a little lost.
>
> Mr. Johnson: The electrician will hang that device - - one end of it. Hunter Security takes the other end of that device, they bring it and integrate it into the system. They test it. Even in hanging the devices they send out personnel to instruct the electrician, supervise that work and check behind them. I mean, they're out there on the job. And we can take some particular jobs here and any time an electrician is involved the Hunter labor on this will be eighty percent of the hours involved in that installation. Hanging those devices may involve twenty percent of the hours for the electrician. But the thing doesn't become real property until the other end is integrated into the system, tested and then approved by - - with the State fire marshal?

T. at 19 – 22.

The Department also assessed the Taxpayer on some of the components of the closed circuit television systems installed by the Taxpayer because the components, although a part of the system, were not attached to the real property. Those items included monitors, access cards, batteries, and digital video recorders. The Department determined that those items did not become a part of realty, and thus were being sold at retail by the Taxpayer, because they could be easily moved and were not mounted or otherwise attached to the structure.

The Taxpayer contends that all components of the closed circuit systems become a part of realty for sales tax purposes because they are a part of the overall system. The Taxpayer thus argues that the components and related materials are taxable at cost.

For Alabama sales tax purposes, "retail sale" includes "[s]ales of building materials to contractors, . . . for resale or use in the form of real estate. . ." Code of Ala. 1975, §40-23-1(a)(10). That is, if a contractor buys materials that are used in making an addition to real property, the contractor owes sales tax when it buys the materials. The Court of Civil Appeals held in *Department of Revenue v. James A. Head & Co.*, 306 So.2d 5 (1974), cert. denied 306 So.2d 12 (1975), that the above "contractor" provision applies if three criteria are met: (1) the taxpayer must be a contractor; (2) the materials must be building materials; and (3) the materials must become part of the real estate.

The Court applied the above test in *State, Dept. of Revenue v. Montgomery Woodworks, Inc.*, 389 So.2d 510 (Ala. Civ. App. 1980), cert. denied 389 So.2d 513 (Ala. 1980). In that case, the taxpayer subcontracted to build custom cabinets for various building contractors. The taxpayer delivered the finished cabinets to the job site, where they were installed by the contractors. However, the taxpayer supervised the installation to insure that the cabinets were properly installed and conformed to the specifications of the particular job.

Applying the criteria announced in *Head*, the Court held that the taxpayer was a contractor, even though it did not actually install the cabinets:

> Therefore, the failure of the taxpayer to actually install the cabinets after they have been fabricated does not prevent the taxpayer from being a "contractor" within the meaning of §40-23-1(a)(10). Especially is this so where taxpayer supervises the installation of the cabinets to assure conformance with the

plans and specifications to which the cabinets were built.

Montgomery Woodworks, 389 So.2d at 512.

The Court next held in *Montgomery Woodworks* that the materials used to build the custom cabinets were building materials, and that the cabinets became a part of realty. The Court thus concluded that the taxpayer owed sales tax on its cost of the materials only, not on the full amount it charged the general contractors for the cabinets.

The rationale of *Montgomery Woodworks* applies in this case. The Taxpayer contracted with its customers, either the property owners or the electrical contractors, to provide a custom-designed fire or security alarm system. The Taxpayer was clearly a contractor within the scope of §40-23-1(a)(10).

Dept. Reg. 810-6-1-.27(2) specifies that "[b]uilding materials as used in the sales and use tax laws includes any materials used in making repairs, alterations, or additions to real property." The completed systems constituted additions to realty. The various components of the systems were thus building materials used in making additions to real property. The third criteria is also present because, as stated, the materials became a part of the buildings in which they were installed.

The Department argues that the components provided by the Taxpayer but actually installed by the electrical contractors were being sold at retail by the Taxpayer. The Court's holding in *Montgomery Woodworks* illustrates, however, that actual installation by the taxpayer is not required. "We find that nowhere in §40-23-1(a)(10) is there a requirement that the taxpayer install building materials before a retail sale (the sale by the vendor to the taxpayer/contractor) can occur." *Montgomery Woodworks*, 389 So.2d at 512. The fact that

the taxpayer in *Montgomery Woodworks* supervised the installation of the cabinets and was responsible that the finished product met specifications was sufficient.

In this case, while the electrical subcontractors partially installed some of the components or materials supplied by the Taxpayer, the Taxpayer supervised the installation and was responsible for completing the job and having the system certified. It is understandable that the Department examiner concluded from the Taxpayer's invoices that it may have been selling the items at retail. The evidence establishes, however, that the Taxpayer was contracting to provide and install completed fire or security alarm systems that constituted additions to realty. The Taxpayer was thus liable for sales tax under §40-23-1(a)(10) on its cost of the components and materials used in fulfilling those contracts.

The above rationale also applies to the remote control television security systems installed by the Taxpayer. The Department contends that the "contractor" provision does not apply, and that the Taxpayer sold various components of the systems at retail, because they were not attached to the real property. I disagree.

Dept. Reg. 810-6-1-.28(2) states that a device or appliance becomes a part of real property if it is connected or attached in such a way that its removal would damage the property. The items in issue, i.e., television monitors, digital video recorders, etc., would not damage the real property if removed. However, paragraph (3) of the regulation provides that even if removal would not damage the property, the item may still be considered a part of realty if it is physically connected, such as by cable, or if it is necessary to make complete or usable something that is real property, or if it is attached to another piece of property that has become a part of real property. Also, the device or appliance

must be necessary to the use or purpose of the real property.

While there is no evidence describing in detail the television security systems in issue, it is assumed that the systems are comprised of surveillance cameras that are bolted, screwed, or otherwise firmly attached to the buildings or structures being monitored. The cameras are attached by cable and/or wires to monitors and/or video recorders. While some of the system components may not themselves be attached to realty, they are required for the system to operate, and together make up a single, integrated security system that was intended to be and is a fixed part of the building or structure in which it is installed. Those items are "necessary to make complete or usable" the overall system, and thus became a part of real property within the scope of Reg. 810-6-1-28(3)(a). As with the fire alarm systems, tax is due on the cost of the materials and components that make up the completed system.

The Department could not allow the Taxpayer a credit for tax previously paid because the Taxpayer did not have separate job files or other records showing the specific materials used on each job. The Department concedes, however, that the Taxpayer paid tax on all materials and components that it purchased from its vendors. As discussed, that was the correct tax due. Consequently, the final assessment is voided. Judgment is entered accordingly.

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

Entered July 25, 2006.

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BILL THOMPSON
Chief Administrative Law Judge