

INDUSTRIAL CHEMICAL TECH., LLC §
798 WEDGEWOOD COURT §
PRATTVILLE, AL 36067-8415, §

STATE OF ALABAMA
DEPARTMENT OF REVENUE
ADMINISTRATIVE LAW DIVISION

Taxpayer, §

DOCKET NO. S. 06-315

v. §

STATE OF ALABAMA §
DEPARTMENT OF REVENUE.

OPINION AND PRELIMINARY ORDER

The Revenue Department assessed Industrial Chemical Technologies, LLC (“Taxpayer”) for State and local use tax for September 2002 through August 2005. 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 August 17, 2006. Courtney Williams represented the Taxpayer. Assistant Counsel Margaret McNeill represented the Department.

The issue in this case is whether water treatment equipment purchased and used by the Taxpayer during the subject period was taxable at the reduced 1 1/2 percent use tax “machine” rate levied at Code of Ala. 1975, §40-23-61(b). The reduced rate applies to machines, equipment, devices, etc. used in processing or manufacturing tangible personal property.

The Taxpayer is a water and wastewater treatment service company headquartered in Prattville, Alabama. It contracted with Teksid Aluminum Components to design, build, and operate a wastewater treatment facility at Teksid’s plant in Sylacauga, Alabama. Teksid manufactures cast aluminum engine blocks for the automobile industry.

Teksid produces the blocks using large, high-pressure die-cast machines. Before a block is cast, water diluted with a die lube substance is sprayed onto the interior of the die.

The die lube prevents the aluminum from sticking to the machine during the process. It also insures that the water is evenly spread on the interior surface of the die so that the molten aluminum inserted into the die rapidly cools at a uniform rate.

A portion of the water/die lube mixture that is sprayed onto the die-cast machine evaporates during the process. However, most of the diluted water is captured in a drain under the machine. It is then pumped to the Taxpayer's treatment facility adjacent to the Teksid plant.

The Taxpayer removes the die lube and other impurities from the water in a reverse osmosis process using filters and separation membranes. The equipment used by the Taxpayer in that process is the equipment in issue in this case. Some of the treated water is recycled and reused in the die casting process. The excess water is released into a sewer or otherwise discharged from the plant.

The untreated wastewater cannot be effectively reused in the die casting process because it contains minerals and contaminants, i.e., calcium and magnesium. Removing or reducing the minerals and contaminants thus allows Teksid to reuse the water in the process. The treated wastewater also works more efficiently than fresh water in the process.

The Taxpayer does not dispute that its treatment equipment was installed primarily for pollution control purposes.¹ It initially argued that the equipment should be exempt pursuant to the use tax pollution control exemption at Code of Ala. 1975, §40-23-62(18). It

¹ The Taxpayer stated in its notice of appeal that it contracted with Teksid "for wastewater treatment services primarily to address the pollution control issues resulting from" Teksid's plant expansion project.

conceded at the August 17 hearing, however, that the pollution control exemption does not apply based on prior case precedent. Instead, the Taxpayer now claims that the equipment should be taxed at the reduced 1 1/2 percent rate as machines used in processing the wastewater from Teksid's plant.

The Administrative Law Division previously addressed the sales and use tax "machine" rate in *Kykenkee, Inc. v. State of Alabama*, S. 01-618 (Admin. Law Div. O.P.O. 5/7/02):

Section 40-23-61(b) levies a 1½ percent use tax on machines "used in mining, quarrying, compounding, processing, and manufacturing of tangible personal property. . . ." The reduced rate also applies to "the parts of such machines, attachments, and replacements thereof, which are made or manufactured for use on or in the operation of such machines and which are necessary to the operation of such machines and are customarily so used." Section 40-23-61(b).

* * *

The Alabama Supreme Court has addressed the sales and use tax machine rate provisions on numerous occasions. (footnote omitted) That Court has broadly construed the provisions to include (1) lumber used to make flasks to hold sand in place during the casting of stoves and furnaces, *State v. Taylor*, 80 So.2d 618 (Ala. 1954); (2) sand used to make molds for casting pipe and steel shot used to remove the sand after the casting process, *State v. Newbury Mfg. Co., Inc.*, 93 So.2d 400 (Ala. 1957); (3) barge unloader equipment that was part of a coal-conveying belt system used in the production of electricity, *Alabama Power Co. v. State*, 103 So.2d 780 (Ala. 1958); (4) paper bags used to shape and hold briquets in a furnace during the production process, *State v. Calumet & Hecla, Inc.*, 206 So.2d 354 (Ala. 1968); and (5) explosive materials used to remove or loosen coal in a coal mining operation, *Robertson & Assoc. (Ala.) v. Boswell*, 361 So.2d 1070 (Ala. 1978). See also, *Overseas Hardwood Co., Inc. v. State of Alabama*, S. 00-664 (Admin. Law Div. 10/1/01) (stacking sticks used to separate lumber in the drying process entitled to the reduced rate); and *NTN Bower Corp. v. State of Alabama*, S. 01-237 (Admin. Law Div. 10/1/01) (coolant and lubricant necessary and essential to the production of roller bearings entitled to the reduced rate).

On the other hand, the Supreme Court rejected the application of the machine rate concerning (1) an ash disposal system used to clear ashes from furnaces used in the production process and overhead cranes used to inspect, maintain, and repair plant machinery, *Alabama Power, supra*; (2) saw sharpeners, grinders, etc. used to repair and maintain saws used in the manufacturing process, *State v. Selma Foundry and Machine Co.*, 160 So.2d 1 (Ala. 1964); and (3) gravel used as a roadbed over which coal was moved from a coal mine, *Robertson & Assoc., supra*. See also, *Ona Corp. v. State of Alabama*, U. 90-315 (Admin. Law Div. 2/10/95) (coolant used only to maintain cutting tools not entitled to the reduced rate).

The general rule of law established by the above cases is that the function of the property in the process is controlling, not the material of which it is composed. If the property performs an integral function in the manufacture, processing, etc. of the end product, the reduced rate applies. But if the material, although necessary in the overall process, serves only as an aid in enabling a machine or its parts to operate, the reduced rate does not apply.

Kykenkee at 3 – 5.

The machines in issue process the wastewater from Teksid's facility and allow the treated water to be reused as an integral and necessary part of Teksid's manufacturing process. I agree with the following statement in the Taxpayer's brief:

Based on the foregoing, Industrial asserts that the machinery and equipment used at the Teksid Plant is processing tangible personal property (water), which would not otherwise be useable, into a form that is useable in the high pressure die casting machines used at the Teksid Plant. Industrial further contends that, while not required to qualify for the machine rate, the processed water performs an integral and necessary function in the manufacturing of the engine blocks. Consequently, Industrial maintains that its equipment and materials are taxable at the reduced machine rate of 1 1/2 %.

The Department is directed to recompute the final assessments in issue by applying the reduced machine rate. A Final Order will then be entered for the reduced amounts due.

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, §40-2A-9(g).

Entered January 30, 2007.

BILL THOMPSON
Chief Administrative Law Judge

bt:dr

cc: Margaret Johnson McNeill, Esq.
M. Courtney Williams, Esq.
Myra Houser
Joe Cowen