

ALABAMA DEPARTMENT OF REVENUE
REVENUE RULING 00-004

This document may not be used or cited as precedent. Code of Ala. 1975, §40-2A-5(a) (1998 Replacement Volume).

TO:

FROM: Commissioner of Revenue
Alabama Department of Revenue

DATE: September 22, 2000

Re: Application of state-administered local taxes to inventory items temporarily stored in company warehouses for use or consumption in other localities and the determination of local use tax liability through the apportionment of inventory based on its usage in localities within the Company's service area.

FACTS

The facts as presented by the Company are as follows:

The Company operates warehouses throughout its service territory in jurisdictions for which the Alabama Department of Revenue administers the local county and municipal sales and use taxes. Company uses these warehouses to store temporarily field equipment and supplies such as transformers, wire, and utility poles. From time to time, inventory items will be issued from a warehouse for use typically in the localities adjacent to the warehouse. The inventory items, however, are commonly used or consumed by Company anywhere within the approximate one hundred and seventy-five (175) local jurisdictions the Company serves.

Some of the items temporarily stored in the warehouses will be issued for use at a specific destination. For instance, when a larger piece of equipment such as a transformer malfunctions or a utility pole breaks within Company's service territory, Company will issue an appropriate replacement from one of its warehouses to the job repair site. Other items are issued from a warehouse without a specific destination

identified at the time of issuance. For example, inventory items are constantly issued from warehouses as field stock on the Company's trucks, which are used to perform the ongoing routine maintenance and repair to the Company's transmission and distributions systems throughout its service territory. During a typical day, Company's employees will use the field stock to perform repairs and maintenance in several different cities and perhaps in more than one county, especially when storm damage has occurred.

Company purchases the equipment and supplies temporarily stored in these warehouses from out-of-state and in-state vendors. Most of the purchases are initially stored at the Company's central warehouse in an unincorporated area of an Alabama County before being transferred to its other warehouses across the state as needed. Other inventory items are delivered directly to the individual warehouses.

All purchases of inventory are made without the payment of sales tax or use tax to vendors pursuant to a direct pay permit issued to Company by the Alabama Department of Revenue. In accordance with the direct pay permit, Company calculates and remits to the Department of Revenue local use taxes on a monthly basis. Company calculates its monthly local use tax liabilities by determining the total amount of inventory items issued from its warehouses during the month and apportioning the total amount to the counties and municipalities within its service area based upon the number of customers within each locality. The Company then applies the appropriate local use tax rates to the apportioned amounts to determine its local use tax liabilities. The local tax returns filed by Company with the Department for localities administered by the Department are based on this apportionment methodology.

ISSUES

(1) Is Company required to report and remit local use taxes to the locality in which items of tangible personal property are initially stored in Company warehouses at the time of issuance or to the locality in which the warehouse items are ultimately used or consumed by the Company in its trade or business?

(2) If local use taxes properly accrue at the time warehouse items are ultimately used or consumed by Company in its trade or business, is the Company's method of apportioning materials among the various localities within its service area based upon the number of customers a permissible, valid, and reasonable method of determining the amount of tangible personal property used within each locality for which the Department of Revenue administers local taxes?

LAW AND ANALYSIS

(1) The Company has purchased the inventory items temporarily stored in its warehouses without the payment of local state-administered sales and use taxes to its in-state and out-of-state vendors in accordance with a direct pay permit issued to it by the Department of Revenue. The direct pay permit was issued to the Company pursuant to Department Regulation §810-6-4-.13. Under this regulation, the Department may issue a direct pay permit to an electric utility and other similar businesses if the Department finds that it is "practically impossible" for the utility or its vendors to determine with any degree of certainty the applicability of state-administered local taxes at the time of purchase and where the direct pay permit would facilitate and expedite the collection of taxes by the consumer. Ala. Dept. of Rev. Reg. § 810-6-4-.13(2) (amended 1998). A direct pay permit allows a utility to purchase tangible personal property without the payment of sales tax or seller's use tax to its vendor and the vendor is accordingly relieved of its normal collection responsibilities.

In issuing Company a direct pay permit, the Department found that it would be practically impossible for the Company or its vendors to accurately assess the applicability of local taxes at the time of purchase. For example, the Department agrees that the Company is unable to determine at the time of purchase which purchases of inventory qualify for the reduced local sales or use tax rates typically available for machinery and equipment used in processing tangible personal property within the meaning of §40-23-2(3) and §40-23-61(b) and which purchases are subject to the local general sales or use tax rates. Rather, the Company is only able to determine the proper local sales or use tax rates applicable to its inventory purchases when these items are used or consumed in its trade or business. The Department has also determined that the issuance of a direct pay permit to the Company would facilitate and expedite the collection of local taxes from the Company.

The direct pay permit requires the Company to report and remit state-administered local taxes to the Department of Revenue on a monthly basis. The local taxes must be paid on or before the twentieth day following the tax reporting period during which the tangible personal property was "used for a taxable purpose". Reg. §810-6-4-.13(2)(b). Since the promulgation of this regulation, the Department has consistently ruled that tangible personal property is "used for a taxable purpose" within the meaning of §810-6-4-.13(2)(b) when it is used or consumed by the holder in its trade or business.

The initial storage of the tangible personal property, or the issuance of the items from the warehouse, is not a taxable event under the regulation since this would not lead to an accurate assessment of local taxes. For example, a permit holder may not be able to classify its tangible personal property at the time of storage or upon issuance as property eligible for the reduced local rates for machinery and equipment. This determination may only be made when the tangible property is actually used or consumed. Similarly, the Company issues inventory items as field stock on Company

trucks. The Company is not able to determine the classification of the property, and the appropriate local rates, until the field stock is actually used or consumed by the Company. Thus, based on Reg. § 810-6-4-.13, local taxes should be reported and remitted by the Company to the Department of Revenue for the counties and cities in which the Company ultimately uses or consumes the inventory items issued from its various warehouses. The Company does not owe state-administered local taxes under the direct pay permit regulation to the jurisdictions in which the warehouse items are initially stored unless the warehouse property is actually used within that locality.

Regulation §810-6-4-.13 was promulgated by the Department pursuant to Section 40-23-31, Alabama Code (1975). Section 40-23-31 specifically authorizes the Department of Revenue to adopt rules and regulations providing for the issuance of direct pay permits to utilities such as the Company in instances where the Department determines that it is practically impossible for a utility or its vendors to determine the applicability of local taxes at purchase and to facilitate and expedite the collection of tax due from the utility. Regulation §810-6-4-.13 reflect's the Department's administrative determination that the payment by the Company of local taxes based upon the location of the actual use of tangible personal property and not the location of the property's initial storage promotes the accurate and efficient collection of local taxes.

Regulation §810-6-4-.13 embodies a reasonable and long-standing interpretation of the State's taxing statutes. With respect to the Company, the State Department of Revenue has audited and approved Company's payment of local use tax under its direct pay permit based upon the location of the use of the tangible personal property, and not the location in which the items are initially stored, for more than twenty years. Accordingly, the direct pay permit regulation, and the Department's practice with respect to it, must be given considerable weight, especially where the legislature has amended the controlling statutes without overruling the Department's interpretation. See Hamm v. Proctor, 198 So. 2d 782, 784-88 (Ala. 1967); Boswell v. Abex Corp., 317 So.2d 317, 318 (Ala. 1975) (A long-standing, administrative interpretation of a statute that is fair and reasonable is entitled to favorable interpretation by the courts); Alabama v. City of Montgomery, 485 So.2d 695, 698 (Ala. 1986) (An administrative interpretation is fair and reasonable if the statutory language is reasonably susceptible to the administrative department's interpretation); See also State v. Southern Elec. Generating Co., 151 So. 2d 216 (Ala. 1963) (following a long-standing and favorable State Department of Revenue construction of a license tax statute with respect to a Company subsidiary). The Alabama Legislature has repeatedly amended the use tax provisions of the Code of Alabama 1975 without overruling the Department's direct pay permit regulation and practice. See 1987 Ala. Acts No. 87-647 § 1; 1988 Ala. Acts No. 88-867 § 3; 1989 Ala. Acts No. 89-920 § 2; 1991 Ala. Acts No. 91-546 § 1. The Legislature has, thus, implicitly approved of the Department of Revenue's direct pay permit and practice for more than 20 years. Since there is no evidence that Regulation §810-6-4-.13 is unreasonable, the Company must continue to report and remit state-administered local taxes based upon the actual use of its inventory items.

Even if the storage of the inventory items could be viewed as a possible taxable event under the direct pay permit regulation, the Company's inventory items would qualify for the "temporary storage" exception from local use tax. In general, section 40-23-61, Alabama Code (1975), imposes a State use tax on the "storage, use or other consumption in this state of tangible personal property ... purchased at retail... ". Section 40-23-60(7), Code of Alabama 1975, defines "storage" to mean, "any keeping or retention in this state *for any purpose except* sale in the regular course of business or *subsequent use solely outside this state*". (emphasis added). This section provides for a "temporary storage" exception from state use tax for any property brought into this State which is intended for use or consumption solely outside Alabama.

In State v. Toolen, 277 Ala. 120, 167 So. 2d 546 (1964), the Alabama Supreme Court stated that a use tax liability attaches after the act of transportation ends and the property comes to rest in this state for use or consumption unless there is a contractual intent to the contrary. Thus, the Court in Toolen recognized that the temporary storage exception is available for tangible personal property stored in Alabama for which a taxpayer can demonstrate an intent to use the property outside of this state.

The Department has issued regulations at 810-6-5-.23 implementing the temporary storage exception. Reg. 810-6-5-23(3) states that "in order for property to be claimed as tax free because of temporary storage for use solely outside of Alabama, records must reflect that it was the intent of the purchaser to use the property in another state at the time of its coming to rest in Alabama. Also, records must reflect that, in fact, the property was removed from Alabama. "

The definition of "storage" in §40-23-60(7), Ala. Code (1975), appears in the state use tax statutes, which are found in Article II of Chapter 23 of Title 40. Department Regulation 810-6-5-.23 describes the temporary storage exception with respect to state use taxes as well. However, the Department is required to recognize and apply a similar temporary storage exception for local use taxes administered by the Department. Section 11-51-202 provides that incorporated cities and towns are authorized to provide for a municipal "use tax parallel to the state...use taxes..." Section 11-51-203 provides that the taxes levied pursuant to §11-51-202:

shall be subject to all definitions, exceptions, exemptions, proceedings, requirements, provisions, penalties, fines, punishments and deductions as are provided by Article 2 of Chapter 23 of Title 40,...

Therefore, pursuant to §40-23-60(7) and Reg. 810-6-5-.23, the temporary storage of tangible personal property within a locality should not be a taxable event for local use tax purposes if the taxpayer intends to use the property outside the locality. Rather, local use tax is owed to the locality in which the stored items are ultimately used or consumed.

Accordingly, Company should not be liable for use tax to those localities in which it temporarily stores inventory within its various warehouses if the requirements of Reg. 810-6-5-.23(3) are met. Reg. 810-6-5-.23(3) requires a taxpayer to maintain records evidencing an intent to use the property in another state. By analogy, in the case of local use tax, if Company can demonstrate a purpose or intent to use the warehoused items outside of the locality in which they are stored, then the initial storage of the items should not constitute a "storage" triggering local use tax liability.

Generally, intent must be shown objectively by contractual documents indicating a destination outside of a particular locality. See Toolen, 167 So. 2d at 551. Toward this end, Department of Revenue Regulation 810-6-5-.23(3) provides that temporary storage intent may be demonstrated by records that show an intent to use the item outside of Alabama and requires the item to be in fact used out of the state. Many taxpayers, including retailers and construction contractors, can show objective intent to use property outside the taxing jurisdiction by contract documents or other written records. However, in cases where the nature of the taxpayer's business precludes a specific determination of the location at which an item will be used outside the taxing jurisdiction, a rule of reasonableness is applied.

The Administrative Law Division has held that Department of Revenue Regulation 810-6-5-.23 must be applied reasonably. In State v. Wilbro Company, Inc., Dkt. No. 86-245, 1987 WL 58149 (Oct. 14, 1987), the taxpayer shipped large numbers of catalogs and flyers into Alabama, randomly assigned mailing labels to the catalogs, and then shipped them to their ultimate destinations. Upon the arrival of the catalogs in Alabama, the taxpayer's records reflected the percentage of catalogs that would be used outside of Alabama. Id. The taxpayer's records did not, however, reflect the specific destination of each catalog. Id. This was because the random assignment of mailing labels made it impracticable to determine which specific catalog would end up in which state at the time of that catalog's initial arrival in Alabama. Id. Because the facts showed that a certain percentage of the catalogs would end up outside Alabama, the Administrative Law Division held that it was reasonable to apply the temporary storage exception, even without a written contract showing an out-of-state usage intent. Id.

Similarly, Company's records indicate that a significant percentage of inventory items stored within its warehouses will be used and consumed within another locality within this state. Based on the holding in Wilbro Company, it is reasonable to apply the temporary storage exception to the Company's inventory items. Local use tax administered by the Department should be due to those state-administered localities where the warehouse items are consumed by the company in its trade or business.

(2) The Company is required under Regulation §810-6-4-.13 to report and remit local taxes based upon the actual use of its tangible personal property. It is practically impossible, however, for the Company to specifically determine in many situations where each item of tangible personal property issued from its various warehouses is used or consumed for local use tax purposes during the course of its trade or business.

The Company operates in more than 175 cities and counties within its service territory. The Company's transmission and distribution systems, for example, are located within multiple cities and counties. Often, a distribution system will meander through several different cities within the span of a few miles. A repairman performing maintenance to these systems is not able to accurately assess the particular location of each item of tangible personal property used to perform the repairs.

Moreover, the Company often needs to quickly restore electrical power to a large number of its residential and commercial customers in several jurisdictions at once as a result of storm damage. In these situations, the Company may have hundreds of employees in the field attempting to repair the damage and a significant amount of inventory will be issued from one or more Company warehouses as replacement parts and supplies. The Company's employees need to be able to move quickly from site to site as they restore electric service to customers and, in these emergency situations, they are not in the position to verify the exact location of tangible personal property used or consumed in the course of the repairs.

A requirement that the Company specifically identify the location of each item of inventory used within each local jurisdiction would impose undue administrative burdens on the Company. An exact determination of the location of each and every inventory item consumed by the Company during the course of its trade or business would require an allocation of enormous resources given the myriad of local jurisdictions in which the Company operates. This requirement could also jeopardize the speedy restoration of power in emergency situations and possibly compromise the health and welfare of its customers.

Based on these facts, the Company is permitted to utilize a method, which reasonably approximates the amount of inventory items used or consumed within each locality within its service area. The Company's method of apportioning inventory usage among the various localities within its service area based upon the number of customers is a method, which fairly and reasonably achieves this result. Accordingly, this method is a permissible, valid, and reasonable method of determining the amount of tangible personal property used within each locality for which the Department of Revenue administers taxes.

RULINGS

(1) In accordance with Reg. §810-6-4-.13, Company should report and remit state-administered local use taxes to the Department for the localities in which the tangible personal property is ultimately used or consumed in its trade or business. The Company does not owe use tax to a locality in which the tangible personal property is stored temporarily if the property is actually used or consumed in another local jurisdiction.

(2) Based on the fact that the company is a utility whose operations throughout Alabama prohibit the Company from specifically determining the localities in which each item of inventory is used or consumed, the Company's method of apportioning inventory usage among the various localities within its service area based upon the number of customers is a permissible, valid, and reasonable method of determining the amount of tangible personal property used within each locality for which the Department of Revenue administers taxes in satisfaction of the requirements of Reg. §810-6-4-.13.

Michael Patterson
Commissioner