

ALABAMA DEPARTMENT OF REVENUE
REVENUE RULING 01-010

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

TO:

FROM: Commissioner of Revenue
Alabama Department of Revenue

DATE: August 15, 2001

RE: Applicability of Alabama sales tax to coating materials withdrawn from inventory and used or consumed by Company "A" when it performs its coating processes on pipes supplied by its customers.

FACTS

The facts as represented by the Requestor are as follows:

Company "A" currently is constructing, in City "X", Alabama, a Facility. Company "A" is investing approximately \$55 million in the Facility which, when completed, primarily will manufacture and apply polypropylene foam, solid polypropylene, glass syntactic polyurethane, pipe-in-pipe polyurethane foam, pipe-in-pipe high efficiency steel outer pipe systems ("coating operations") to piping.

The mission of Company "A" is to deliver a wide range of end-to-end coating solutions, from big-inch anti-corrosion and concrete coatings, to flow assurance solutions including pipe-in-pipe systems and thermal installation systems with integrated anti-corrosion substrates. Although the bulk of Company "A's" operations at the Facility will consist of coating operations, it also will engage in welding, dimensioning and traceability. This is onshore fabrication of multi-joints, pipe-in-pipe, connectors, special pieces, and other pipeline components for offshore use.

With respect to Company "A's" business, the method of operation is that Company "A's" client supplies the pipe and specifies the manufacturing process to be applied to the pipe, depending upon the specific application to which the product will be devoted. Upon completion of the coating process, and the inspection and acceptance of the coated pipe by the customer, the coated pipe is shipped to the customer.

Although Company "A" employs a number of different methods of manufacturing depending upon the type of coating applications specified by its customers, some elements which are common to each process are as follows:

1. Pipe Receipt - The pipes are removed from the stockpile using cranes and vaculift attachments, front loaders with padded forks or cranes with padded hooks. The pipes are placed on the incoming rack and such end rings/caps are removed. Pipe number and length is recorded at this time. Foam cushions are inserted into each pipe end to prevent shot ingress, and the external surface examined for contamination. All contaminants are removed prior to the pipe moving to the next stages of the coating process.

2. Preheat and Surface Preparation - The pipe is then conveyed through a pre-heater prior to entering the blasting unit. The blast unit is stocked with the correct mix of blast media to achieve the required surface profile, and has adequate dust extraction to achieve the required surface cleanliness. Then, if specified, the pipe is subjected to an oakite wash/rinse. The pipes are then visually checked for steel defects. Any minor defects are removed using an air-powered/electric grinder, any major defects which are considered detrimental to the coating and which would be disruptive to production flow, are set aside for further inspection. The pipes are then conveyed through the second blast unit and enter the pipe preparation area,

3. Pipe Preparation - Upon completion of the inspection, the pipes enter the ready racks where the internal bores are blown out using a lance to remove any blast media from the inside of each pipe. End couplings are attached to the leading end of each pipe. The pipes are kicked onto the coating line conveyor and linked by the couplings before passing through the preset induction coils. The coils pre-heat the pipes to the required powder application temperature.

4. Coating Application - The raw materials are introduced to the application system where they are treated in readiness for application. Company "A" makes several types of coating as follows:

Concrete - Company "A" purchases sand, cement, and iron ore which it mixes with measured quantities of water to form a low moisture content concrete. Company "A" also purchases steel reinforcing wire which is fed through a proprietary forming machine, along with the concrete mixture, to produce a tubular casting around a steel pipe which is previously received an anti-corrosion barrier coating. The concrete castings are made in thickness ranging from 1 inch to 6 inches, and

provide negative buoyancy for submarine pipeline. The attachment of concrete coatings directly to the pipes eliminates the need for applying bolt on pipe weights during the installation of pipeline.

Fusion Bonded Epoxy - Company "A" purchases epoxy powder which it then filters, aerates in a fluidized bed, and electrostatically applies to pipes which have previously been cleaned by shot or grip blasting, chemically etched in some cases, and preheated to 450° Fahrenheit. The reaction between the aerated and electrically charged powder and the heated pipe transforms the powder into a liquid which is then rapidly cooled to form a hard solid film of corrosion resistant epoxy on the exterior of the pipe.

Polyethylene and Polypropylene - These products are made by adding an adhesive plus polyethylene or polypropylene over the top of fusion bonded epoxy to form a tubular plastic shielding running the length of the pipe. This type of product gives not only good anti-corrosion protection, but also provides superior protection against physical handling damage during pipeline installation in the field. To make the products, Company "A" purchases polyethylene or polypropylene in pelletized form which it heats and pressurizes in a large extruder to form a molten extrudate. This extrudate is molded through a film die and the resultant film is wrapped around pipes immediately after application of the fusion bonded epoxy coating and held in place with an adhesive which is applied between the protective layers of epoxy and plastic.

Polyurethane Foam - Company "A" purchases liquid isocyanurate and polyol which it combines chemically in a mixer to produce liquid foam. This foam is molten by various methods onto the exterior of a pipe where it forms a solid thermal installation jacket around the pipe. The foam is typically protected from external damage by a polyethylene outer casing which Company "A" makes using an in-line extrusion process similar to those described above.

5. Pipe Identification/Tally - Upon entering the Facility, the pipe number and length of each joint (or double joint) are recorded and entered into the pipe tracking system so that tractability is maintained.

6. Inspection - The coating products are inspected and tested in accordance with the requirements of the specification. Products requiring rework are identified and taken to the rework area. Reject products are indelibly marked "stripper" on the coating surface.

7. Stockpile - Upon completion of inspection, all pipe is removed from the coating plant and stockpiled using cranes with vacuumlifts, front loaders with spreader bars fitted with padded forks or cranes with padded hooks.

ISSUE

Whether Company "A" should be taxed on retail sales under the "withdrawal provision" of Ala. Code § 40-23-1(a)(10), when it withdraws from inventory raw materials previously purchased at wholesale and used or consumed by Company "A" when it performs its coating processes?

LAW AND ANALYSIS

Ala. Code § 40-23-1(a)(10), the "withdrawal provision", reads, in pertinent part as follows:

... The term 'sale at retail' or 'retail sale' shall also mean and include the withdrawal, use, or consumption of any tangible personal property by any one who purchases the same at wholesale, except property which has been previously withdrawn from the business or stock and so used or consumed and with respect to which property tax has been paid because of previous withdrawal, use, or consumption, except property which enters into and becomes an ingredient or component part of tangible personal property or products manufactured or compounded for sale as provided in subsection (9) and not for the personal and private use or consumption of any person so withdrawing, using or consuming the same; and wholesale purchaser shall report and pay the taxes thereon.

In White v. Campbell & Associates, Inc., 473 So.2d 1071 (Ala. Civ. App. 1985), the Alabama Court of Civil Appeals interpreted the Ala. Code § 40-23-1(a)(10), "withdrawal provision" in a case analogous to the instant case. In Campbell, Campbell & Associates filed a petition for refund of taxes paid with the Alabama Department of Revenue. In its petition, Campbell alleged that it had mistakenly paid sales tax assessed against it, under the "withdrawal provision" of Ala. Code, § 40-23-1(a)(10), on materials used by it in the rubberlining process. The Commissioner of Revenue argued that under the wording of Ala. Code § 40-23-1(a)(10), when Campbell withdrew from inventory rubberlining materials which it purchased at wholesale and then used those materials to rubberline objects that belonged to others, and which were subsequently returned to the owner for his use or sale, the withdrawal provision did not fit any of the exceptions to the provisions of Ala. Code § 40-23-1(a)(10), and therefore, must be considered a "retail sale", upon which sales tax must be paid by Campbell, the wholesale purchaser. Id. at 1073.

In tracking Ala. Code § 40-23-1(a)(10), the Court found the following to be true: (1) the rubberlined materials were withdrawn from inventory or used or consumed by Campbell when it performed rubberlining; (2) the materials were previously purchased at wholesale; (3) when applied to an object not owned by Campbell, the materials were personally and privately used in performance of Campbell's business of providing a service. Id. at 1074.

All this being true, the next inquiry became whether Campbell fell within any of the exceptions to the withdrawal provision. In this case, the relevant exception for Campbell was whether the materials entered into or became an ingredient or component part of a product manufactured for sale. Id. Therefore, in order for Campbell to escape retail sales tax upon the withdrawal of materials purchased at wholesale, the materials must have "entered into or become an ingredient or component part of a product manufactured by Campbell for sale." Id.

In rendering its decision, the Court accepted the fact that Campbell manufactured the rubber lining, however, the Court also held that such acceptance did not prevent the Court from coming to the conclusion that the withdrawal and consumption of the manufactured rubber lining in the performance of a personal contract, i.e., the lining of another's property, came within the definition of a "retail sale" as provided by Ala. Code § 40-23-1(a)(10). The Court further distinguished the situation in Ex parte Disco Aluminum Products Company, 455 So.2d 849 (Ala. 1994), by stating that the title to the materials consumed is not transferred or sold. What Campbell sold to its customers that gave it objects to rubberline was not a manufactured rubber lining. Instead, Campbell sold its capability to produce and apply the rubber lining. Campbell at 1075.

Therefore, the Court held in those cases where Campbell rubberlined someone else's product, it fell within the definition of a retail sale, and in those instances the raw materials used in the rubberlining must be taxed at the regular 4% rate upon its costs of raw materials purchased at wholesale. Id.

Similarly, in the instant case, Company "A" is applying its coating processes to pipe supplied by its customer. Such pipe is then returned to the customer after the specified coating process is applied with no transfer of title of the pipe from Company "A's" customer to Company "A". Additionally, Company "A" does not sell the coating processes as a separate product, but instead, sells its capability to produce and apply the coating processes. Thus, Company "A's" withdrawal and consumption of coating materials in the performance of a personal contract to coat another's pipe falls within the definition of a "retail sale" under Ala. Code § 40-23-1(a)(10), and the coating materials previously purchased at wholesale, when withdrawn from inventory, must be taxed to Company "A" at the regular 4% rate upon the cost of purchase at wholesale.

HOLDING

Based on the particular facts of this case, Company "A's" withdrawal and consumption of coating materials, previously purchased at wholesale, and used or

consumed by Company "A" when it performs its coating processes on another's property, falls within the definition of a retail sale under the "withdrawal provision" of Ala. Code §40-23-1(a)(10). These materials must therefore be taxed to Company "A", upon withdrawal, at the regular 4% rate upon the cost of purchase at wholesale.

CYNTHIA UNDERWOOD, Commissioner
Alabama Department of Revenue

CU:MJM:pj