

ALABAMA MARBLE, INC. §
1016 RIVERCHASE PKWY. W. §
BIRMINGHAM, AL 35244-1524, §

STATE OF ALABAMA
DEPARTMENT OF REVENUE
ADMINISTRATIVE LAW DIVISION

Taxpayer, §

DOCKET NO. S. 10-257

v. §

STATE OF ALABAMA §
DEPARTMENT OF REVENUE.

FINAL ORDER

The Revenue Department assessed Alabama Marble, Inc. (“Taxpayer”) for use tax for January 2006 through December 2008. 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 September 16, 2010. The Taxpayer’s representative was notified of the hearing by certified mail, but failed to appear. Assistant Counsel Wade Hope represented the Department.

The Taxpayer manufactured and installed custom-ordered marble tubs, sinks, showers, etc. for specific jobs during the period in issue. It purchased the raw marble sales tax-free from both in-state and out-of-state vendors during the period using its Alabama sales tax account number. It then reported and paid use tax on its cost of the marble purchased from the Alabama vendors using its sales tax number.

The Department audited the Taxpayer and determined that the Taxpayer owed use tax on the marble purchased from both the in-state and out-of-state vendors under the use tax “contractor” provision at Code of Ala. 1975, §40-23-60(5). It allowed the Taxpayer a credit for the tax previously paid on the materials purchased from the Alabama-based vendors. It then assessed the Taxpayer for the additional use tax in issue on the previously untaxed marble purchased from the out-of-state vendors.

The Taxpayer argues that the “contractor” provision does not apply because the

marble does not become a part of realty. It also contends that the marble should not be taxed in full because only a part of the marble actually remains in the finished products.

The Taxpayer's appeal letter reads in pertinent part as follows:

Pursuant to 810-6-1-28 "building materials" are defined as "all tangible personal property, including any device or appliance used by builders, contractors or landowners in making improvements, additions, alterations or repairs to real property in such a way that such tangible personal property becomes identified with a part of realty." The raw materials we use becomes a part of the product we manufacture to specifications given to us, the raw materials are never used directly for improvements, additions, alterations or repairs to real property or becomes a part of the real property. Due to the nature of our custom product manufacturing and field cuts required for the final installations, a considerable amount of the total raw materials never reach an end user. There are layout mistakes, dimension errors, color mistakes, breakage, waste from the amount of material mixed and left over from each pour, dissatisfied buyers, and waste from field cuts. These product problems end up in dumpsters and never reach an end user. Mistakes have little or no value and can not be returned to stock, where as standard items can be returned and resold to reach an end user. Out of all these problems the standard manufactured items only have to contend with breakage on their part before it reaches an end user, the custom installer guarantees a finished product. Any unintentional loss of raw materials that does not reach an end user, should not be subject to sales or use tax. The percentage loss in custom manufactured products is significantly higher than that of those manufacturing standard items. The so called purpose of taxing standard items is clear cut, but taxing raw materials that never reach an end user and never become "building materials" that make improvements, additions, alterations or repairs to real properties can not be constitutional and is impractical economically for any custom company (regardless of terminology) to keep up with. These significant wastes never become "building materials" and for that reason should not be taxable, nor any other part because of the impracticability of the costs of keeping up with it. Our cultured marble products do not become "identified with a part of realty."

Taxpayer's Notice of Appeal at 2.

The sales and use tax "contractor" provisions are found at Code of Ala. 1975, §40-23-1(a)(10) and 40-23-60(5), respectively. Those sections provide that "[s]ales 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.” The “contractor” provision applies when a contractor fabricates a custom-designed product from building materials that subsequently becomes a part of realty. The taxable retail sale occurs when the contractor purchases the raw materials from the vendor. The contractor should pay sales tax to the seller at that time. If, however, the sales tax is not paid at the time of purchase, as in this case, the contractor is required to report and pay use tax when the materials are used. See generally, *State, Dept. of Revenue v. Montgomery Woodworks, Inc.*, 389 So.2d 510 (Ala. Civ. App. 1980); *Dept. of Revenue v. James A. Head and Co., Inc.*, 306 So.2d 5 (Ala. Civ. App. 1974); *State v. Air Conditioning Engineers, Inc.*, 174 So.2d 315 (Ala. 1965). The “contractor” provision applies if three requirements are met: (1) the taxpayer must be a “contractor”; (2) the raw materials involved must be “building materials”; and, (3) the building materials must be sufficiently attached to the building to become a part of real property. *Montgomery Woodworks, Inc.*, 389 So.2d at 511.

The contractor provision clearly applies in this case. The Taxpayer is a contractor within the purview of the contractor provision when it contracts to produce and also install custom-ordered marble tubs, sinks, etc.

The marble used by the Taxpayer are “building materials,” which has been defined “to include any type of material used for the improvement of one’s premises,” and “anything essential to the completion of a building or structure of any kind for the use intended.” *Head*, 306 So.2d at 141. Marble sinks, tubs, etc. that are installed in a structure clearly are building materials “used for the improvement of one’s premises.”

Finally, the marble tubs, sinks, etc. are also attached to and become a permanent

part of the buildings in which the items are installed.

Because the contractor provision applies, the sales by the marble vendors to the Taxpayer were retail sales. The Taxpayer thus should have paid sales tax when it purchased the marble from the vendors. It failed to do so, and instead purchased the marble tax-free using its Alabama sales tax number.¹ Consequently, it is now liable for use tax on the marble. The Department thus correctly assessed the Taxpayer for use tax on its cost of the marble purchased from the out-of-state vendors and on which no sales or use tax was previously paid.

The Taxpayer also owes tax on its full cost of the marble, even though a part of the marble slab may have been trimmed and discarded during the custom design or production process.

In *Counter Top, Inc. v. State of Alabama*, S. 08-699 (Admin. Law Div. O.P.O. 3/31/2009), the taxpayer made and installed custom-ordered marble countertops, and also sold countertops over-the-counter at retail. The taxpayer correctly purchased all marble tax-free at wholesale because it was in a “dual business,” i.e., it purchased materials as a contractor for use on custom-ordered jobs and also sold some materials at retail. As a “dual business,” the taxpayer was subsequently required to report and remit tax on its cost of the materials used and consumed on the custom jobs, and also on the gross proceeds derived from the over-the-counter sale of the materials at retail. See, Department Reg. 810-6-1-.56.

At issue in the case was whether the taxpayer owed tax on 100 percent of the cost

¹ The Department has canceled the Taxpayer’s sales tax account and has issued it a use tax number.

of the marble it purchased for use on a custom job, even if a portion of the marble was returned to inventory and later used on another job or sold at retail. The Administrative Law Division held that only that discernable part of the marble that is withdrawn and actually used on a job is taxable at that time. That portion that remains in or that is returned to inventory is later taxed at cost, if it is subsequently used on another job, or at the retail sales price, if it is subsequently sold over-the-counter at retail.

The §40-23-1(10) “withdrawal” provision applies when a taxpayer withdraws materials from inventory and then uses or consumes the materials in its business. If, as in this case, property is withdrawn from inventory, divided or separated, and then part is used or consumed by the withdrawing party and the other part is returned to inventory for subsequent use or sale, the withdrawal provision only applies to that part of the property actually used or consumed by the withdrawing party. Consequently, the Taxpayer in this case owes sales tax on only that part of the materials purchased at wholesale that are subsequently used or consumed by the Taxpayer on a job. Sales tax is due on the remaining materials when they are later used on a job (wholesale cost) or sold at retail (retail sales price), assuming the sale is not exempt.

Counter Top, S. 08-699 at 4.

The Department was concerned in *Counter Top* that the taxpayer may escape tax on that part of the marble that is cut or removed from the slab and that does not become a part of the finished product. The Administrative Law Division held that all of the marble removed from inventory and used or consumed on a specific job was taxable, even that part trimmed and discarded as scrap.

The Department is concerned that by allowing the Taxpayer to report and pay sales tax on a percentage of the countertop material actually used on a job, the Taxpayer may be allowed to escape tax on scrap or discarded portions of the material that do not become a part of the installed countertop and are not returned to inventory. I agree that the Taxpayer should be required to pay tax on 100 percent of the materials purchased, assuming that all of the materials are either used on a job or resold at retail, and assuming further that if resold, the sale is not exempt from sales tax.

The following illustrates the point. Again using the 10 foot piece of granite example, assume the Taxpayer uses one-half of the piece on a custom job. The 5 foot piece used may, after edges are rounded, etc., actually constitute only 40 percent of the original slab. The other 10 percent is scrap that the Taxpayer discards. The Taxpayer has in fact used or consumed 50 percent of the piece in completing its contract, and would be required to report and pay sales tax on the wholesale cost of that 50 percent. If the 5 foot remnant is later used on a job, sales tax would then be due at that time on the full wholesale cost of the remnant, even though a portion may be cut or shaved off before it is installed.

Counter Top, S. 08-699 at 4 – 5.

Unlike the taxpayer in *Counter Top*, the Taxpayer in this case should have paid sales tax when it purchased the marble from its vendors because it was not also selling the marble over-the-counter, and thus was not in a “dual business.” But like the taxpayer in *Counter Top*, the Taxpayer is liable for tax on 100 percent of the materials used on a job, even if a part of the marble slab is trimmed, cut, or otherwise removed and discarded as scrap. A contractor that builds a house is liable for tax on 100 percent of the lumber purchased for use on the job, even though the lumber is cut as necessary and a portion discarded as scrap. Likewise, the Taxpayer is liable for tax on 100 percent of the marble or other materials used on a job, even if a portion is removed and discarded as scrap.

The final assessment is affirmed. Judgment is entered against the Taxpayer for use tax, penalty, and interest of \$5,922.82. Additional interest is also due from the date the final assessment was entered, February 9, 2010.

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

Entered November 3, 2010.

BILL THOMPSON
Chief Administrative Law Judge

bt:dr

cc: J. Wade Hope, Esq.
Joe Stamba
Joe Cowen
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