DAVID MARSH WALTER WALTER MARINE/REEFMAKER P.O. BOX 998 ORANGE BEACH, AL 36561,	§	STATE OF ALABAMA DEPARTMENT OF REVENUE ADMINISTRATIVE LAW DIVISION
Taxpayer,	§	DOCKET NO. S. 06-559
v.	§	
STATE OF ALABAMA DEPARTMENT OF REVENUE.	§	

OPINION AND PRELIMINARY ORDER

The Revenue Department assessed David Marsh Walter ("Taxpayer"), d/b/a Walter Marine/Reefmaker, for privilege license tax for the fiscal years ending September 30, 2004 and September 30, 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 October 12, 2006. The Taxpayer attended the hearing. Assistant Counsel Duncan Crow represented the Department.

The Taxpayer has been in the artificial reef business since the mid-1980's. He began manufacturing artificial reefs in 2002 at his business located on the Intercoastal Waterway in Gulf Shores, Alabama. He uses concrete, rebar, and old tires to make the reefs. He then transports the reefs to locations in the Gulf of Mexico in a vessel he purchased in 1996.

Baldwin County audited the Taxpayer's business for sales tax in 2004. During the audit, the County examiner noted that the business had failed to obtain the "manufacturer's" license levied at Code of Ala. 1975, §40-12-87. That license ranges from a $10 State license if the manufacturer's total investment in its plant, equipment, fixtures, and supplies is less than $15,000, up to a $200 State license if the investment exceeds $1

million. A corresponding county license is also due equal to half of the applicable State license. Code of Ala. 1975, §40-12-2(e).

The Baldwin County License Inspector's Office investigated and subsequently billed the Taxpayer for the maximum $300 annual license amount based on documents obtained during the County's sales tax audit of the Taxpayer's business. The documents relied on by the License Inspector were entitled "Assets Solely Owned," and had been prepared by the Taxpayer for purposes of obtaining a loan from a bank. The documents indicated that in 2002 and 2003, the Taxpayer and his wife had assets with a net value of approximately $1.3 - $1.4 million. The Taxpayer subsequently provided the License Inspector's Office with additional information. Based thereon, the Inspector reduced the combined State and County license tax to $225 a year, plus penalties and interest.

The License Inspector's Office submitted the matter to the Department for assessment. The Department subsequently deleted the fiscal year ending September 30, 2003 because it was outside of the statute of limitations for assessing tax. It then entered the final assessment for the two years in issue for the $225 annual license tax, plus penalties and interest.[1]

The Taxpayer objects on three grounds. He first argues that his business is not subject to the §40-12-87 license because it is licensed and regulated by the Alabama Department of Conservation and Natural Resources. He next contends that the Baldwin County License Inspector violated the Alabama Taxpayer Bill of Rights by auditing him twice. He also claims the License Inspector violated Code of Ala. 1975, §40-12-10(b)

[1] The Department also allowed the Taxpayer a $15 credit for the fiscal year ending September 30, 2005 for tax previously paid for that year.

because it failed to record the Taxpayer's license citation with the Baldwin County Probate Judge. Finally, the Taxpayer asserts that the business was not assessed at the correct rate because his investment in the business was less than determined by the Department.

Concerning the Taxpayer's first argument, the Taxpayer cites the following sentence in §40-12-87 – "The license taxes levied under this section shall not apply where the factory, mill, or plant which would be licensed by this section is covered by a specific license under this article." The Taxpayer claims that the term "article," as used in §40-12-87, refers to Alabama law in general. He thus argues that the §40-12-87 manufacturer's license does not apply to his business because the business is regulated by the Conservation Department. I disagree.

The "article" referred to in §40-12-87 is Article 2, Chapter 12, Title 40, Code of Alabama 1975. The Taxpayer's business is not subject to another specific license in that Article. The §40-12-87 license thus applies. It is irrelevant for purposes of the §40-12-87 license that the business is also regulated and/or licensed by the Department of Conservation.

The Taxpayer next contends that Baldwin County violated the Taxpayer Bill of Rights, Code of Ala. 1975, §40-2A-1, et seq., because it audited his records twice. That is, the County audited his records for sales tax purposes, and then used some of the records obtained in the sale tax audit to assess the license tax in issue.

Code of Ala. 1975, §40-2A-13(b) provides that "no more than one examination of a taxpayer's books and records by each respective taxing entity relating to each type of tax

shall be made every three taxable years, . . ."[2] The County did audit the Taxpayer's records for sales tax purposes and then use some of those records to determine his license tax liability. But that clearly did not violate the above quoted statute because two types of taxes were involved. Only a reaudit of a taxpayer's records for the same type of tax within a three year period is prohibited. In any case, a taxing entity is allowed by §40-2A-13(b) to reaudit a taxpayer for the same tax within three years as long as the entity "notifies the taxpayer in writing that an additional examination is necessary," and the reasons why.

The Taxpayer also argues that the County violated Code of Ala. 1975, §40-12-10(b) because it did not file a copy of the license citation with the Baldwin County Probate Judge. The filing of a license citation with the probate judge is required by §40-12-10(b), but no evidence was submitted at the October 12 hearing indicating whether the County did or did not file a copy of the Taxpayer's citation with the Baldwin County Probate Judge's Office. In any case, even if the County did not file a copy with the Probate Judge, the Taxpayer would still not be relieved of liability for the license tax in issue. The §40-12-10(b) filing requirement is a due process measure that is intended to ensure that a delinquent taxpayer is properly notified that he must appear and show cause why the license tax has not been paid. It is undisputed in this case that the Taxpayer was notified of the citation and allowed due process, up to and including the October 12 hearing before the Administrative Law Division.

The Taxpayer finally argues that if his business is subject to the license, the Department did not assess him for the correct amount. He contends that the "Assets Solely Owned" documents relied on by the County License Inspector do not accurately

[2] See also, Code of Ala. 1975, §40-2A-7(2)j.

show the investment in his reef manufacturing business. He asserts that the amounts listed in the documents are only estimates of the current value of the various assets owned by he and his wife. He contends that many of the assets are not used in his reef making business, and thus should not be considered.

The Taxpayer testified that he uses the following items to manufacture his reefs: a crane, two welding machines, a cutting torch, two used front-end loaders, and various other miscellaneous tools and supplies. He claims that his investment in the above items is less than $15,000, and consequently, that he is only liable for the minimum $10 State and $5 County license in each year.

The County License Inspector determined the Taxpayer's investment in the business to be $958,300. See, Dept. Ex. 6. Specifically, she used the Assets Solely Owned documents to determine that the value of the Taxpayer's vessel was $350,000, that the intangible value of his business was $250,000, that the value of real estate used in the business was $127,000, that he had vehicles, trailers, etc. valued at $79,100, and that he owned equipment and supplies valued at $152,200. See again, Dept. Ex. 6.

To determine the correct license amount owed by the Taxpayer in each year, it is only necessary to determine if the Taxpayer's vessel, the intangible value of his business, and the real estate owned by the Taxpayer should be considered an investment in the business for purposes of the license.

The Taxpayer purchased his vessel in 1996 for $5,000. He later spent $180,000 refurbishing and repairing it. He claims that the depreciated value of the vessel in the subject years was less than $18,000, not the $350,000 amount used by the County. He further claims that the value of the vessel should not be considered in any case because it

is not directly used in his reef-making business.

A tax levy statute must be strictly construed against the Department. *City of Arab v. Cherokee Elec. Co-op.*, 673 So.2d 751 (Ala. 1995). Consequently, §40-12-87 must be strictly construed so that only the investment in the plant, equipment, supplies, and fixtures used directly in a manufacturing facility should be considered in determining the amount of license tax due. The Taxpayer's vessel is used to haul the reefs after they are manufactured, but it is not used in the manufacturing process. The Taxpayer's investment in the vessel thus should not be considered in computing the §40-12-87 license. In any case, the evidence shows that the depreciated value of the vessel is considerably less than $350,000.

For purposes of obtaining a loan from a bank, the Taxpayer estimated the intangible value of his reef-making business, including the related patents, to be $500,000. Based thereon, the License Inspector determined that the Taxpayer's investment in the business, excluding the patents, was $250,000. The Taxpayer argues that the $250,000 should not be considered in determining his license liability because it is an arbitrary amount that does not represent an actual investment in the business.

I agree with the Taxpayer on this point. The estimated intangible value of the Taxpayer's business should not be considered an investment in tangible assets for purposes of the §40-12-87 license. The $250,000 was thus erroneously included as an investment in computing the license amount.

Concerning the real estate, the Taxpayer testified that he and his wife bought three lots on the Intercoastal Waterway in 2002. He operated his reef-making business on the property during the years in issue. He contends that the property should not be considered

an investment in the business because it is personally owned by he and his wife. He also argues that his wife has rented the property to the business, and that rented property cannot be considered as an investment for purposes of the license.

The Taxpayer used the three lots in his reef-making business. They thus should be considered an investment in the business in computing the amount of the §40-12-87 license. The Taxpayer testified that he purchased the lots because he needed a place to operate his business. He responded to questions at the October 12 hearing, as follows:

> Q. Okay. And you did this reef manufacturing on all three lots or one of the lots or what.
>
> A. All three lots, yes, sir.
>
> Q. What did you buy the lots for.
>
> A. I think it was – I can't remember. I think we paid $195,000 for all three lots. I think. I may be wrong about that.
>
> Q. Are these residential lots?
>
> A. It was zoned industrial.
>
> Q. Industrial?
>
> A. Yes, sir.
>
> Q. Why did y'all buy them to begin with; to continue operating your business?
>
> A. Yeah, to be able to operate our business.

T. at 56 – 57.

The Taxpayer claims that his wife rented the property to the business, and that rented property should not be considered for purposes of the §40-12-87 license. However, no rental agreement was submitted into evidence. In any case, the Taxpayer operated as

a sole proprietorship in the subject years. He could not rent the property to himself, and thereby avoid or reduce the license tax that is otherwise due. Substance over form must govern in tax matters. *Sizemore v. Franco Dist. Co., Inc.*, 594 So.2d 143 (Ala. Civ. App. 1991).

The License Inspector valued the three lots at $127,000. The Taxpayer testified that he bought the property for $195,000. It is irrelevant, however, which value is used because after the $350,000 value of the vessel and the $250,000 intangible value of the business are deleted, the investment in the business is between $100,000 and $500,000. Pursuant to §40-12-87, the Taxpayer is thus liable for a $100 State license and a $50 County license in each year, plus applicable penalty and interest.

The Department is directed to recompute the Taxpayer's liability as indicated above. An appropriate Final Order will then be entered.

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 March 22, 2007.

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BILL THOMPSON
Chief Administrative Law Judge

bt:dr
cc: Duncan R. Crow, Esq.
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