# ALABAMA TAX TRIBUNAL

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| CHARLES E. WATTS, INC., | § | |
| Taxpayer, | § | DKT NO. CITY/COUNTY 16-103 |
| v. | § | |
| VARIOUS ALABAMA CITIES & COUNTIES, | § | |
| Respondents. | § | |

## FINAL ORDER

On December 2, 2016, Revenue Discovery Systems ("RDS"), on behalf of seven Alabama counties, namely; Clay County, Etowah County, Marshall County, Monroe County, Pickens County, Sumter County, Walker County, and twenty-seven Alabama cities, namely; Ashford, Attalla, Brilliant, Calera, Clanton, Coffeeville, Columbiana, Cottonwood, Courtland, Cowarts, Dothan, Double Springs, Flomaton, Fultondale, Fyffe, Gadsden, Lanett, Moulton, Opelika, Opp, New Site, Phenix City, Rainsville, Reform, Sand Rock, Sanford, and Scottsboro (collectively "Respondents"), assessed the Taxpayer for local use tax pursuant to Code of Ala. 1975, §40-2A-7(b)(4), for the periods of January 1, 2012 through December 31, 2015.

The Taxpayer timely appealed the above referenced final assessments to the Tax Tribunal pursuant to §40-2A-7(b)(5)a.[1] A hearing was conducted on June 14, 2017.

[1] RDS also entered assessments for municipal business license fees on behalf of the Respondent Alabama cities. The Taxpayer's Notice of Appeal only includes the assessments for consumer's use tax entered by RDS on behalf of the Respondents. At some point during the pendency of the appeal, the Taxpayer also disputed the validity of the business license assessments. Those assessments are not before the Tax Tribunal in this appeal, as the Taxpayer has not properly appealed those assessments to the Tax Tribunal. Further, the Tax Tribunal does not have jurisdiction to hear taxpayer disputes of business license assessments. The jurisdiction of the Tax Tribunal over final assessments from self-administered municipalities and counties is statutorily limited to "appeals of final assessments or denied refunds in whole or in part, of any

Attorney Jonathan Gerth represented the Respondents. Attorney Luther Abel represented the Taxpayer.

The Taxpayer disputes that it was liable for sales tax on its purchases of materials used in its performance of asphalt paving contracts for various governmental entities, or that it was liable for use tax on its subsequent use or consumption of materials purchased tax-free. Simply put, the Taxpayer argues that it was entitled to purchase tax-free the materials that it used on construction projects it performed for governmental entities who are exempt from the payment of sales tax pursuant to Code of Ala. 1975, §40-23-4(a)(11).

The Respondents argue that the Taxpayer is a contractor, and that its purchases of the materials at issue were retail sales to the Taxpayer, not to the tax-exempt governmental entities, pursuant to Code of Ala. 1975, §40-23-1(a)(10). Consequently, there was no subsequent sale of the materials to the governmental entities and the Taxpayer is the end-user of the materials. They argue that because the Taxpayer was liable for the sales tax on its purchases of materials at the time the purchases were made, and because the tax was not paid, the Taxpayer owes the use tax on its use or consumption of those materials. For the reasons set forth below, I agree.

## Facts

The Taxpayer is an asphalt and paving contractor with a principal office located in Gadsden, Alabama. The Taxpayer is primarily in the business of performing asphalt paving on state highway projects and city and county roadways. The Taxpayer does not make retail sales, and is not an asphalt manufacturer.

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*sales, use, rental, or lodgings taxes* levied or collected from time to time by or on behalf of the self-administered county or municipality." Code of Ala. 1975, §40-2B-2(g)(2) (emphasis added).

The Taxpayer's primary purchases are of rock and emulsions which are combined and used as resurfacing materials in asphalt paving. The Taxpayer either transports the materials it purchases to the job site, or has the materials drop-shipped directly to the job site. The Taxpayer purchases materials from in-state and out-of-state suppliers.

On behalf of the Respondents, RDS audited the Taxpayer's books and records to determine compliance with local sales and use tax laws. A review of the Taxpayer's purchase invoices and other purchase records indicated that the Taxpayer purchased most of the materials it used on asphalt paving jobs performed within the Respondents' jurisdictions tax-free. The Taxpayer was assessed use tax on the cost of the materials it purchased tax-free and subsequently used or consumed within the respective local jurisdictions.

Analysis

Unless specifically exempted, a sales tax is levied on the retail sale of tangible personal property. Code of Ala. 1975, §40-23-2(1). Retail sales include "[sales] of building materials to contractors, builders or landowners for resale or use in the form of real estate . . . in whatever quantities sold." Code of Ala. 1975, §40-23-1(a)(10); Ala. Tax Reg. 810-6-1-.46. This portion of the sales tax law is commonly known as the "contractor provision."

It is well-settled that the contractor provision applies when a contractor fabricates a product from building materials that subsequently become a part of realty. *State, Dep't of Revenue v. Montgomery Woodworks, Inc.*, 389 So.2d 510 (Ala. Civ. App. 1980); *Dep't. 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). A taxable retail sale occurs

when the contractor purchases the raw materials from the vendor; there is no retail sale to the principal under a furnish and install contract and the contractor is considered the ultimate user and consumer of the raw materials. *Alabama Precast Products, Inc. v. Boswell,* 357 So.2d 985 (Ala. 1978); *Head*, 306 So.2d 5. 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; *Head,* 306 So.2d at 8-10.

The Taxpayer is a contractor. Alabama courts have defined "contractor" as (1) one who formally undertakes to do anything for another; (2) one who contracts to furnish a product or service to another; or (3) one who undertakes to supply labor and materials for specific improvements under a contract with an owner or principal. *Montgomery Woodworks, Inc.,* 389 So.2d at 511–12; *Head*, 306 So.2d at 8-9. The Taxpayer, as one who contracts for the construction of highways, roads, and other paved surfaces, falls within this classification. The Taxpayer is not a dual-business because the Taxpayer does not also make retail sales. Ala. Tax Reg. 810-6-1-.56. The Taxpayer is not a contractor-manufacturer because the Taxpayer is not a manufacturer of ready-mix concrete or asphalt plant mix. Code of Ala. 1975, §40-23-1(b); Ala. Tax Reg. 810-6-1-.29.

"Building material" has been defined "to include any type of materials 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 9. Clearly, the asphalt

used to construct the roads was an essential material used to improve the land upon which the roads were built.

The test for determining whether materials become a part of real estate was explained in *Head*, as follows:

> ". . . first, annexation to the realty, either actual or constructive; second, adaptation or application to the use or purpose to which that part of the realty to which it is connected is appropriated; and, third, intention to make the article a permanent accession to the freehold."

*Head*, 306 So.2d at 10, citing *Patterson v. Chaney*, 173 P. 859 (N.M. 1918). The Taxpayer used rock and emulsions to build asphalt roads on real property. I cannot think of a single example more illustrative of materials becoming affixed to real property than that of an asphalt road. Certainly, the asphalt roads were intended to become a permanent part of the real property on which they were constructed.

The Taxpayer was a contractor that contracted to build highways and roads using building materials, and those highways and roads became a part of real property. Consequently, the contractor provision applied and the Taxpayer was liable for State and any applicable local sales tax on the materials used to construct the roads when it purchased the materials. It is undisputed that, for most of its purchases, it did not. Because the Taxpayer did not pay the applicable sales tax on the materials when it purchased them, the Taxpayer is liable for State and any applicable local use taxes on its subsequent use or consumption of the materials in Alabama that it purchased tax-free. *Crown Housing Group, Inc. v. State of Alabama*, Dkt. S. 06-399 at 15-17 (Admin. Law Div. O.P.O. 7/26/2007).

The Taxpayer cannot rely on the tax exemption granted to the State and its cities and counties, and the Taxpayer does not qualify for the exemption in Code of Ala. 1975,

§40-9-14.1. Although title to the materials was ultimately transferred to the Taxpayer's tax-exempt customers, there was no subsequent retail sale of the materials to the customer – the Taxpayer was the ultimate consumer of the materials. *See Vision Southeast Companies, Inc. v. State of Alabama,* Dkt. S. 14-1006 at 17-18 (Ala. Tax Tribunal O.P.O. 12/07/2015); *see generally State of Alabama v. King and Boozer, et al.,* 314 U.S. 1 (1941). Section 40-9-14.1 and Ala. Tax Reg. 810-6-1-.46(3) generally exempt a contractor's purchase or use of materials incorporated into realty pursuant to a contract with a governmental entity, provided the contractor complies with the provisions of Ala. Tax Reg. 810-6-3-.77. However, that exemption is only available for sales of materials after January 1, 2014, and does not extend to a contractor's purchases of materials for contracts for the construction of any highway, road or bridge. *Id.*

The Taxpayer also argues that the assessments are invalid because RDS made no effort "to identify the untaxed materials or the location where the materials were actually used." The audit methodology was explained in the audit report and at the hearing. The auditor reviewed each job to determine the job's location. Only jobs located in RDS client jurisdictions were audited. The auditor noted that materials for the jobs performed during the audit period were delivered to the job site or transported to the job site by the Taxpayer, so it was reasonably clear where the materials were being used or consumed by the Taxpayer.

The auditor further noted that some jobs were only partially within a city or police jurisdiction. To reasonably account for the fact that materials used in such jurisdictions would be subject to the city or police jurisdiction use tax and that materials used outside of such jurisdictions would not, the auditor only assessed the city or police jurisdiction use

tax to a percentage of the materials used on those jobs. Since the materials were used to construct highways or roads, the percentage was calculated by dividing the total miles of road within the city or police jurisdiction by the total miles of road constructed for each job. For instance, if the Taxpayer constructed 100 miles of road in one job, and only 25 miles of road were constructed within the city or police jurisdiction, the auditor assessed the city or police jurisdiction use tax to 25% of the materials purchased for that job.

A final assessment is prima facie correct, and the burden of proving that the assessment is incorrect is on the taxpayer. Code of Ala. 1975, §40-2A-7(b)(5)c. Here, the Taxpayer has failed to produce any evidence whatsoever that the audit methodology employed by the auditor is unreasonable, that the auditor applied incorrect use tax rates, or that the final assessments are otherwise incorrect.

The final assessments are affirmed. Judgment is entered against the Taxpayer for use tax, penalties, and interest as follows; $466.20 (Clay County), $1,445.14 (Etowah County), $227.51 (Marshall County), $1,558.55 (Monroe County), $696.22 (Pickens County), $907.05 (Sumter County), $5,158.97 (Walker County), $761.14 (Ashford), $17.14 (Attalla), $140.31 (Brilliant), $98.48 (Calera), $188.83 (Clanton), $137.62 (Coffeeville), $190.74 (Columbiana), $48.68 (Cottonwood), $371.40 (Courtland), $24.10 (Cowarts), $4,468.02 (Dothan), $138.32 (Double Springs), $82.46 (Flomaton), $387.30 (Fultondale), $232.22 (Fyffe), $7,213.82 (Gadsden), $6.85 (Lanett), $40.20 (Moulton), $502.17 (Opelika), $40.37 (Opp), $303.25 (New Site), $188.63 (Phenix City), $218.38 (Rainsville), $539.26 (Reform), $86.65 (Sand Rock), $53.69 (Sanford), and $167.24 (Scottsboro). Additional interest is also due from the date the final assessments were entered, December 2, 2016.

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

Entered January 31, 2018.

/s/ C. O. Edwards
CHRISTY O. EDWARDS
Associate Tax Tribunal Judge

cc: Luther D. Abel, Esq.
Jonathan V. Gerth, Esq.