

NELSON SERVICE GROUP, INC. §
902 S. Chestnut Street
Florence, AL 35630, §

STATE OF ALABAMA
DEPARTMENT OF REVENUE
ADMINISTRATIVE LAW DIVISION

Taxpayer, §

DOCKET NO. S. 03-1101

v. §

STATE OF ALABAMA §
DEPARTMENT OF REVENUE.

**FINAL ORDER ON
TAXPAYER'S APPLICATION FOR REHEARING**

The Revenue Department assessed Nelson Service Group, Inc. ("Taxpayer") for use tax for June 1997 through January 2003. The Taxpayer appealed to the Administrative Law Division pursuant to Code of Ala. 1975, §40-2A-7(b)(5)a.

The Taxpayer submitted additional records to the Department after it appealed. The Department reviewed the records and reduced the Taxpayer's liability to \$13,174.13. A Preliminary Order was entered directing the Taxpayer to respond by June 30, 2004 if it disagreed with the reduced amount due. The Taxpayer failed to respond. Consequently, a Final Order was entered on July 14, 2004 reducing the final assessment to \$13,174.13.

The Taxpayer timely applied for a rehearing, arguing that it still disputed the reduced amount due, and that it had misunderstood the Preliminary Order. The petition was granted, and a hearing was conducted on September 8, 2004. Attorney Leah Wilson and CPA David Wilson represented the Taxpayer. Assistant Counsel Wade Hope represented the Department.

The issue in this case is whether a high pressure hydro-blaster and related equipment used by the Taxpayer during the audit period was exempt from Alabama use tax pursuant to the pollution control exemption at Code of Ala. 1975, §40-23-62(18).

The Taxpayer is a commercial coatings and painting contractor. During the period in issue, the Taxpayer contracted with Occidental Chemical to remove mercury contaminated rubber coatings from equipment owned by Occidental. To perform the job, the Taxpayer purchased the high pressure hydro-blaster and related equipment in issue.

Occidental had previously removed the coatings by sandblasting. However, sandblasting disbursed the mercury into the atmosphere, which caused environmental problems. The Taxpayer thus used the hydro-blaster on the Occidental job in lieu of sandblasting to prevent the mercury from polluting the environment. The Taxpayer has also used the hydro-blaster on other jobs.

The Taxpayer purchased the hydro-blaster and related equipment tax-free. The Department audited the Taxpayer and assessed it for use tax on those items. The Taxpayer appealed.

The Taxpayer argues that the hydro-blaster and related equipment is exempt from use tax because its use of the equipment prevented the mercury imbedded in the rubber linings from polluting the environment.

I agree that by using the hydro-blaster in lieu of sandblasting, the Taxpayer prevented mercury from entering the environment. Unfortunately for the Taxpayer, its use of the equipment still does not qualify for the pollution control exemption at §40-23-62(18).

All tangible personal property “acquired primarily” or “used or placed in operation primarily” for pollution control purposes is exempt from Alabama sales and use tax. Code of Ala. 1975, §§40-23-4(a)(16) and 40-23-62(18), respectively. The sales and use tax pollution control exemptions are intended to ease the financial burden on businesses that are required to purchase nonproductive equipment and materials to comply with mandatory

pollution control laws. *Chemical Waste Management, Inc. v. State*, 512 So.2d 115 (Ala. Civ. App. 1987). The exemptions do not apply, however, to property acquired and used as an integral part of a profit-motivated business, even if the property serves to reduce or control pollution.

The Administrative Law Division addressed the scope of the pollution control exemptions in *Air Products & Chemicals, Inc. v. State of Alabama*, U. 95-359 (Admin. Law Div. O.P.O. 12/14/95), as follows:

The exemption does not apply to all property that performs a pollution control function. Rather, the exemption applies only if the property is acquired or placed in operation by the purchaser/user primarily for pollution control purposes. Consequently, material or equipment is not exempt if it is purchased and/or used by the purchaser primarily as an integral and necessary part of a profit-motivated business activity. *Chemical Waste Management, Inc. v. State*, 512 So.2d 115 (1982).

In *Chemical Waste Management*, the Alabama Supreme Court held that equipment used in a hazardous waste disposal facility was an integral and necessary part of the taxpayer's business activity, and thus was not exempt from tax. ". . . The taxpayer's containment equipment is the very property from which its profits are derived". *Chemical Waste Management*, at page 118. *Chemical Waste Management* has been relied on by the Administrative Law Division in at least three cases.

In U. 88-107, the exemption was denied to a taxpayer that used trucks and roll-on containers in its solid waste disposal business:

The purpose for the pollution control exemption is to give businesses a break with the cost of purchasing the extra, non-productive equipment necessary to comply with mandatory pollution control legislation. *Chemical Waste Management, Inc. v. State*, 512 So.2d 115. However, the court of civil appeals ruled in the above case that the exemption should not apply if the property is used as an integral part of the taxpayer's primary business, and is only incidentally related to pollution control. That is, the property must be acquired primarily for pollution control, and not as an essential element of the business activity or services provided by the taxpayer. The containers and trucks in issue are used directly and are a

necessary part of the Taxpayer's primary business activity, the removal and disposal of solid waste. The exemption was not intended to apply to equipment acquired primarily for and used directly in a profit motivated activity. Thus, the containers and trucks were not acquired or used primarily for pollution control purposes and should not be exempted under §40-23-62(18).

U. 88-107, at page 6.

In U. 91-144, an exemption was denied to a commercial wastewater disposal facility that disposed of toxic wastewater produced by oil and gas wells:

The taxpayer's facility in this case obviously controls pollution in one sense because it disposes of the toxic waste water from surrounding oil and gas wells. However, the primary purpose of the facility is not pollution control but rather profit. Consequently, the facility does not come within the scope of the exemption statute and the tangible personal property used at the facility is subject to use tax.

U. 91-144, at page 2.

Finally, in S. 90-257, the exemption was denied to a taxpayer engaged in the asbestos removal business:

Material or equipment purchased and used primarily as an integral and necessary part of a profit-making business activity is not tax exempt. In Chemical Waste Management, Inc. v. State, 512 So.2d 115, a pollution control facility and equipment used to control and contain hazardous waste was determined to be integral and necessary to the taxpayer's business and thus not exempt -- ". . . the taxpayer's containment equipment is the very property from which its profits are derived". See, Chemical Waste Management, at page 118. Likewise, the materials in issue were purchased and used by the contractors as a necessary and integral part of their primary business activity. The fact that the contractors' primary business involves pollution control should not allow them to purchase the tools of their trade tax-free.

S. 90-257, at page 3.

Air Products at 4 – 6.

While using the hydro-blaster instead of a sandblaster prevented the mercury from entering the environment, the Taxpayer nonetheless acquired and primarily used the hydro-blaster to complete its contract with Occidental. Consequently, while the equipment may have been exempt if purchased and used directly by Occidental, the Taxpayer's use of the equipment was not exempt because the Taxpayer used the equipment in its profit-motivated business.

It might be true, as the taxpayer contends that another company engaged in a different business, but with the same equipment to contain, say, solid waste from leaking into a water supply, would get the exemption, whereas the taxpayer here would not. In the case of the taxpayer here, that equipment is integral to and is in fact the very service that the taxpayer purports to provide. It does not represent an unrecoverable cost of the enterprise – as it would to a company which manufactures widgets and is required by law to contain its solid waste; the taxpayer's containment equipment is the very property from which its profits are derived.

Accordingly, the primary purpose of the property is not pollution control within the intended meaning of the statute; rather, it is part and parcel of the taxpayer's business purpose.

Chemical Waste Management, 512 So.2d at 118.¹

The tax of \$11,590.98 and interest of \$424.04 computed through April 30, 2004 is affirmed. The penalty of \$1,159.11 is waived for reasonable cause. Code of Ala. 1975, §40-2A-11(h). The Final Order entered on July 14, 2004 is voided. Judgment is entered against the Taxpayer for \$12,015.02. Additional interest is also due from April 30, 2004.

¹ For other cases on point, see *Lesaffre Yeast Corp. v. State of Alabama*, S. 03-1130 (Admin. Law Div. 6/16/04); *Waste Away Group, Inc. v. State of Alabama*, S. 02-810 (Admin. Law Div. 7/16/03); *HLH Constructors, Inc. v. State of Alabama*, S. 00-678 (Admin. Law Div. 8/15/01), *aff'd* 2004 Ala. Civ. App. LEXIS 172; *Service Chemical Industries v. State of Alabama*, S. 00-710 (Admin. Law Div. O.P.O. 7/11/01).

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

Entered October 7, 2004.

BILL THOMPSON
Chief Administrative Law Judge