

STATE OF ALABAMA

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DEPARTMENT OF REVENUE

V.

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ADMINISTRATIVE LAW DIVISION

PHIFER WIRE PRODUCTS, INC.

§

DOCKET NO. U.85-179

P. O. Box 1700

Tuscaloosa, AL 35403,

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ORDER

This matter involves a contested preliminary assessment of use tax entered by the Department against the Taxpayer, Phifer Wire Products, Inc., concerning the period April 1, 1982 through March 31, 1985. A hearing was conducted by the Administrative Law Division on February 27, 1986, at which the parties were represented by attorneys Ted Northington and Charles Edward Morgan, for the Taxpayer, and assistant counsel Arthur Leslie, for the Department. Based on the evidence submitted at the hearing, and in consideration of the authorities and arguments presented by the parties, the following findings of fact and conclusions of law are hereby made and entered.

FINDINGS OF FACT

The Taxpayer is in the business of manufacturing wire and wire related products. The products are manufactured from bulk aluminum rod. At various stages of the manufacturing process, samples of the rod are tested for tensile strength and elongation properties through the use of an Instron Universal Testing Instrument. The question to be decided is whether the Instron machine is used in the "processing or manufacturing" of tangible personal property within the purview of Code of Alabama 1975. §40-23-61(d).

Because of the diversity of products manufactured by the Taxpayer, a variety of production processes are employed. However, at the hearing, Mr. Anthony Gamble, the Taxpayer's Director of Quality Control, testified as to a typical production process concerning aluminum rivet:

Upon receipt of a roll of bulk aluminum rod, a sample is tested on the Instron machine to insure conformity with purchase order requirements. If acceptable, the processing begins with the rod being drawn on a rod mill through a series of dies, each of which reduces the material in diameter. The number of dies used varies depending on the desired tensile strength and size of the final product. The material may also be put through a heat treating oven to be annealed or softened to facilitate further reduction and to eliminate brittleness.

The aluminum rod is subjected to Instron testing at various stages of the production process. The quality of a given spool of rod is consistent throughout. Accordingly, only a very short section of each spool is subjected to testing. The test material is discarded after use. The number of tests necessary depends on the requirements of each order. The intermediate testing is required to insure that the product meets certain standards necessary for quality (tensile strength, brittleness, etc. ) certification. Adjustments are made in the processing stages if the testing so indicates. Finally, the product is subjected to

final goods testing on the Instron, and, if satisfactory. is put into inventory.

Most of the products manufactured by the Taxpayer require certification that the product has been tested and meets certain military or federal standards. Mr. Gamble testified that in most cases the final product would not be complete or acceptable to the customer without the Instron testing and certification. For those products that do not require testing (coathangers), the Instron is still used by the Taxpayer to insure standard quality control.

#### CONCLUSIONS OF LAW

Code of Alabama 1975. 640-23-61(b) provides as follows:

An excise tax is hereby imposed on . . . any machines used in mining, quarrying, compounding, processing and manufacturing of tangible personal property. . . . at the rate of one and one-half percent of the sales price of any such machine; provided, that the term "machine". as herein used, shall include machinery which is used for mining, quarrying, compounding, processing or manufacturing tangible personal property. and the parts of such machines, attachments and replacements therefor, which are made or manufactured for use on or in the operation of such machines and which are necessary to the operation of such machines and are customarily so used.

As stated, the issue is whether the Instron machine, as used by the Taxpayer. is a machine used in the manufacturing or processing of tangible personal property. There has been no Alabama case concerning the type of machine in dispute (testing equipment). However. there have been a number of cases on the general issue of what constitutes a machine used in manufacturing. State v. Try-Me Bottling Co., 57 So.2d 537 (1952); State v. Calumet and Hecla

Consol. Copper Company. 66 So.2d 726 (1953); State v. Alabama Gas Corporation, 62 So.2d 454 (1953); State v. Newbury Manufacturing Co., Inc., 93 So.2d 400 (1957); State v. Calumet and Hecla, Inc., Alamet Division, 206 So.2d 354 (1968); Robertson and Associates (Alabama), Inc. v. Boswell, 361 So.2d 1070 (1975); and State v. Nelson Brothers, Inc.. 406 So.2d 425 (1981). among others.

From a review of the above cases, it is evident that no hard and fast rule is available for easy guidance, and that each situation must turn on its own particular circumstances. Some of the machines found to have been used in the manufacturing process are a soft drink bottle washer. State v. Try-Me Bottling, supra; a crane used to move objects along a production line, State v. Calumet and Hecla Consolidated Copper. supra; gas pipeline regulators, State v. Alabama Gas Corporation, supra; and paper bags used to hold and shape briquettes during the production process. State v. Calumet and Hecla, Inc., Alamet Division, supra. just to name a few. On the other hand, the Court of Civil Appeals found in State v. Nelson Brothers, Inc., supra, that storage magazines used to store explosives that were used in strip mining were not machines used in the mining process. Judge Holmes dissented, arguing that the magazines performed an integral function in the strip mining process and therefore should be taxed at the lower one and one-half percent (1 1/2%) rate.

The only standard that has been developed by the Alabama courts

is the "integral function" test, which was first annunciated in State v. Newbury Manufacturing Co., Inc., supra, and later followed in State v. Calumet and Hecla, Inc., Alamet Division, supra; Robertson and Associates (Alabama), Inc., supra; and most recently in State v. Nelson Brothers, Inc... supra.

As succinctly stated by the Supreme Court in the Newbury case, the "integral function" test is as follows:

Their (machines) status is not controlled by the material of which they are composed. but by the office they serve in the process. if the article in question performs an integral function in the procedure by which the tangible personal property is produced. we think it is a part and parcel of the machinery used in its production.

However, even after application of the "integral function" test, the particular facts of each situation must still control. Clearly some machines are directly and integrally related to the manufacturing process, while others are obviously not. The dispute arises concerning a machine that may be necessary and related to the production process, but not in a direct, hands-on manner, as is the Instron machine in question.

While the Alabama cases cited above shed some light on the general issue in dispute, the Missouri Supreme Court, in Noranda Aluminum, Inc. v. Missouri Department of Revenue, 599 S.W.2d 1 (1980), has directly addressed the issue of whether laboratory testing equipment is exempt from sales and use tax as being "used directly for manufacturing or fabricating a product". In that case, the taxpayer produced aluminum and aluminum products. During

the production process, samples of the molten aluminum were taken and transmitted to a laboratory for testing. The testing was done "to insure satisfactory performance of the production process and to identify each constituent element of the aluminum oxide". There is no evidence that the testing was required by law or federal standards, or that certification of such testing was required for the final product.

As noted in the Noranda Aluminum decision, the Missouri statute in question, §144.030 RSMO 1969, an exemption statute which exempts machines used directly in the manufacturing process. was first interpreted by the Missouri Supreme Court in Floyd Charcoal Company, Inc. v. Director of Revenue, 599 S.W.2d 173 (1980). There the Missouri Revenue Department argued that the exemption should be limited to machinery which actually performed a function involving a change of the raw material into the finished product. Under that interpretation, any machinery used in preparation for manufacture or after completion would not be exempt. The Court rejected the Department's argument in favor of an "integrated plant" approach, which is in substance only a slight variation of Alabama's "integral function" test. The Missouri Court stated as

follows:

In the Floyd Charcoal case the taxpayer. as does Noranda in this case, supported what is known as the "integrated plant" theory of construction of the exemption provisions. We shall not here set forth in detail the reasoning of the opinion in the Floyd Charcoal case; it is sufficient to say that the result, with which we agree, is that the "integrated plant" approach is "consistent with the . . . legislative intent behind the exemption."As there pointed out". Modern manufacturing facilities are designed to operate on an integrated basis," and "to limit the exemption to those items of machinery or equipment which produce a change in the composition of the raw materials involved in the manufacturing process would ignore the essential contribution of the devices required for such operation."

The Court went on to find that the laboratory equipment was essential to and an integral part of the manufacturing process in that the lab results were used to alter and direct the manufacturing process as necessary so as to produce the desired finished product.

Based on the above Missouri cases, and in consideration of the "integral function" test that has been followed by the Alabama courts, it must be found that the Instron testing machine in issue is an integral and necessary part of the manufacturing process by which the Taxpayer produces its wire products, and is therefore subject to the 1 1/2 percent rate as a machine used in the manufacturing or processing of tangible personal property.

As with the laboratory test results in the Noranda Aluminum case, the Instron test results are used by the Taxpayer as a guidance to alter the production process when necessary so as to achieve the desired final product. In addition, whereas in Noranda Aluminum the laboratory testing was not required by law or for certification purposes. the evidence is clear that the Instron testing and certification is a necessary part of the Taxpayer's marketable finished product. That is, a majority of the products manufactured by the Taxpayer are certified wire and wire products. which require the use of the Instron testing equipment. As testified to by Mr. Gamble, without the Instron testing and certification, most of the Taxpayer's products would be

unacceptable to their customers. it is inconsequential that the testing and certification is not required on all of the Taxpayer's products. As stated by the Alabama Supreme Court in State v. Calumet and Hecla Consolidated Copper Co., supra, if a machine is used in the manufacturing process, the reduced rate applies regardless of the fact that the machine may also be used for purposes not related to or essential to production of the final product.

The above considered, it is hereby determined that the Instron testing machine is subject to the one and one-half percent (1 1/2%) tax rate set out in §40-23-61(b). The preliminary assessment in dispute having been entered based on the higher four percent (4%) rate, the Revenue Department is hereby directed to reduce and make final the assessment in the amount of zero.

Done this 21st day of May, 1986.

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BILL THOMPSON  
Chief Administrative Law Judge