KLOMAR SHIP SUPPLY CO., INC. P.O. BOX 1118 MOBILE, AL 36633-1118,	§	STATE OF ALABAMA DEPARTMENT OF REVENUE ADMINISTRATIVE LAW DIVISION
Taxpayer,	§	DOCKET NO. S. 11-428
v.	§	
STATE OF ALABAMA DEPARTMENT OF REVENUE.	§	

FINAL ORDER

The Revenue Department assessed Klomar Ship Supply Company, Inc. ("Taxpayer") for State sales tax for August 2006 through July 2009. 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 November 2, 2011. Attorney Mark Irwin and CPA Mitch Lawley represented the Taxpayer. Assistant Counsel Duncan Crow represented the Department.

ISSUES

Code of Ala. 1975, §40-23-4(a)(10) exempts from Alabama sales tax the sale of fuel and supplies to ships engaged in foreign, international, or interstate commerce. The statute also specifies that proof that the sale of fuel and supplies are exempt may be accomplished by the seller obtaining a certificate from the purchaser, on a form provided by the Department, verifying that the fuel and supplies are to be used on vessels engaged in international, foreign, or interstate commerce. The primary issue is whether the seller, the Taxpayer in this case, is required to obtain the above certificate before the exemption can be allowed. If the certificate is not mandatory, a second issue is whether the Taxpayer carried its burden of proving that its sales during the subject period were to ships engaged in international, foreign, or interstate commerce, and thus exempt pursuant to §40-23-

4(a)(10).

FACTS

The Taxpayer has operated a ship supply business in Mobile, Alabama since 1985. It sold food, supplies, etc. to ships docked at the Port of Mobile during the period in issue. It did not collect Alabama sales tax on those sales because it believed that the sales were exempt sales to ships engaged in foreign, international, or interstate commerce.

The Department audited the Taxpayer for sales tax for the period in issue. The Taxpayer provided the Department with its sales invoices, purchase invoices, delivery receipts, federal and State income tax returns, and other records, which, according to the Department examiner, "were sufficient to conduct the sales tax audit." See, Department's Confidential Audit Report at 2.

The examiner also asked the Taxpayer to provide all of its executed certificates relating to the §40-23-4(a)(10) exemption. The Taxpayer had not obtained any certificates from its customers during the audit period because it did not believe that the certificates were required for the exemption to apply. The examiner consequently determined that the §40-23-4(a)(10) exemption could not apply, and the Department subsequently assessed the Taxpayer for the sales tax in issue. This appeal followed.

ANALYSIS

The Department argues that for a sale to be exempt under §40-23-4(a)(10), a seller is required to obtain a certificate from the purchaser verifying that the fuel and/or supplies will be used or consumed on ships engaged in international, foreign, or interstate commerce. The Taxpayer contends that the certificate is optional, and that the right to the exemption can be proved by other means. I agree with the Taxpayer.

Section 40-23-4(a)(10) provides in pertinent part that "proof that fuel and supplies purchased are for use or consumption aboard vessels engaged in foreign or international commerce or in interstate commerce may be accomplished by" the seller obtaining an executed certificate to that effect from the purchaser. Department Reg. 810-6-3-67.03, which addresses the §40-23-4(a)(10) exemption, also provides that the seller "may accomplish proof of the applicability of the exemption by" obtaining an executed certificate.

The Department's position is based on Reg. 810-6-3-.67.04, which in substance constitutes the "certificate" form to be used by sellers claiming the exemption. That regulation reads in pertinent part in paragraph (1) that "any claim of exemption (pursuant to §40-23-4(a)(10)) shall be supported by" a duly executed certificate.

As indicated, the statute in issue, §40-23-4(a)(10), specifies that proof of the exemption "may be accomplished" by the seller obtaining a certificate from the purchaser. Use of the word "may" clearly indicates that the Legislature did not intend for a certificate to be the exclusive method for a seller to prove or verify the exemption. "The word 'may,' when given its ordinary meaning, denotes a permissive term rather than the mandatory connotation of the word 'shall.'" *Ralston v. Miller*, 357 So.2d 1066 (1978). The Taxpayer is thus correct that a certificate is not mandatory.

Reg. 810-6-3-.67.04(1) is contrary to §40-23-4(a)(10) to the extent that it requires that the exemption "shall be supported" by a duly executed certificate. That portion of the regulation is thus invalid. A regulation that is contrary to the statute it seeks to interpret must be rejected and the statute followed. *Ex parte City of Florence*, 417 So.2d 191 (1982).

This case can be distinguished from the Alabama Supreme Court's holding in *Ex*

parte White, 477 So.2d 422 (Ala. 1985). In that case, the taxpayer, Shellcast Corporation, used electricity and natural gas for various purposes in its manufacturing processes. Some of the electricity and gas was statutorily exempt from the utility gross receipts tax levied at Code of Ala. 1975, §40-21-82.

Department Reg. 810-6-5.26 specified that if a utility customer used both taxable and exempt utility services, the customer must keep records identifying the taxable and exempt services. "This would require separate meters for taxable and nontaxable services furnished. . . ."

Shellcast failed to separately meter its taxable and exempt services, and instead argued that it could prove the amount of the exempt services by other means. The Supreme Court disagreed, holding that the regulation requiring separate metering was a valid exercise of the Department's authority to adopt reasonable rules.

The regulation in *Ex parte White* that required separate metering was not contrary to a statute, and was thus upheld, because the utility tax exemption in issue did not statutorily provide a method by which the exemption should be verified. The Department was thus free to establish a reasonable method, i.e., separate metering, by which the exempt services must be verified. In this case, however, the Legislature, by using the word "may" in §40-23-4(a)(10), clearly intended to give sellers an optional safe harbor method for proving the exemption. The Department cannot by regulation convert the optional certificate method of proof allowed by the Legislature into a mandatory requirement.

Although certificates are not required for the exemption to apply, the burden was still on the Taxpayer to prove that the sales in issue were exempt. *State v. Ludlum*, 384 So.2d 1089 (Ala. Civ. App.), cert. denied 384 So.2d 1094 (Ala. 1980); *Industrial Tire of Ala., Inc. v.*

State of Alabama, Docket S. 01-276 (Admin. Law Div. 7/17/2001).

The §40-23-4(a)(10) exemption is unusual because it is triggered by how the seller uses the goods after the sale. That is, the exemption applies only if the purchaser uses the goods in international, foreign, or interstate commerce after the ship leaves the Port of Mobile. The problem is how can the seller know or prove that the purchaser subsequently used the fuel or supplies for an exempt purpose.

The Legislature was obviously aware of the seller's "proof" problem because it enacted the safe harbor certificate provision discussed above. But as indicated, the statute does not require a seller to obtain the safe harbor certificate. The question then is how can a seller otherwise establish, and the Department verify, that a sale qualifies for the exemption.

The only practical and reasonable method by which a seller can prove it is entitled to the §40-23-4(a)(10) exemption is to show that the sale was to a purchaser that customarily and routinely engages in international, foreign, or interstate commerce. The Legislature thus included in §40-23-4(a)(10) a statutory presumption "that vessels engaged in the transportation of cargo between ports in the State of Alabama and ports in foreign countries or possessions or territories of the United States or between ports in the State of Alabama and ports in other states are engaged in foreign or international commerce or interstate commerce, as the case may be."

The Port of Mobile is Alabama's only deep water port. Consequently, any container ship or commercial vessel docked at the Mobile facility must necessarily be engaged in foreign, international, and/or interstate commerce, in which case the above presumption would apply.

The Department argues that the Taxpayer failed to present records sufficient to convince the examiner that the Taxpayer's ship customers were engaged in international, foreign, or interstate commerce. The evidence shows, however, that once the examiner learned that the Taxpayer did not have the optional certificates, she determined that the §40-23-4(a)(10) exemption could not apply, and thus did not review the Taxpayer's records.

The Taxpayer presented evidence at the November 2 hearing that the sales in issue were to foreign owned ships registered outside of the United States. The evidence included purchase orders showing the names of the foreign ship owners, delivery receipts stamped with the ships' foreign registry, and payments from foreign bank accounts. That evidence is sufficient to at least trigger the presumption that the Taxpayer's customers were engaged in foreign, international, and/or interstate commerce.[1] There is no evidence rebutting that presumption.

The final assessment in issue is voided.

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

[1] Even if a seller provides the Department with a duly executed certificate, the Department may (or should) still investigate and determine if the fuel and supplies were used for an exempt purpose. If the Department determines that the fuel and supplies were not used for an exempt purpose, then it can assess the purchaser for the tax due. As discussed, the only practical way the Department has of determining if the purchaser used the fuel and supplies for an exempt purpose is by determining if the ship is of the type that is regularly (and necessarily) engaged in foreign, international, and/or interstate commerce. Foreign owned cargo ships registered outside of the United States clearly fit that description.

Entered March 12, 2012.

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BILL THOMPSON
Chief Administrative Law Judge

bt:dr
cc: Duncan R. Crow, Esq.
C. Mark Erwin, Esq.
Joe Walls
Mike Emfinger