JIM BOOTHE CONTRACTING & SUPPLY CO., INC. 26201 CAPITAL DRIVE DAPHNE, AL 36526,	§	STATE OF ALABAMA DEPARTMENT OF REVENUE ADMINISTRATIVE LAW DIVISION
Taxpayer,	§	DOCKET NO. S. 08-922
v.	§	
STATE OF ALABAMA DEPARTMENT OF REVENUE.	§	

FINAL ORDER

The Revenue Department assessed Jim Boothe Contracting & Supply Company, Inc. ("Taxpayer") for State sales tax for January 2004 through June 2007. 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 December 22, 2009. Greg Watts and Deborah Hembree represented the Taxpayer. Assistant Counsel Duncan Crow represented the Department.

ISSUE

The Taxpayer contracted to perform construction work on projects owned by various tax-exempt entities during the period in issue. The issue is whether the Taxpayer owes Alabama sales tax on the materials that it used on the projects. That issue turns on whether the Taxpayer complied with Department Reg. 810-6-3-69.02, which provides that an exempt entity may designate a contractor as its purchasing agent on a construction project, and the contractor may thereafter purchase the materials to be used on the project tax-free, provided that certain requirements are satisfied.

FACTS

The Taxpayer is a commercial drywall and insulation contractor headquartered in

Baldwin County, Alabama. It maintains an inventory of drywall and related materials that it either uses to fulfill a contract or sells over-the-counter at retail. Because the Taxpayer both withdraws materials from inventory for its own use or consumption and also sells materials at retail, the Taxpayer is considered a "dual business," and is thus allowed to purchase all inventory materials tax-free at wholesale. It is subsequently required to remit the appropriate sales tax on the materials when it either uses the materials on a contract or sells them at retail. See, Dept. Reg. 810-6-1-.56.

The Taxpayer contracted to perform work for various hospitals, schools, and other tax-exempt entities in Alabama during the period in issue. The Taxpayer either contracted directly with the exempt entity, or with a general contractor that had contracted with the exempt entity. In either case, the Taxpayer was designated in writing as a purchasing agent for the exempt entity for purposes of purchasing the materials to be used on the project.

The Taxpayer either purchased the required materials from a third party vendor or obtained them from its own inventory of materials previously purchased at wholesale. If purchased from a third party vendor, the Taxpayer provided the vendor with the project specifications that identified the exempt project owner and the materials needed on the project. It then issued the vendor purchase orders for the materials, which also identified the exempt entity. The vendor in turn invoiced the Taxpayer for the materials. The Taxpayer paid the vendor for the materials, and then billed the exempt entity, plus a mark-up.[1] The exempt entity subsequently paid the Taxpayer for the materials.

[1] If the Taxpayer was a subcontractor on a project, it submitted the bills or invoices to the general contactor, who forwarded them to the exempt entity.

If the Taxpayer obtained the needed materials from its own inventory, it issued an internal inventory transfer invoice, which also included a mark-up. The Taxpayer periodically submitted the internal invoices along with the third party vendor invoices to the exempt entity (or general contractor) for payment, and, as indicated, was paid by the exempt entity for the materials.

All materials used by the Taxpayer on a project for an exempt entity, whether obtained from a third party vendor or from its own inventory, became the property of the exempt entity when delivered to the job site.

The Department audited the Taxpayer for sales tax for the period in issue and determined that the Taxpayer owed sales tax on the materials it had purchased from vendors and then used on the projects for the exempt entities because the Taxpayer had failed to comply with Dept. Reg. 810-6-3-.69.02. The Department examiners specifically concluded that the Taxpayer had failed to comply with the regulation because the Taxpayer, and not the exempt entities, had paid the vendors for the materials. "This procedure (the regulation requirement that the exempt entity must pay for the materials) was not followed. Jim Boothe Contracting & Supply, Inc. purchased the items at wholesale from their vendors for use in completing the furnish and install contracts. The vendor billed Boothe directly and Boothe paid the vendor. Boothe then billed the exempt entity at a mark-up for the materials used to complete the furnish and install contract." Examiners' Audit Report, Dept. Ex. 1 at 5.

The examiners also determined that the Taxpayer was liable for sales tax on the materials it withdrew from its own inventory and used on the projects pursuant to the sales tax "withdrawal" provision at Code of Ala. 1975, §40-23-1(a)(10). The withdrawal provision

specifies that a retail sale occurs when tangible personal property previously purchased at wholesale is withdrawn from inventory and subsequently used or consumed by the wholesale purchaser/withdrawer. The taxable event is the withdrawal of the materials from inventory. *City of Huntsville v. City of Madison*, 628 So.2d 584 (Ala. 1993). It is thus irrelevant whether the person or entity withdrawing the materials uses the materials on a contract with an exempt or non-exempt entity. *American Chalkboard Co., LLC v. State of Alabama*, S. 99-473 (Admin. Law Div. 10/3/2000), and cases cited therein.

The Taxpayer argues that the materials it purchased from the vendors for use on the projects were exempt because it fully complied with Reg. 810-6-3-.69.02. It contends that the exempt entities in substance paid the vendors for the materials when they reimbursed the Taxpayer for the materials. It further asserts that "[i]f the regulation were read to require payment by the tax-exempt entity directly to the third party vendors as the revenue agents have suggested previously, such a reading would make the regulation unreasonable." Taxpayer's Post-Hearing Brief at 35. Finally, the Taxpayer claims that the intent and spirit of the regulation was satisfied because it is undisputed that all of the materials in issue were used on projects for tax-exempt entities, and were ultimately paid for by those entities.

Concerning the materials the Taxpayer obtained from its own inventory, the Taxpayer contends that the materials were exempt because it resold those items to itself as a designated purchasing agent for the exempt entities.

ANALYSIS

Generally speaking, when a contractor contracts to furnish and install building materials that become a part of real property, the contractor is liable for sales or use tax

when it purchases the materials from the vendor. Code of Ala. 1975, §40-23-1(a)(10). ("Sales of building materials to contractors, builders, or landowners for resale or use in the form of real estate are retail sales in whatever quantity sold.") It is irrelevant that the contractor's customer may be an exempt entity. See, *State of Alabama v. King & Boozer*, 62 S. Ct. 43, 314 U.S. 1 (1941); *American Chalkboard*, *supra*.

The Revenue Department has, however, recognized through various regulations that contractors may purchase construction materials tax-free as a purchasing agent on behalf of an exempt entity; provided, that certain conditions specified in the applicable regulation are satisfied. For example, concerning an exempt industrial development board ("IDB"), the Department issued Rule G27-916 (now Reg. 810-6-3-.33) in 1968, which provided that a person or entity could purchase tangible property tax-free as purchasing agent on behalf of an IDB if the purchase was (1) made in the name of the IDB, and (2) the IDB's credit was obligated.

That regulation was in issue in *State v. Allied Paper, Inc.*, 325 So.2d 171, *cert denied*, 325 So.2d 176 (1975). Allied Paper operated a paper mill that had been constructed and was owned by the IDB of the City of Jackson, Alabama. The IDB issued purchase orders to various suppliers to purchase replacement equipment for the mill. The suppliers invoiced the IDB, but Allied actually paid the suppliers and was later reimbursed by the IDB. The Department argued that Allied, and not the IDB, had in substance purchased the equipment, and was thus liable for sales tax on the equipment.

The Court of Civil Appeals held that Allied was not liable because the requirements of Rule G27-916 had been satisfied, i.e., the purchases were made in the name of the IDB and the IDB's credit was obligated. The Court explained that it was irrelevant that Allied

and not the IDB had paid for the equipment because that was not required by the regulation, as it then read.

The Department amended Rule G27-916 after *Allied Paper* to require that the property must also be paid for with funds belonging to the IDB. That amended Rule was in issue in *Champion International Corporation v. State of Alabama*, 405 So.2d 928 (Ala. Civ. App. 1979). Champion had purchased property in the name of an IDB and the IDB's credit was obligated. Champion paid for the property, and was subsequently reimbursed by the IDB.

The Court of Civil Appeals held that the IDB had in substance paid for the materials, and consequently, that the amended regulation had been satisfied.

The Supreme Court reversed, holding that Rule G27-916, as amended, was not satisfied because Champion, and not the IDB, had paid the seller for the property.

> In order for Champion to have complied with Rule G27-916, as amended, *the purchases must have been paid for with funds belonging to the Board*. Since the purchases were paid for with checks drawn and made payable to Champion's account, this did not constitute payment with funds belonging to the Board. The fact that Champion later deposited monies in the Construction Fund and applied to the trustee for reimbursement did not cure this fatal defect. The fact is the purchases were not paid for with funds belonging to the Board but were paid for with funds belonging to Champion. (emphasis in original)

Ex parte: State of Alabama; Re: Champion International Corporation v. State of Alabama, 405 So.2d 932, 935 (1980).

Turning to this case, the regulation in issue, Reg. 810-6-3-69.02, was readopted pursuant to the Administrative Procedures Act, Code 41-22-1, et seq., in 1982, and at the time read as follows:

> The State of Alabama and counties and cities of the state have specific exemption from the payment of sales and use tax on any of the property they purchase or use. Note, however, that a sale to the state or to a county or city of the state is a transaction where the property is sold as the result of an order issued by an official of one of these bodies having authority to make such purchases and acting in his official capacity and, by issuing the order, obligates the agency of which he is an official for the payment of the purchase price.

The 1982 version of Reg. 810-6-3-69.02 was in issue in *V & W Supply Company, Inc. & Hoar Construction, Inc. v. State of Alabama*, *Inc*. S. 95-180 & S. 95-185 (Admin. Law Div. 8/6/1996). In that case, Hoar was the general contractor on an exempt Jefferson County construction project. V & W was a vendor that sold materials to some of Hoar's subcontractors. Hoar and the subcontractors had been appointed as purchasing agents by the County. Hoar and the subcontractors paid the vendors for the materials used on the project, and were in turn reimbursed by the County. The Department argued that Hoar and the subcontractors, and not the exempt County, had purchased the materials because, among other things, Hoar and the subcontractors had paid the vendors.

The Administrative Law Division held that the requirements of Reg. 810-6-3-.69.02, as it then read, had been satisfied because the materials had been ordered by a duly designated purchasing agent that had the authority to obligate the County's credit. It was irrelevant that the materials were not paid for by the exempt County because that was not required by Reg. 810-6-3-.69.02, as it then read.

> The Department argues that the materials are not exempt because (1) they were not purchased in the name of the County, (2) the County's credit was not obligated, and (3) the materials were not paid for with funds belonging to the County. However, those criteria are required by Reg. 810-6-3-.33 and relate only to sales to an exempt Industrial Development Board ("IDB"), not sales to a government entity. (footnote omitted)

> Reg. 810-6-3-.69.02 requires only that a sale to an exempt government entity must be the result of an order issued by someone authorized to purchase for the entity, and with the authority to obligate the government entity to pay for the purchase. That regulation was complied with in this case because Hoar and the subcontractors, as agents for the County, were specifically authorized to purchase the materials for the County. Under general principal/agent law, the County was also ultimately liable to pay for the authorized purchases by its agents. See again, 41 Ala. Digest, Principal and Agent, Key No. 99 (1995).
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> The Department may promulgate regulations requiring exempt government agencies to follow the same or similar procedures as required by Reg. 810-6-3-.33 concerning IDBs. But under current law and regulations, those requirements are not applicable.

V & W Supply, S. 95-180 at 4 – 6.

The Department amended Reg. 810-6-3-.69.02, effective November 1997, to include a requirement that purchases by a designated purchasing agent must be "paid for by the tax-exempt entity with funds belonging to the tax-exempt entity." That requirement remains in the regulation.

Reg. 810-6-3-.69.02(1) specifies the procedures that must be followed for a designated purchasing agent to purchase materials tax-free on behalf of a tax-exempt entity. That paragraph reads as follows:

> The United States Government, the State of Alabama, counties and incorporated municipalities of the state, and various other entities within the state are specifically exempt from paying sales and use tax on their purchases of tangible personal property. These exempt entities may appoint purchasing agents to act on their behalf for making tax-exempt purchases. In such situations the department will recognize that a agency relationship exists, provided that a written contract between the owner and the contractor-agent has been entered which clearly establishes that: (i) the appointment was made prior to the purchase of materials; (ii) the purchasing agent has the authority to bind the exempt entity contractually for the purchase of tangible personal property necessary to carry out the entity's contractual obligations; (iii) title to all materials and supplies purchased pursuant to such

> appointment shall immediately vest in the exempt entity at the point of delivery; and (iv) the agent is required to notify all vendors and suppliers of the agency relationship and make it clear to such vendors and suppliers that the obligation for payment is that of the exempt entity and not the contractor-agent. All purchase orders and remittance devices furnished to the vendors shall clearly reflect the agency relationship. The tax-exempt entity may enjoy its tax-exempt status when utilizing a purchasing agent, provided that the purchase is paid for by the tax-exempt entity with funds belonging to the tax-exempt entity and the proper documentation as listed above exists to confirm the agency relationship.

The Taxpayer argues, and I agree, that the requirements of Reg. 810-6-3-.69.02(1)(i), (ii), and (iii) were satisfied in this case. The Taxpayer was appointed as purchasing agent before the materials were purchased, the Taxpayer had the authority to bind the exempt entities, and title to the materials passed to the exempt entities upon delivery.[2]

I also agree that requirement (iv) was satisfied to the extent that the Taxpayer notified all vendors that the materials were being purchased for use on projects owned by tax-exempt entities. Unfortunately for the Taxpayer, the last requirement of the regulation was not satisfied. That is, the materials were not paid for by the tax-exempt entities with funds belonging to the tax-exempt entities.

The Taxpayer claims that "[t]here is no prohibition in the regulation against reimbursement of advanced funds, the legal presumption is that the tax-exempt entity is bound, and as such the authorized purchases were paid for by the tax-exempt entity as it

[2] Concerning requirement (i), the Taxpayer was appointed purchasing agent before it purchased the materials from the third party vendors, and also before it withdrew the materials from its own inventory. But the Taxpayer may have purchased some of the materials withdrawn from inventory before it was appointed as purchasing agent on a specific project. There is no evidence on that point, but that question has no bearing on the ultimate outcome of the case.

was bound to do." Taxpayer's Post-Hearing Brief at 30, 31. I disagree. As discussed, Reg. 810-6-3-.69.02, as last amended, requires the exempt entity to directly pay the vendor for the materials. The exempt entities failed to do so concerning the materials in issue.

Department Reg. 810-6-3-.69.02 requires an exempt entity to actually pay the vendor for the materials to prevent an unscrupulous contractor from purchasing materials in the name of an exempt entity and then using or consuming the materials on a non-exempt job without the exempt entity's knowledge. The Court of Civil Appeals recognized the reasonableness of the requirement in *Champion International*, as follows:

> We would be remiss if we did not acknowledge the soundness of the State's arguments in justifying the amendment to rule G27-916. We are told that prior to the amendment a lessee could theoretically purchase equipment with its own funds so long as it was invoiced to an industrial development board. It was possible the board might never even become aware of the purchase. It is obvious the drafters of the Cater Act did not intend to sanction such a patent evasion of our tax laws.

Champion International, 405 So.2d at 931.

The Court of Civil Appeals found in *Champion International*, however, that there was no such abuse in the instant case. The Court consequently held that the regulation had been satisfied.

As discussed, the Supreme Court reversed. It recognized that allowing the exemption for all purchases made in the name of an exempt IDB, without more, could result in rampant fraud. "This Court, by refusing to review the decision in *Allied*, should not be understood as having approved, for tax exempt status, every purchase made in the name of an industrial development board. The opportunity for tax avoidance would be rampant if this Court authorized such a practice." *Ex parte Champion International*, 405 So.2d at 935. The Court then concluded that even though the IDB later reimbursed Champion for the

equipment, the equipment had been purchased by Champion, and thus was not exempt, because Champion had paid the vendors – ". . . we do hold, as did the trial judge, that under the facts of this case, the Industrial Development Board was not the 'purchaser' because the purchases were not paid for with funds of the Board." *Ex parte Champion International*, 405 So.2d at 936.

The Alabama Supreme Court's holding in *Ex parte Champion International* is directly on point in this case. The regulation in issue in this case, Reg. 810-6-3-69.02, is identical to the IDB regulation in issue in *Ex parte Champion International* in that both require that the exempt entity must pay for the materials with funds belonging to the exempt entity. Because the Taxpayer and not the exempt entities paid the vendors for the materials in issue, the regulation was not satisfied. The Taxpayer is thus liable for sales tax on those materials.

Concerning the materials withdrawn by the Taxpayer from its own inventory, those materials were not exempt because the Taxpayer clearly did not purchase the materials as a purchasing agent on behalf of the exempt entities. Rather, the Taxpayer purchased those materials in its own name to hold in its own inventory for subsequent use or sale.

The Taxpayer contends that it resold the inventory materials to itself for use on the projects. I disagree. Substance over form must govern in tax matters. *Dept. of Revenue v. Acker*, 636 So.2d 470 (Ala. Civ. App. 1994). In substance, the Taxpayer withdrew the materials previously purchased at wholesale from its inventory and used those materials to fulfill its furnish and install contracts with the exempt entities. The sales tax withdrawal provision at §40-23-1(a)(10) applies, and the Taxpayer owes sales tax on its wholesale cost of the materials.

I sympathize with the Taxpayer because the exempt entities instructed the Taxpayer how to purchase and then get reimbursed for the materials used on the projects. It is also undisputed that all of the materials in issue were actually used by the Taxpayer on projects for exempt entities. The Alabama Supreme Court has plainly held, however, that if the specifics of the applicable regulation are not strictly satisfied, the exemption cannot apply. Consequently, just as in *Ex parte Champion International*, because the Taxpayer and not the exempt entities paid the vendors for the materials, the Taxpayer is liable for sales tax on the materials. Following the regulation may be inconvenient, but requiring the exempt entity to directly pay the vendors is as reasonable today as it was when the Supreme Court affirmed the requirement in *Ex parte Champion International* in 1980.

The final assessment is affirmed. The Taxpayer should, however, be allowed a credit for tax previously paid on the materials of $224.75, $1,085.96, and $320. Judgment is entered against the Taxpayer for tax of $36,060.37, plus applicable interest on the tax up to the date of the final assessment, October 15, 2008. Additional interest is also due from October 15, 2008 on the tax and interest due on that date.

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

Entered July 8, 2010.

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BILL THOMPSON
Chief Administrative Law Judge

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