WES TECH RESOURCES, INC P.O. BOX 680363 PRATTVILLE, AL 36068,	§	STATE OF ALABAMA DEPARTMENT OF REVENUE ADMINISTRATIVE LAW DIVISION
Taxpayer,	§	DOCKET NO. S. 13-122
v.	§	
STATE OF ALABAMA DEPARTMENT OF REVENUE.	§	

FINAL ORDER

The Revenue Department assessed Wes Tech Resources, Inc. ("Taxpayer") for State sales tax for January 2005 through August 2011. 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 March 19, 2013. The Taxpayer's owners, Pamela and Gary West, attended the hearing. Assistant Counsel Keith Maddox represented the Department.

The Taxpayer opened in the early 1980's as a contract engineering company.

In 1992, Pamela West ("West") opened an "invisible" fence pet containment business in Montgomery, Alabama. West's husband, Gary West, subsequently invented/developed an attachment that fits onto a rototiller that can be used to efficiently bury the wire used by pet containment businesses. The Taxpayer consequently started selling those attachment kits and related items to pet containment companies in Alabama and elsewhere.

The Taxpayer applied to the Department for a sales tax exemption certificate in April 2004. The application indicated that "98% of all sales are to out-of-state pet containment companies." The Department issued the Taxpayer a sales and use tax exemption certificate in October 2004.

The Taxpayer did not file Alabama sales tax returns after receiving the exemption certificate in 2004, even though it thereafter made some taxable retail sales in Alabama. West explained in a February 18, 2012 letter to the Department that "I was also told (by a Department employee) that with this Exemption, in the event our company collected any (Alabama) sales tax, that it could be filed on an occasional status, or at the end of the year." She also indicated in the letter that "we have changed accountant firms and I think somewhere in the mix is where this (payment of sales tax) fell through the cracks."

In 2011, one of the Taxpayer's vendors requested a copy of the Taxpayer's exemption certificate. West could not locate the certificate, and contacted the Revenue Department. She was told that the Taxpayer needed to reapply for the certificate annually.

The Taxpayer reapplied for an exemption certificate in May 2011. The Department denied the application in June 2011 because it determined that the Taxpayer was making retail sales. The Department also notified the Taxpayer that it was auditing the Taxpayer for sales tax for June 2008 through May 2011.

The Department examiner discovered during the audit that the Taxpayer had not filed sales tax returns since at least 2004. He consequently expanded the audit period back to January 2005.[1] The Department subsequently entered a preliminary assessment against the Taxpayer for sales tax of $5,385.21, interest of $741.06, and a late filing penalty of $4,000, for a total due of $10,126.27.

[1] Alabama law at Code of Ala. 1975, §40-2A-7(b)(2)a. allows the Department to assess a taxpayer at any time if no return is filed as required for a reporting period.

The Taxpayer did not dispute that it owed a portion of the assessed tax, and subsequently paid the uncontested sales tax and interest totaling $2,185. It contested the remaining tax and all the assessed penalties, however, and accordingly petitioned for a review of the disputed amounts.

The Department conducted an informal conference and thereafter determined that the disputed tax and interest was still due, but that it would waive the penalties if the Taxpayer paid the remaining amount due. The Taxpayer did not pay, and the Department entered the final assessment in issue for tax of $3,959.86, interest of $82.03, and a late penalty of $4,000. The Taxpayer appealed.

The disputed tax in issue involves wire the Taxpayer purchased from a New Jersey vendor from 2008 until 2010. West explained that before 2008, her pet containment business and various other such businesses in Alabama had each individually purchased the wire "fencing" used in their businesses directly from the New Jersey vendor. In 2008, however, because of the depressed economy and the high cost of shipping the wire, West and four other pet containment businesses in Alabama agreed that they would buy their wire together in bulk to save on shipping costs. "So in order to save money we all decided to go in together and buy wire in bulk to save the additional cost of shipping. This is where the contested sales tax comes in." Taxpayer's notice of appeal, at 1. West explained that because the various pet containment companies had previously purchased items from the Taxpayer, and thus had an account with the Taxpayer, the parties agreed that the Taxpayer would order the wire from the vendor and then bill each company for their pro rata cost of the wire, plus a minimal handling fee.

Based on the above agreement, the Taxpayer purchased wire in bulk from the New Jersey vendor on several occasions from 2008 until sometime in 2010. When asked how many times the Taxpayer purchased wire from the supplier, West responded "[n]o more than twice a year." (T. 36). The supplier shipped the wire to the Taxpayer's facility, where the Taxpayer separated it according to the amount ordered by each containment company. Those companies subsequently picked up the wire, and the Taxpayer thereafter issued invoices to the companies for their share of the cost of the wire, plus a small handling charge.

The Department examiner reviewed the Taxpayer's wire invoices to the pet containment companies and determined that the Taxpayer was selling the wire to those companies at retail. He also concluded that the pet containment companies were contractors, and consequently that the Taxpayer's sales of the wire to those companies constituted taxable retail sales under the sales tax "contractor" provision at Code of Ala. 1975, §40-23-1(a)(10). As discussed below, the "contractor" provision defines "retail sale" in part to include the sale of building materials to contractors for use in the form of real estate. The Department assessed the Taxpayer accordingly.

West argues that since opening her pet containment business in 1992, she has always purchased her wire tax-free and then charged her customers sales tax on the wire and the other tangible components of the invisible fence system. She presented sworn affidavits from three other Alabama pet containment companies which also indicated that they had always purchased the wire tax-free and then charged their customers sales tax on the wire.

West also argued in her notice of appeal that she and the other pet containment businesses are not contractors.

> (The Department examiner) in his opinion comes to the conclusion that I am a fence "contractor" and that I should be paying tax on my purchases of equipment and wire and not charge tax to my customers. And that if I purchase equipment and wire out of state (which I do) that I should pay a "use tax" in the event that I do not pay sales tax. Well, that is the first I've ever heard of this in all the years I've been in the "Invisible" underground electronic pet containment business! Why was I not told this when I first contacted the Alabama Department of Revenue when this business was started? This is not a physical fence in the regular sort of way; actually some are even "wireless". These type fences can be taken with the home owner if they decide to move. So in essence, it is a temporary fence not a permanent part of the house as say a chain link or wooded privacy fence would be.
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> This brings us to the argument of why Wes/Tech is being charged with the contested sales tax. It is because (the examiner) thinks that We/Tech should have charged sales tax on the wire to the other local fence dealers because they are quote "fence contractors" and put in a physical fence. This is simply not true. We are really considered pet containment and avoidance specialists who use both wired and wireless means to keep pets out of rooms or off furniture inside the house, or keep pets out of flowerbeds and keep pets within their yard either by means of standalone electronic fencing or reinforcement of traditional fencing (chain link, privacy, etc.). Again this is not a permanent part of the house and should not be considered the same or taxed the same as "fence contractors". If a customer takes the electronics with them when they move, the wire in the ground is useless and is not seen anyway. Again, the whole purpose of buying the wire was to save money on shipping as I've previously stated, not to resell for retail profit to the local fence dealers, it's for them to resell to their customers. The tax as far as my fence company is concerned has already been paid into the state on a monthly basis; this would be taxing me twice!

The first question is whether pet containment companies are contractors within the purview of the §40-23-1(a)(10) "contractor" provision when they contract to furnish and install invisible fence systems for their customers.

As indicated, the "contractor" provision at §40-23-1(a)(10) defines "retail sale" to include the sale of building materials to contractors for use in the form of real estate. The

provision applies if (1) the purchaser/user is a "contractor," (2) the item purchased is a "building material," and (3) the item is sufficiently attached so as to become a part of the realty. See generally, *State of Alabama v. Montgomery Woodworks, Inc.*, 389 So.2d 510 (Ala. Civ. App. 1980); *Dept. of Revenue v. James B. Head*, 306 So.2d 5 (Ala. Civ. App. 1974).

West is correct that her invisible fence pet containment company and similar companies are not typical fence contractors because they do not erect traditional wooden, chain link, or similar type above-ground fences. The facts show, however, that those companies are contractors within the scope of the "contractor" provision when they furnish and install the invisible fence systems.

In *Head*, the Court defined the term "contractor" to include "one who formally undertakes to do anything for another (cite omitted); or one who contracts to furnish a product or service to another (cite omitted). . . (or) the person who undertakes to supply labor and materials for specific improvements under a contract. . . ." *Head*, 306 So.2d at 8.

Pet containment companies contract with homeowners, businesses, and others to furnish and install invisible fence systems for their customers. They provide the labor and materials needed to complete the contracts, and thus are clearly contractors as defined above.

The wire also constitutes a "building material," which "has been defined as materials used in construction work and is not limited to materials used in constructing a building with sides and covering." *Head*, 306 So.2d at 13. Department Reg. 810-6-1-.28, entitled "Building Materials Defined," defines the term as "all tangible personal property. . . used by

builders, contractors, or land owners 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." An invisible fence system constitutes an improvement and/or addition to the real property on which it is installed, and the wire used in the system is clearly a building material. This is confirmed by Reg. 810-6-1-.27, which identifies wire, electric cable, and electrical fixtures as "building materials."

Finally, the wire is buried in the ground or sufficiently attached to a fence or other fixed object so that it becomes a part of the realty. Although the wire can be dug up or otherwise detached and moved, it is intended to be a permanent part of the realty where it is installed. Based on the above, pet containment companies are contractors for purposes of the sales tax "contractor" provision when they furnish and install invisible fence systems for their customers.

In *Hunter Security, Inc. v. State of Alabama*, Docket S. 05-1309 (Admin. Law Div. 7/25/2006), the taxpayer furnished and installed custom-designed fire alarm and security systems for its customers. The Department conceded that if the taxpayer furnished and also installed the system, the "contractor" provision applied and tax was due only on the taxpayer's cost of the materials. The dispute involved contracts where third party electrical contractors installed some of the system components provided by the taxpayer. The Department argued that the taxpayer was selling those components at retail to the electrical contractors. The Administrative Law Division disagreed, holding that the "contractor" provision also applied to those materials provided by the taxpayer but installed by the electrical contractors, citing *Montgomery Woodworks* ("The Court holding in

Montgomery Woodworks illustrates, however, that actual installation by the taxpayer is not required." *Hunter Security* at 5).

Hunter Security is relevant in this case because a house security or alarm system, although perhaps more complicated and expensive, is similar in substance to an invisible fence pet containment system. A home security system prevents, or at least discourages, intruders from entering the house, while a pet containment system prevents, or at least discourages, pets from leaving the designated area. As discussed, in *Hunter Security* the Department conceded that the "contractor" provision applied when the taxpayer furnished and also installed the various alarm and security systems. Likewise, the "contractor" provision also applies when a pet containment business contracts to furnish and install invisible fence systems.

Hunter Security is also instructive because one type of system installed by the taxpayer, a remote control television security system, included items that were not permanently attached to the realty. The Department argued that the "contractor" provision did not apply to those items. The Division again disagreed.

> The above rationale also applies to the remote control television security systems installed by the Taxpayer. The Department contends that the "contractor" provision does not apply, and that the Taxpayer sold various components of the systems at retail, because they were not attached to the real property. I disagree.
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> Dept. Reg. 810-6-1-.28(2) states that a device or appliance becomes a part of real property if it is connected or attached in such a way that its removal would damage the property. The items in issue, i.e., television monitors, digital video recorders, etc., would not damage the real property if removed. However, paragraph (3) of the regulation provides that even if removal would not damage the property, the item may still be considered a part of realty if it is physically connected, such as by cable, or if it is necessary to make complete or usable something that is real property, or if it is attached to

> another piece of property that has become a part of real property. Also, the device or appliance must be necessary to the use or purpose of the real property.
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> While there is no evidence describing in detail the television security systems in issue, it is assumed that the systems are comprised of surveillance cameras that are bolted, screwed, or otherwise firmly attached to the buildings or structures being monitored. The cameras are attached by cable and/or wires to monitors and/or video recorders. While some of the system components may not themselves be attached to realty, they are required for the system to operate, and together make up a single, integrated security system that was intended to be and is a fixed part of the building or structure in which it is installed. Those items are "necessary to make complete or usable" the overall system, and thus became a part of real property within the scope of Reg. 810-6-1-28(3)(a). As with the fire alarm systems, tax is due on the cost of the materials and components that make up the completed system.

Hunter Security, at 6, 7.

While this case only involves the wire used by West's business and the other pet containment businesses, the above holding in *Hunter Security* illustrates that the "contractor" provision also applies to the other tangible items that are a part of and necessary to the invisible fence system. The record does not show exactly what items comprise a complete invisible fence system, but invoices submitted by the Taxpayer show that they may include receivers, wire, buried splices, batteries, and transmitters, among other items. It is presumed that the above items, and perhaps others, are essential and necessary components of the system. Accordingly, pursuant to Reg. 810-6-1-.28(3)(a), the "contractor" provision also applies to those items.

To summarize, pet containment companies that contract to furnish and install invisible fence systems are contractors for purposes of the §40-23-1(a)(10) "contractor" provision. Those companies are not selling the various components of the systems to their

customers, but rather are using the components to complete their furnish and install contracts with the customers. Sales tax is thus due on the companies' cost of the components. As explained below, however, because the companies sometimes also sell the components at retail over-the-counter, the companies should purchase the components at wholesale and then report and pay sales tax on its cost, if the component is used in a furnish and install contract, or on the retail sales price, if the component is sold at retail over-the-counter to a customer.

Some of West's customers purchased invisible fence system components from West's business, but installed the system themselves. The "contractor" provision would not apply to those transactions because the containment company did not also contract to install the system. Rather, those transactions would constitute retail sales by West's business, and sales tax would be due on the retail sales price charged by the business. Consequently, because West's containment business (and presumably others) both contracts to furnish and install systems and also sells system components at retail, it is a "dual" business pursuant to Reg. 810-6-1-.56. The business should accordingly purchase all of its system components sales-tax free. It should then report and pay sales tax on the retail sales price of those components sold at retail to customers, and on its wholesale cost of those components that it uses to furnish and install the invisible fence systems for its customers.

Concerning the specific sales tax in issue in this case, the Department concluded that because the pet containment companies were contractors, the Taxpayer should have collected sales tax when it sold the wire to the contractors at retail. As discussed, I agree

that the companies were contractors within the purview of the "contractor" provision, but I disagree that the Taxpayer sold the wire to the companies at retail.

The Taxpayer was in the business of selling rototiller attachment kits and related parts to its pet containment customers. It was not, however, in the business of selling wire or the other invisible fence system components to its customers, and other than the few isolated transactions in issue involving the wire, there is no evidence that the Taxpayer ever sold wire or any other system components to its customers.

Substance must govern over form in tax matters. *Sizemore v. Franco Dist. Co., Inc.*, 594 So.2d 143 (Ala. Civ. App. 1991). It is understandable that the Department examiner treated the Taxpayer's wire invoices to the containment companies as retail sales because in form they looked like retail sales. But in substance, the parties agreed that the Taxpayer would purchase the wire in bulk from the New Jersey supplier as de facto agent for the pet containment companies. The Taxpayer issued the companies invoices only as a practical and convenient way of notifying the companies of their pro rata portion of the cost of the wire. The minimal handling fee paid by the companies was deminimus and irrelevant. The Taxpayer thus did not resell the wire to the companies.[2]

The Taxpayer, as de facto agent for the containment companies, should have paid sales tax when it purchased the wire as agent for those companies. It failed to do so. Consequently, the containment companies, as the true purchasers and actual users of the

[2] Even if it is assumed that the Taxpayer did resell the wire, the sales were in the nature of nontaxable casual or occasional sales because the Taxpayer was not in the business of selling the wire and the other system components. See generally, Regs. 810-6-1.33 and 810-6-1-.111.

wire in Alabama, are liable for Alabama use tax on their use of the wire in Alabama.

The Department may, of course, audit and assess the containment companies for the use tax due on their cost of the wire. As discussed, however, it appears that those companies actually charged their customers sales tax on the higher price they charged the customers for the wire. That is, the pet containment companies collected from their customers and remitted to the Department more sales tax than was actually due on their cost of those items.

West's frustration in this case is understandable. She had since 1992 always believed that her pet containment business was selling the invisible fence components to its customers, and consequently, she had always collected the sales tax from the customers and remitted it to the Department. Other similar companies, who were also not aware of the sales tax "contractor" provision, had also apparently done the same. To my knowledge, the Department has never audited West's business or any other pet containment business in Alabama, and thus was unaware that those businesses were incorrectly collecting sales tax from their customers on the invisible fence system components. Hopefully, this Order adequately explains how the companies should report and pay Alabama sales tax, or, if the wire and other system components are purchased from an out-of-state vendor, Alabama use tax.

The Department examiner performed a good audit and correctly concluded that the pet containment companies were contractors subject to the "contractor" provision. I only disagree with the conclusion that the Taxpayer was selling the wire to the pet containment companies at retail. The pet containment companies were the true purchasers/users of the

wire, with the Taxpayer only acting as de facto agent when it purchased the wire on behalf of those companies.

The final assessment is voided.[3]

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

Entered April 19, 2013.

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BILL THOMPSON
Chief Administrative Law Judge

bt:dr
cc: Margaret Johnson McNeill, Esq.
Pamela A. West
Joe Walls
Mike Emfinger

[3] Even if the Taxpayer owed the tax in issue, the penalties would be waived under the unusual circumstances of this case.