TENNESSEE RIVER STEEL, LLC AND ITS MEMBERS, BETTY BARBER, ROBERT F. BARBER, MICHAEL L. BRATTON, AND MARY B. BRATTON, 1705 ASHLEY STREET SCOTTSBORO, AL 35768-0968,	§	STATE OF ALABAMA DEPARTMENT OF REVENUE ADMINISTRATIVE LAW DIVISION
Taxpayers,	§	DOCKET NO. S. 10-612
v.	§	
STATE OF ALABAMA DEPARTMENT OF REVENUE.	§	

FINAL ORDER

The Revenue Department assessed Tennessee River Steel, LLC ("Taxpayer"), and its members, Betty Barber, Robert F. Barber, Michael L. Bratton, and Mary B. Bratton, for State and local sales tax for June 2004 through June 2008. The Taxpayer appealed the final assessments to the Administrative Law Division pursuant to Code of Ala. 1975, §40-2A-7(b)(5)a. A hearing was conducted on December 1, 2011. Mike Wisner represented the Taxpayer. Assistant Counsel David Avery represented the Department.

The Taxpayer is a structural steel contractor headquartered in Hollywood, Alabama. It performed in-state and out-of-state furnish and install contracts for both exempt and taxable customers during the subject period. It also sold structural steel and related materials to customers inside and outside of Alabama during the period.

The parties stipulated that the Taxpayer did not maintain a general inventory or "stock of goods" during the audit period from which it made sales and also withdrew materials for use on the furnish and install contracts. Rather, it special ordered the structural steel and related materials as needed for each furnish and install or sales contract. The steel and related materials were physically segregated at the Taxpayer's

Alabama facility by specific job. The Taxpayer subsequently fabricated the materials, if required, and then either sold the materials to a customer or used them on a furnish and install contract with a customer.

The Taxpayer performed 47 furnish and install contracts outside of Alabama and 28 in Alabama during the audit period. It also entered into 17 sales contracts during the period, i.e., the Taxpayer provided but did not also install the steel and related materials. Fourteen of those sales were to one customer located outside of Alabama. The remaining sales were to in-state customers. The Taxpayer did not also erect the steel concerning the sales to the out-of-state customer because the customer was required to use local union labor to erect the steel.

The Taxpayer did not have an Alabama sales tax license during the audit period. It sometimes paid Alabama sales tax to its vendors when it purchased the structural steel and related materials during the period. It paid Alabama use tax to at least one out-of-state vendor during the period. It also sometimes purchased the materials tax-free using an exemption certificate issued by the Department in November 2000.[1] The Taxpayer's owner explained at the December 1 hearing that the company's purchasing agent used the certificate to purchase materials tax-free on furnish and install contracts performed outside of Alabama or for tax-exempt entities in Alabama.

The Taxpayer inquired with the Department in October 2005 about how it should pay tax on materials used on its out-of-state furnish and install contracts. The Taxpayer's October 2005 inquiry letter to the Department is not in evidence. It is presumed, however, that the Taxpayer inquired about how it should pay use tax on structural steel purchased outside of Alabama, delivered into Alabama and fabricated by the Taxpayer, and then used

on furnish and install contracts outside of Alabama. The Department's October 11, 2005 response, a copy of which was attached to the Taxpayer's notice of appeal, stated that materials purchased for out-of-state jobs are subject to Alabama use tax when the materials are delivered (presumably from outside of Alabama) to a location in Alabama. The response further indicated, however, that if the Taxpayer intended to use the materials in another state at the time they came to rest in Alabama, Alabama use tax would not be due pursuant to the temporary storage regulation, Dept. Reg. 810-6-5-.23. In that case, the Taxpayer could petition for a refund of any Alabama use tax previously paid on the materials.

The Taxpayer subsequently filed 49 joint petitions for refund with the Department concerning the period in issue. Nine joint petitioners/vendors were involved. Eight were located in Alabama, and one was outside of Alabama. The Taxpayer had paid Alabama sales tax to the eight Alabama vendors, and Alabama use tax to the one out-of-state vendor. According to the Department's audit report, the petitions requested refunds for the "taxes paid on items which were sold at retail (outside of Alabama) as well as items which were used on furnish and install contracts outside of Alabama." Department Ex. 1 at 2. The basis for the petitions was that the items in issue were not subject to Alabama tax under the use tax temporary storage regulation.

A Department examiner reviewed the petitions and discovered that the Taxpayer had performed numerous taxable jobs on which it had erroneously purchased the steel and related materials tax-free using its exemption certificate. She consequently audited the Taxpayer for the four year period in issue, not the usual three year period, because the Taxpayer had not filed sales tax returns during the period. See, Code of Ala. 1975, §40-

2A-7(b)(2)a., which allows the Department to assess a taxpayer "at any time if no return is filed as required."

The examiner determined that the Taxpayer had operated as a "dual business" during the audit period because it both sold structural steel and related materials at retail, and also used the steel and materials on furnish and install contracts during the period. As discussed below, if a taxpayer sells items at retail and also withdraws items for use from the same stock of goods, the taxpayer is a dual business operator, and should purchase all items tax-free at wholesale using its Alabama sales tax license number. It should then report and pay sales tax on the sales price of the items sold at retail, and on its cost of the items withdrawn for use, and not resold. See, Dept. Reg. 810-6-1-.56; *American Chalkboard Company, LLC v. State of Alabama*, Docket S. 99-473 (Admin. Law Div. 10/3/2000).

The examiner concluded that because the Taxpayer was a dual operator, it owed sales tax under the sales tax withdrawal provision at Code of Ala. 1975, §40-23-1(a)(10) when it withdrew the steel and materials from inventory in Alabama and subsequently used the items on the furnish and install contracts. Sales tax is due under the withdrawal provision when and where the property is withdrawn from inventory. *City of Huntsville v. City of Madison*, 628 So.2d 584 (Ala. 1993). The Department accordingly taxed the Taxpayer on its cost of the materials withdrawn from inventory in Alabama and used on the furnish and install contracts, and on which sales tax had not been paid, regardless of whether the contracts were performed inside or outside of Alabama. It also assessed the Taxpayer on a small number of taxable sales to Alabama customers on which the Taxpayer had failed to pay sales tax.

Concerning the refund petitions, the examiner denied the petitions relating to the sales tax paid on the materials used on the furnish and install contracts because, according to the examiner, Alabama sales tax was due under the withdrawal provision when the Taxpayer withdrew the materials used on the contracts from inventory in Alabama, regardless of where the materials were later installed. The examiner agreed that refunds were due for the sales tax paid by the Taxpayer on the steel and related materials that were sold to the one out-of-state customer – "Those petitions will be reduced to include only those purchases which were for resale outside of Alabama. The amounts determined to be refunded will be applied to the state and local tax audit liabilities." Department Ex. 1 at 3.

The Taxpayer argues that it was not a dual operator during the audit period because it did not maintain a general inventory of materials, and thus did not make retail sales and also withdraw materials for use "from the same stock of goods," as required for the dual business regulation to apply, see Dept. Reg. 810-6-1-.56(1). It also contends that it did not have a "substantial number of retail sales" during the audit period, as also required for the dual business regulation to apply, see Dept. Reg. 810-6-1-.56(3). It asserts that in determining if it had a substantial number of retail sales during the subject period, only sales in Alabama should be considered.

This case is another example of how complicated Alabama's sales and use tax laws can be to understand and follow.[2] The below analysis will give the Taxpayer guidance as to how to report and pay Alabama sales and use tax in the future.

To begin, I agree with the Taxpayer that the dual business regulation does not apply because the parties stipulated that the Taxpayer did not maintain a general inventory of structural steel and related materials during the assessment period from which it both made

retail sales and also withdrew materials for use on the furnish and install contracts. The rationale behind the dual business regulation is that if a business maintains a general inventory of goods from which it both makes retail sales and also withdraws items for use or consumption, the business cannot know when it purchases the inventory items how they should be taxed. In such cases, the dual business regulation requires the business to purchase all inventory items tax-free at wholesale using its Alabama sales tax number. The business is then required to report and pay sales tax on the retail sales price, if it sells an item at retail, or on its cost, if it withdraws an item from inventory to complete a furnish and install contract, or otherwise.

The dual business regulation, at Dept. Reg. 810-6-1-.56(1), provides that "'dual business' as used in this rule shall mean a business which both makes retail sales of tangible personal property to the public on a recurring basis and withdraws tangible personal property for use *from the same stock of goods*" (emphasis added). Because the Taxpayer did not maintain a general stock of goods during the subject period from which it both made sales and also withdrew materials for use, it was not a dual business. Rather, the Taxpayer special ordered the steel and related materials only after it had contracted with a customer. The Taxpayer thus knew when it purchased the materials whether the materials would be used on a furnish and install contract or resold to a customer. The dual business regulation does not apply in such cases where the purchaser knows when it purchases tangible personal property how the property should be taxed.[3]

The issue of whether the Taxpayer had a "substantial number of retail sales" during the period, as required for the dual business regulation to apply, is pretermitted by the above holding. I note, however, that the Administrative Law Division held in a case

involving a similar percentage of sales versus withdrawals that the taxpayer did have a substantial number of retail sales for purposes of the dual business regulation. *State of Alabama v. Copeland Building Co., Inc.*, Docket S. 90-155 (Admin. Law Div. 8/6/1991), at 4.

The withdrawal provision at §40-23-1(a)(10) provides that a "retail sale" shall include "the withdrawal, use, or consumption of any tangible personal property by anyone who *purchases same at wholesale*. . . ." (emphasis added). The withdrawal provision, which is an integral part of the dual business regulation, thus could not apply in this case because the Taxpayer did not have an Alabama sales tax license during the audit period, and consequently could not have purchased the materials in issue at wholesale, as required for the withdrawal provision to later apply. See, Code of Ala. 1975, §40-23-1(a)(9)a., which defines "wholesale sale" to include "[a] sale of tangible personal property by wholesalers to *licensed retail merchants*. . . ." (emphasis added).[4] See also, *State of Alabama v. The Advertiser Company*, 337 So.2d 942 (Ala. Civ. App. 1975), in which the Court of Civil Appeals held that the Montgomery Advertiser's sale of newspapers to unlicensed newscarriers constituted taxable retail sales, even though the newscarriers resold the papers to the public.

Even though the Taxpayer was not a dual business during the audit period, it is still liable for sales tax on the steel and materials purchased in Alabama for use on the furnish and install contracts under the sales tax "contractor" provision at Code of Ala. 1975, §40-23-1(a)(10). That provision provides that "[s]ales of building materials to contractors, . . . for resale or use in the form of real estate are retail sales in whatever quantity sold." The Taxpayer was clearly a contractor when it purchased the steel and related items, i.e., building materials, and subsequently erected the materials in the form of real estate. The

Taxpayer thus should have paid sales tax when it purchased the materials from its Alabama vendors. It is irrelevant that some of the materials were later installed outside of Alabama. See generally, *Dept. of Revenue v. James A. Head & Co., Inc.*, 306 So.2d 5 (Ala. Civ. App. 1974), cert. denied 306 So.2d 12.

Concerning the materials the Taxpayer purchased from the one out-of-state vendor, if the Taxpayer intended to use the materials on an out-of-state furnish and install contract when the materials were brought into Alabama for fabrication, the Department's October 11, 2005 letter to the Taxpayer is correct that Alabama use tax would not be due under the use tax temporary storage exemption, Dept. Reg. 810-6-5-.23. See also, *C & S Components, Inc. v. State of Alabama*, Docket S. 01-300 (Admin. Law Div. O.P.O. 2/15/2002). (Convenience store canopy components purchased by an Alabama contractor outside of Alabama, brought into and fabricated/assembled by the contractor in Alabama, and then installed by the contractor outside of Alabama were not subject to Alabama use tax under the temporary storage regulation.)

Concerning the Taxpayer's sales to the one out-of-state customer, and also the few sales it made to in-state customers, the Taxpayer should have purchased those materials tax-free at wholesale for resale using an Alabama sales tax number. No Alabama sales tax would have been due if the materials had been purchased at wholesale and then resold at retail outside of Alabama. Sales tax would have been due if the materials were resold at retail in Alabama to a non-exempt customer.

As explained below, the Department also correctly assessed the Taxpayer for sales tax on the steel and materials that the Taxpayer had improperly purchased tax-free using its exemption certificate.

When a purchaser fails to pay sales tax on a taxable purchase of tangible personal property in Alabama, the Department can as a general rule only assess sales tax against the seller that failed to collect and remit the tax, although it can assess the purchaser for Alabama use tax if the purchaser subsequently uses, stores, or consumes the property in Alabama. "If (an Alabama) vendor fails to charge sales tax, the vendor remains liable and the Department may assess the vendor for the sales tax due. But the (purchaser) is also liable for any State (and any applicable local) use tax on its subsequent use or consumption of the property . . . in Alabama." *Crown Housing Group, Inc. v. State of Alabama*, Docket S. 06-399 (Admin. Law Div. O.P.O. 7/26/2007) at 16.

This case involves an exception, however, because Alabama law allows the Department to assess sales tax against the purchaser if the purchaser improperly purchased the property tax-free using an exemption number. Code of Ala. 1975, §40-23-121 authorizes the Department "to collect or recover any sales tax due on purchases made illegally with state tax exempt numbers from the party or parties using such number. . . ." See also, Dept. Reg. 810-6-5-.02(14), which provides that §40-23-121 "will be enforced by the Department in the same manner as the state sales or use tax law, as the case may be, is enforced, including but not limited to the power to examine purchasers' records; assess tax, penalty, and interest; and file tax liens." The Department was thus allowed to assess the Taxpayer for the sales tax due on the structural steel and materials the Taxpayer erroneously purchased tax-free using its exemption certificate. As indicated, the Department also correctly assessed the Taxpayer on the materials it sold to non-exempt customers in Alabama, and on which no sales tax was paid. The final assessments in issue correctly show the additional tax owed by the Taxpayer, and are due to be affirmed.

The Taxpayer should report and pay sales tax as follows in the future, assuming it continues to contract with its customers before purchasing the steel and other materials, and thus knows when it purchases the materials whether it will resell the materials at retail or use them on a furnish and install contract.

The Taxpayer should obtain a sales tax license from the Department. It should then purchase items tax-free at wholesale using its tax number when it purchases items that it knows will be resold to its customers. It should report and remit sales tax on those taxable retail sales closed in Alabama. Alabama sales tax would not be due on sales closed outside of Alabama, or on sales in Alabama that are exempt from sales tax.

When the Taxpayer purchases steel and other building materials in Alabama for subsequent use on furnish and install contracts, it should, as discussed, pay sales tax to the vendor at the time of purchase under the §40-23-1(a)(10) contractor provision. Because the taxable sale is closed in Alabama, it is irrelevant that the materials may later be installed outside of Alabama. *American Cast Iron Pipe Co. v. Boswell*, 350 So.2d 438 (Ala. 1977). If the Taxpayer purchases materials outside of Alabama, brings them into Alabama for fabrication, and then uses them on a furnish and install contract outside of Alabama, the materials would not be subject to Alabama use tax under the temporary storage regulation. (Sales or use tax may be due, however, in the state where the materials are purchased or where they are installed, depending on the particular laws in those states.) If the Taxpayer purchases materials outside of Alabama and then uses them on a contract in Alabama, Alabama use tax would be due. The Taxpayer would, however, be allowed a credit against the Alabama tax due for any sales or use tax paid on the property by the Taxpayer to the out-of-state seller. Code of Ala. 1975, §40-23-65.[5]

Concerning the Taxpayer's refund petitions, the Department denied the petitions concerning the tax paid on the steel and related materials used on the furnish and install contracts. It also determined that the sales tax paid by the Taxpayer on the items sold to the out-of-state customer is due to be refunded, and that any refund due on those transactions will be applied to offset any additional tax due per the final assessments in issue.

This case involves the Taxpayer's appeal of the two disputed final assessments. In appeals involving final assessments, the Administrative Law Division is authorized to "increase or decrease the (final) assessment to reflect the correct tax due." Code of Ala. 1975, §40-2A-7(b)(5)d.1. As indicated, the amounts shown on the final assessments in issue correctly show the additional tax owed by the Taxpayer. Consequently, no increase or decrease in the final assessments is warranted.

The Taxpayer did not appeal its partially denied refunds to the Administrative Law Division. Consequently, while it may be self-evident from the above analysis, the Division cannot address whether the Department correctly denied the refunds of the tax paid on the steel and materials used on the furnish and install contracts, or whether it correctly determined that refunds are due on the steel and materials sold by the Taxpayer to its one out-of-state customer. See also, *Rheem Mfg. Co. v. State, Dept. of Revenue*, 33 So.3d 1 (Ala. Civ. App. 2009), which further limits the Administrative Law Division's jurisdiction to address issues in refund cases.

Judgment is entered against the Taxpayer for State and local sales tax of $55,590.62 and $35,435.53, respectively, plus additional interest from June 10, 2010. [6] Those amounts should be offset by the State and local refunds due as determined by the

Department pursuant to its audit.

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

Entered April 26, 2012.

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BILL THOMPSON
Chief Administrative Law Judge

bt:dr
cc: David E. Avery, III, Esq.
Michael K. Wisner, Esq.
Joe Walls
Mike Emfinger

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[1] The Department issued the Taxpayer the exemption certificate so that the Taxpayer could purchase certain materials tax-free pursuant to the contractor exemption at Code of Ala. 1975, §40-9-33, which became effective October 1, 2000. That statute exempted from Alabama sales and use tax all materials purchased and used by a contractor on contracts entered into with the State and other governmental entities. The exemption was repealed by Act 2004-638, effective July 1, 2004, but the exemption continued to apply to any materials purchased for use on qualifying contracts entered into before the repeal date. The Department examiner testified at the December 1 hearing that the Taxpayer continued to apply for renewal of the exemption certificate after the exemption was repealed, even though it no longer had qualifying contracts with any governmental entities.

[2] "Sales and use taxes are viewed by the general public as the simplest taxes to understand. They can, however, be the most difficult to administer." *Kykenkee, Inc. v. State of Alabama*, Docket S. 01-618 (Admin. Law Div. O.P.O. 5/7/2002) at 3. The complicated nature of Alabama's sales and use tax laws, especially as they relate to contractors, manufacturers, etc., is also illustrated by the holdings in *Crown Housing Group, Inc. v. State of Alabama*, Docket S. 06-399 (Admin. Law Div. O.P.O. 7/26/2007), and *American Chalkboard Company, LLC v. State of Alabama*, Docket S. 99-473 (Admin. Law Div. 10/3/2000), among others.

[3] The Department suggested at the December 1 hearing that a business should not pay sales tax on some purchases and make other purchases tax-free because the business could not keep proper records of the transactions. (T. 22). I disagree. The Taxpayer in this case and all similarly situated businesses could easily keep records showing that sales tax was paid to a vendor for materials purchased for use on a furnish and install contract, and also records showing that materials intended for resale were purchased tax-free using a sales tax number and later resold at retail.

[4] The Department audit report, at 6, states that "[t]hese purchases (by the Taxpayer) were made at wholesale using an exemption certificate." But a wholesale sale occurs only when property is sold to a licensed retail merchant for resale. Section 40-23-1(a)(9)a. A tax-free sale to an unlicensed purchaser using an exemption certificate, i.e., the Taxpayer in this case, thus technically does not constitute a wholesale sale, regardless of whether the certificate is properly or improperly used.

[5] Various statements by the Department also should be addressed so as to clarify the law in this area. To begin, the Department asserts on Page 3 of its Initial Brief that "[t]he (refund) petitions were assigned to the field . . . to determine if the Taxpayer was a contractor subject to the use tax laws or a dual business with sales and withdrawals subject to the sales tax laws." (emphasis in original). That statement is incorrect because, as discussed, the Taxpayer was a contractor during the subject period, and was thus liable for Alabama sales tax, not use tax, under the contractor provision when it purchased the steel and materials used on the furnish and install contracts from its vendors in Alabama.

The Department asserts on page 6 of its Initial Brief that "[t]he Taxpayer's positions are tax motivated." That statement at least implies that the Taxpayer intentionally attempted to avoid if not evade Alabama sales tax during the audit period. I disagree.

Alabama's sales and use tax statutes relating to contractors, dual business operators, withdrawals from inventory, etc. are complex and difficult to understand, as illustrated by this case. See also, n. 2. The Taxpayer's owner previously operated another structural steel business that was involved in a prior appeal before the Administrative Law Division. See, *Scottsboro Structural Steel, Inc. v. State of Alabama,* Docket S. 92-282 (Admin. Law Div. O.P.O. 5/1/1996). The Division ruled in that case that the taxpayer was not liable for Alabama tax on the disputed steel and materials in issue based on a 1983 amendment to the withdrawal provision that was in effect during the period in issue, April 1987 through December 1989. But the Taxpayer's owner could not have learned from that case how to report and pay sales and use tax during the period in issue in this case because (1) the withdrawal provision was later amended and returned to its pre-1983 language before the period in issue, and (2) the taxpayer in the prior case had a sales tax number, and thus, unlike the Taxpayer in this case, could purchase all steel and materials at wholesale.

The Taxpayer also inquired with the Department in 2005 concerning how it should report and pay tax on its contracts, which shows it was attempting to understand and comply with Alabama's sales and use tax laws. The Taxpayer subsequently petitioned for refunds for some of the tax it had paid after receiving the Department's October 2005 response to its inquiry. The claimed refunds total $300,000 - $400,000 (the exact amount is not in evidence), and the Department concedes that the Taxpayer had "substantial" sales to the one out-of-state customer concerning which refunds are due. The amount of the refunds that the Department concedes is due is also not in evidence, but the total could easily exceed the additional tax due as assessed by the Department and affirmed by this Order. The Taxpayer, or any other individual or business, certainly would not overpay tax if it was

intentionally attempting to avoid or evade tax.

The Department also did not assess the Taxpayer for the fraud penalty, the negligence penalty, or any other penalty, which indicates that the examiner and the reviewing assessment officer did not believe that the Taxpayer was intentionally attempting to evade its correct liability.

It could be argued that any position taken by a taxpayer in a tax appeal is "tax motivated." In this case, however, it is clear that the Taxpayer's owner and the purchasing agent that incorrectly used the exemption certificate simply did not understand Alabama's complicated sales and use tax laws.

The Department argues on page 7 of its Initial Brief that "[t]his Taxpayer incorrectly expenses its inventory on a cash basis," and that its "method of inventory accounting violated IRC §471 and distorts its income and tax reporting requirements," see page 7, n. 8. The Department continues on page 8 that "[w]hether or not this Taxpayer has inventory of unused materials is not dependent on the accounting method chosen. This Taxpayer has inventories for both its retail sales and for its furnish and install business that is purchased from the same vendor and that is physically indistinguishable one from the other under the Taxpayer's accounting system."

I agree that the Taxpayer's chosen method of accounting has no bearing on whether it was operating a dual business for sales tax reporting purposes during the audit period. Rather, the determining factor was whether the Taxpayer maintained a general inventory or stock of goods from which it made retail sales and also withdrew materials for use on its furnish and install contracts. Clearly, it did not. The parties stipulated that the Taxpayer did not maintain a general inventory or stock of goods during the period, and the evidence supports that stipulated fact. The Department examiner also found that "[t]he structural steel is not a stock item." Department's audit report at 5.

I also agree with the Taxpayer that the fact that it may have purchased materials from the same vendor that were later sold by the Taxpayer and also used on furnish and install contracts has no bearing on whether the Taxpayer maintained a general inventory of materials, as required for the dual business regulation to apply. There is also no evidence supporting the Department's claim on page 8 of its Restated Answer that "[t]he reality is that at times items that are purchased for one job are sometimes used on another job." Rather, the evidence shows just the opposite, as does the joint stipulation, which specifies that "[a]ll materials are purchased by the Taxpayer for specific jobs . . ., and are physically segregated for the job for which purchased until used in the performance of the job." Nor is it relevant that some of the steel and materials sold by the Taxpayer were indistinguishable from the steel and materials used on the furnish and install contracts.

[6] The individual LLC members are not liable for the sales tax in issue pursuant to the Administrative Law Division's holding in *Kingsley v. State of Alabama*, Docket Inc. 09-1194

(Admin. Law Div. 4/15/2010). The Department appealed that case to the Jefferson County Circuit Court. *State of Alabama v. John R. Kingsley,* CV-2010-901445, filed 4/29/2010. The Court subsequently dismissed the case, and the Department did not appeal. The Department now concedes that multi-member LLC members are not personally liable for the non-income taxes owed by the LLC.