

STATE OF ALABAMA, §

v. §

STATE OF ALABAMA
DEPARTMENT OF REVENUE
ADMINISTRATIVE LAW DIVISION

OCTA-STRUCTURES, a partnership §
composed of James H. Ballard §
and Calvin Taylor, §

OCTA-STRUCTURES, a §
partnership §
composed of Octa-Structure §
International, §

OCTA-STRUCTURES, a partnership
ship composed of Octa-Structure
International and Octa-Structure
Manufacturing Company, Inc.,

DOCKET NO. S.85-123

§
OCTA-STRUCTURE §
MANUFACTURING COMPANY, INC., §

§
Taxpayers. §

ORDER

This case involves a number of disputed preliminary assessments entered by the Revenue Department against the various entities listed above (hereinafter jointly referred to as Taxpayer). The assessments are for State of Alabama, Marion County and City of Hamilton sales tax, each concerning part of the period September 1, 1981 through May 31, 1984. A hearing was conducted pursuant to the provisions of the Alabama Administrative Procedure Act, Code of Alabama 1975, §41-22-1, et seq., on June 10, 1985. Representing the parties were attorney Robert A. Huffaker, for the Taxpayer, and assistant counsel J. Wade Hope, for the Department. Based on the testimony and exhibits introduced at said bearing, and in consideration of the arguments and authorities submitted by the

parties, the following findings of fact and conclusions of law are hereby made and entered.

FINDINGS OF FACT

The Taxpayer manufactures and sells various component parts for a structure known as an "Octa-Structure". Said components are manufactured from raw materials and generally consist of a series of wall and roof units, a completed bathroom unit, and "ready-to-hang" kitchen cabinets.

The Taxpayer sells its product to a network of dealers throughout the State. The dealers market and sell the Octa-Structure units to the public. All Octa-Structure dealers must attend an instructional seminar conducted by the Taxpayer on how to properly prepare an Octa-Structure foundation and erect an Octa-Structure building. Also, all dealers are provided with a catalog and price list outlining a number of possible designs which can be constructed from the Octa-Structure components. Said catalog presently contains over five hundred different plans.

Upon receipt of an order from a dealer, the Taxpayer manufactures the components as specified by the order. The dimensions of the basic Octa-Structure unit are standard, as are the measurements of the typical wall and roof components. However, a buyer has flexibility in choosing the location and size of windows and doors, the composition of the roof and other variations in the actual construction of the components. Thus, as stated above, the components are not constructed until receipt of an order, at which

time they are custom built to fit the particular order. Unused components cannot normally be used in a subsequent building without substantial modification.

Upon completion of the components, the Taxpayer transports the material by truck to the construction site. The components are off-loaded by crane and attached one at a time to a pre-set foundation which has been prepared by the dealer or property owner.

The erection process is performed in general by the dealer. However, the truck driver that delivers the components, an employee of the Taxpayer, customarily renders assistance, advice and supervision in the erection process to insure proper construction.

The degree of supervision provided by the truck driver depends on the familiarity of the dealer and his crew with the Octa-Structure erection process.

Upon erection of the components provided by the Taxpayer, the structure is complete with all exterior walls, roof, windows, doors, complete bathroom and "ready-to-hang" kitchen cabinets. The ultimate purchaser receives a warranty from the Taxpayer covering the components constructed by the Taxpayer. The dealer is responsible for all additional electrical wiring, insulation, erection of inside walls and other items necessary to finish the building.

When an order is placed with the Taxpayer, the dealer usually pays a small deposit. Payment in full is made by the dealer upon delivery of the components at the construction site. The price

charged by the Taxpayer during the period in question included sales tax computed on approximately 60% of the total sales price.

The Taxpayer estimated that amount to be the cost of the materials used in manufacturing the components.

The Revenue Department audited the Taxpayer and determined that sales tax was due on the full sales price received by the Taxpayer from the dealer. The Taxpayer acknowledges that the transactions are taxable, but argues that tax is due only on the cost of the materials used in manufacturing or building the components. Upon completion of the audit, the Taxpayer paid to the State approximately 60% of the audit liability, which, as agreed by the Department, reflects sales tax on the Taxpayer's cost of the materials. The assessments in issue are based on the difference between the Taxpayer's cost of materials and the full sales price received by the Taxpayer from the dealers.

CONCLUSIONS OF LAW

Under §40-23-2(1), sales tax is levied on the gross receipts derived from "the business of selling at retail any tangible personal property . . .". A retail sale is normally considered as a sale to the ultimate consumer. State v. T. R. Miller Mill Company, 130 So.2d 185 (1961); State v. Hertz Skycenter, Inc., 317 So.2d 319 (1975). However, §40-23-1(a)(10) defines "sale at retail or retail sale" to also include the below transactions.

(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.

Sales of building materials, fixtures or other equipment to a manufacturer or builder of modular buildings for use in manufacturing, building or equipping a modular building ultimately becoming a part of real estate situated in the State of Alabama are retail sales, and the use, sale or resale of such buildings shall not be subject to the tax.

The issue in this case is whether the sale of materials to the Taxpayer for construction or manufacture of the OctaStructure components is a retail sale under either the "building materials" or "modular building" provisions of subsection (a)(10) set out above.

The "building materials" provision has been interpreted by the Alabama appellate courts on several occasions. The two cases most pertinent to the present case are Department of Revenue v. James A. Head and Company, Inc., 306 So.2d 5 (1974), and State, Etc. v. Montgomery Woodworks, Inc., 389 So.2d 510 (1980).

In the Head case, the taxpayer bid on and was awarded contracts to furnish and install carpet, auditorium seats and carrels for various state educational institutions. The taxpayer argued that it had sold the carpet, etc. to the tax exempt entities. The Department argued that the "building materials" provision of §40-23-1(a)(10) was applicable and that tax was due on the cost of the materials to the taxpayer. The Court of Civil Appeals reversed the trial court and held for the Department.

In deciding the Head case, the Court set out the test that

three requirements must be met for subsection (a)(10) to apply. First, the Taxpayer must be a "contractor". Second, the property involved must constitute "building materials". Finally, the materials must be attached to and become a part of real estate.

From the facts of the case, the Court readily determined that the property was attached to and became a part of real estate. The Court also gave the term "building materials" a broad definition so as to "include anything essential to the completion of a building or Structure of any kind for the use intended (citations omitted)".

Finally, the Court also broadly defined a "contractor" for purposes of subsection (a)(10) as follows:

(2] The term "contractor" has been defined generally as one who formally undertakes to do anything for another, *Stocking v. Johnson Flying Service*, 143 Mont. 61, 387 P.2d 312; or one who contracts to furnish a product or service to another, *Grand Rapids Gravel Co. v. State Dept. of Treas.*, 14 Mich.App. 677, 166 N.W.2d 53. Also, a "contractor" is ordinarily understood to be the person who undertakes to supply labor and materials for specific improvements under a contract with an owner or principal. *Moorhead v. Grassle*, 254 Minn. 103, 93 N.W.2d 678.

In the Montgomery Woodworks case, the taxpayer custom built cabinets and woodwork according to specific plans. Upon completion of the cabinets and woodwork at its shop, the taxpayer delivered the products to the job site for installation. The installation was performed by either the taxpayer or a general contractor. If the general contractor did the installation work, the taxpayer would assist and supervise to insure that the work conformed to the particular specifications of the job.

The Revenue Department entered an assessment against the taxpayer, arguing that tax was due on the full sales price of the cabinets and woodwork which the taxpayer did not actually install.

The taxpayer argued that under subsection (a)(10), tax was due only on the cost of the materials used to make the wood products.

The Court of Civil Appeals ruled for the taxpayer.

As in the Head decision, the Court found that the taxpayer met the three requirements necessary for the application of subsection (a)(10). The taxpayer was a "contractor", the raw materials were "building materials", and said materials were sufficiently attached so as to become a part of real estate.

For purposes of the present case, it is important to note that in determining that the taxpayer was a "contractor", the Court held that it was not necessary that the product actually be installed by the taxpayer, especially in that the taxpayer supervised in the installation process. The Court stated as follows:

However, in these instances the installation of the cabinets is supervised by the taxpayer to assure that the cabinets are properly installed in order to conform to the particular location and building needs which the specifications required. Therefore the failure of the taxpayer to actually install the cabinets after they have been fabricated does not prevent the taxpayer from being a contractor within the meaning of §40-23-1(a)(10). Especially is this so where taxpayer supervises the installation of the cabinets to assure conformance with the plans and specifications to which the cabinets were built.

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We find that nowhere in §40-23-1(a)(10) is there a

requirement that the taxpayer install the building materials before a retail sale can occur. The cases cited by the Department were decided upon the facts in each instance and we view the present case in light of its particular facts. We hold that the facts in the instant case bring it within the purview of §40-23-1(a)(10).

From a review of the Head and Montgomery Woodwork cases, it is clear that the facts in the present case are similar in substance so as to support a finding in favor of the Taxpayer.

The materials used to construct the Octa-Structure components were clearly "building materials" within the scope of subsection (a) (10). As to whether the Taxpayer in the instant case was a "contractor", the Montgomery Woodworks case is directly on point.

In both cases the building materials were used to build or construct a product that was installed by another party. As in Montgomery Woodworks, the present Taxpayer assisted or supervised in the erection or installation process. In the earlier case, the Court of Civil Appeals made it clear that failure to actually install the product does not exclude the applicability of subsection (a)(10). Finally, it is clear that the Octa-Structure components were attached to and became a permanent part of real estate. In summary, the three criteria necessary for the applicability of the "building materials" provision of subsection (a)(10) are clearly present in the instant case.

The Revenue Department argues against the applicability of both the Head and Montgomery Woodworks cases. The Department

attempts to distinguish the Head case by pointing out that the taxpayer in that case actually installed the materials, whereas the present Taxpayer did not. While the factual distinction is present, as stated above the Montgomery Woodworks holding made the distinction irrelevant by finding that actual erection or installation by the contractor or builder is not a prerequisite, especially if the contractor assists in supervising the erection process.

The Department also denies the applicability of Montgomery Woodworks by contending that the components presently in issue are "standard" units, whereas the earlier case involved "custom built" cabinets and woodwork. However, assuming arguendo that there is a legal distinction between "standard" and "custom built" products for purposes of applying subsection (a)(10), the facts of the case do not support the Department's argument.

While it is true that the basic component dimensions are generally a standard size, each Octa-Structure unit is special ordered and the individual components must be custom built to comply with each specific order. The evidence shows that components for over five hundred differently designed structures have been built by the Taxpayer. Because of the specialized nature of each unit, the Taxpayer as a rule does not construct the components until an order has been submitted. Further, if a completed component is not used, it generally cannot be used in a subsequent structure without substantial modification. Clearly the

components are sufficiently custom built for a particular job so as to fit within the holding of the Montgomery Woodworks case.

Having determined that the "building materials" provision of subsection (a)(10) is applicable, a discussion of the "modular building" provision is rendered unnecessary.

Based on the above findings and conclusions, it is hereby determined that the Taxpayer is liable for sales tax on the transactions in issue based on its cost of the materials used to construct the Octa-Structure components. Accordingly, the Revenue Department is hereby directed to make the preliminary assessments final showing no tax due.

Done this the 8th day of October, 1985.

BILL THOMPSON
Chief Administrative Law Judge