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ALABAMA DEPARTMENT OF REVENUE REVENUE RULING 2012-001

This document may not be used or cited as precedent. Ala. Code §40-2A-5(a) (2011 Replacement Volume).

TO:

FROM: Commissioner of Revenue
Alabama Department of Revenue

DATE: SEPTEMBER 4, 2012

RE: WHETHER A COAL REFINING PLANT QUALIFIES AS A "POLLUTION CONTROL FACILITY" UNDER THE PROVISIONS OF ALA. CODE, §§40-23-4(16) AND 40-23-62(18).

FACTS

The facts as represented by the Requestor are as follows:

Recently, Company A began contemplating a new business venture in the U.S. that involved using new, state of the art technology developed by Company A to upgrade low grade western coals to low moisture, high Btu value fuel. Company A anticipates that this innovative coal refinement technology will increase the energy efficiency generated by the burning of coal and reduce the resulting air pollution and water pollution. If successful, the new technology will address the increasing energy demand in the U.S.

Company A is planning to create and fund a special purpose company, Company X, to construct the first coal refinement plant in the U.S. A proposed site for this demonstration facility is Company B's plant in Alabama ("Coal Refining Plant"). It is anticipated that Company X will contract with Company C for all engineering services and with Company B for the construction site utilities. Construction will be completed by a third party contractor. Company X, therefore, is requesting this ruling in order to determine the proper state tax treatment of the proposed facility and equipment.

Refined coal is the product of a coal-upgrading technology that removes moisture and certain pollutants from lower-ranked coals. It involves a series of treatments and processes that alters coal's characteristics before it is burned. The goal of this technology is to increase efficiency and to reduce hazardous emissions (primarily mercury and particulate matter) when the coal is burned.

Company A would like to proceed with the development of the technology in two phases. During the initial phase, Company X would construct a demonstration plant, which will be used to perform various tests and to gather data to evaluate whether the coal refinement technology can generate the desired outcome. Upon completion of the demonstration plant, it is hoped that the facility can be used to demonstrate the refinement of coal through the processes of dehydration, pyrolysis, dry distillation, and subsequent cooling of raw coal. The demonstration plant, however, is expected to have the capacity to process only 30 tons of raw coal per day; therefore, it would not be operating at a commercial level. This initial phase of the project is anticipated to take approximately one year to complete.

If the coal refining technology increases energy efficiency and reduces pollution as anticipated at the demonstration plant, Company X intends to begin the next phase of the project, which will involve constructing a commercial coal refinement plant in Alabama. Upon completion, the commercial plant is expected to have the capacity to process 9,000 tons of raw coal per day, in a more energy efficient manner than current production.

ISSUE

I. Does the proposed coal refining plant described above qualify as a structure “built primarily for the control, reduction, or elimination of air and water pollution” within the provisions of Ala. Code, §§40-23-4(a)(16) and 40-23-62(18)?

LAW AND ANALYSIS

Company X’s position is that both phases of the coal refining plant, including all devices or facilities, and all identifiable components thereof, or materials for use therein, are acquired primarily for the control, reduction, or elimination of air pollution and, thus, are exempt from sales and use tax. See Ala. Code §§40-23-2(a)(16) and 40-23-62(18).

The Department is aware of the sweeping regulations passed by the United States Environmental Protection Agency (“EPA”) on December 16, 2011 to reduce mercury and other toxic air pollutants from coal and oil fired power plants. Many companies like Company A Japan that provides cost-effective technology that reduces emissions and enables coal fired power plants to meet the new regulations are looking at a potential \$9 billion per year market for emissions control based on EPA’s estimates. In order to determine whether the coal providing plant qualifies as a “pollution control facility,” the Department must review every case on an individual basis to determine whether the facts presented meet the guidelines listed in the law for qualifying for pollution control. First, the Department must determine if the property or equipment controls, reduces or eliminates air or water pollution. Then, the Department must determine if the property is acquired primarily for pollution control purposes and not for a profit-motivated business purpose. Finally, the Department must determine if the property serves to protect the public and the public interest.

Ala. Code, §40-23-4(a)(16) provides an exemption from sales tax as follows:

(16) The gross proceeds from the sale of all devices or facilities, and all identifiable components thereof, or materials for use therein, acquired primarily for the control, reduction, or elimination of air or water pollution and the gross proceeds from the sale of all identifiable components of or materials used or intended for use in structures built primarily for the control, reduction, or elimination of air and water pollution.

A similar exemption from use tax is found in Ala. Code §40-23-62(18), which states as follows:

(18) The storage, use, or consumption of all devices or facilities, and all identifiable components thereof or materials for use therein, used or placed in operation primarily for the control, reduction or elimination of air or water pollution, and the storage, use, or consumption of all identifiable components of or materials used or intended for use in structures built primarily for the control, reduction, or elimination of air or water pollution.

The Department has also issued Sales and Use Tax Rules to aid in the identification of those items that constitute pollution control facilities and devices pursuant to Ala. Code, §§40-23-4(a)(16) and 40-23-62(18). Rule No. 810-6-3-.46, Alabama Department of Revenue – Sales and Use Tax Rules, provides in pertinent part, as follows:

(1) The term "pollution control facilities" shall mean any system, method, construction, device, or appliance appurtenant thereto acquired for the primary purpose of eliminating, preventing, or reducing air and water pollution, or for the primary purpose of treating, pretreating, modifying, or disposing of any potential solid, liquid, or gaseous pollutant which, if released without such treatment, pretreatment, modification, or disposal, might be harmful, detrimental, or offensive to the public and the public interest.

(2) The term "air pollution" shall mean the presence in the outdoor atmosphere of one or more air contaminants or combinations of contaminants in such quantities and of such characteristics, location, and duration which are injurious to the public and the public interest, or which unreasonably interfere with the comfortable enjoyment of life or property or to the conduct of business within affected areas.

(3) The term "air contaminant" shall mean dust, fumes, mist, smoke, other particulate matter, vapor, gas, odorous substances, or any combination thereof.

(4) The term "air contamination source" shall mean any source at, from, or by reason of which there is admitted into the atmosphere any air contaminant regardless of who owns or operates the building, premises, or other property in, at, or on which source is located, or the facility, equipment, or other property by which the emission is caused or from which the emission comes.

(5) The term "water pollution" shall mean the discharge or deposit of sewage, industrial wastes, or other wastes of such condition, manner, or quantity as may cause ground or surface water to be contaminated, unclean, or impure to such an extent to make said waters detrimental to the public and the public interest.

(6) Sections 40-23-4(a)(16) and 40-23-62(18), Code of Alabama 1975, exempt from sales and use tax the sale, storage, use, or consumption of (i) all devices or facilities, including all identifiable components of the devices or facilities and all materials used in the devices or facilities, which are acquired primarily for the control, reduction, or elimination of air or water pollution and (ii) all identifiable components of or materials used or intended for use in structures built primarily for the control, reduction, or elimination of air or water pollution.

(8) To qualify for the pollution control exemption the primary purpose for acquiring tangible personal property purchased, stored, used, or consumed shall be the control, reduction, or elimination of air or water pollution. Property acquired for the primary purpose of controlling, reducing, or eliminating air or water pollution, qualifies for the exemption even though a secondary or incidental purpose may be its use in the production of goods or services. Property which is acquired primarily for the production of goods or services and is integral to a profit-motivated business purpose or activity does not qualify for the pollution control exemption even when the property controls, reduces, or eliminates air or water pollution. (Chemical Waste Management, Inc. v. State, 512 So. 2d 115 (Ala. Civ. App. 1987)) (Adopted March 9, 1970, amended August 16, 1974, readopted through APA effective October 1, 1982, amended July 30, 1998, amended March 14, 2001)

Based on the facts presented in the request, it clearly states that “the primary purpose of the proposed facility is to transform coal into a clean energy source” and a secondary purpose is to implement “the technology on a larger scale, allowing more coal to be converted to a clean energy source...”. Structures built for the furtherance of a taxpayer’s business purpose do not qualify even if they also help control pollution. The pollution control exemption does not apply to property acquired and used as an integral part of a profit-oriented business, even if property reduces or controls pollution. The exemption is intended to limit the costs of buying extra, nonproductive equipment necessary to comply with mandatory pollution laws. See Nelson Service Group Inc. v. Ala. Dept. of Rev., Admin. Law Div., Docket No. 03-1101 (11/07/2004); Chemical Waste Management, Inc. v. State, 512 So.2d 115 (Ala. Civ. App. 1987).

In your request you made references to Chemical Waste Management, Inc. v. State, 512 So.2d 115 (Ala. Civ. App. 1987) and Alabama Department of Revenue Ruling 99-007 (7/27/2000). In Chemical Waste Management, the Alabama Supreme Court held that property which was acquired primarily for the production of goods or services integral to a profit-motivated business purpose or activity did not qualify for the pollution control exemption contained in Ala. Code §40-23-4(a)(16). Furthermore, Alabama Department of Revenue Ruling 99-007 is based on the facts presented in that particular request and may not be used or cited as precedent. The pollution control exemption applied to the construction of a plant to convert calcium sulfite slurry, a solid

industrial waste, into gypsum for sale to consumers in agricultural, cement, filler, and wallboard industries. The construction of the gypsum plant was a continuation of the company's efforts to abate air or water pollution. The gypsum plant was not integral to a profit-motivated business purpose or activity of the company, and the company did not expect to recognize any profits from the operation of the plant or the sale of the gypsum. Any financial gains or losses from the plant were incidental or secondary to the value of the plant as a pollution control facility.

The distinction is between non-productive property acquired and used by a business to contain its own pollution (exempt), and property acquired and used by a business as a necessary and integral part of a profit making activity (taxable). Company X is not building the facility/plant for the purpose of protecting the environment and will not be building the facility/plant "but for" the fact that the plant/facility is necessary for the continued production of refined coal that can be used as a fuel source.

Furthermore, some of the facts stated in your request imply that the demonstration plant is an operation of experimental and untested technology with no guarantee that the technology will increase energy efficiency and reduce pollution. The construction of the demonstration plant is for purposes of research and development. See Hamm v. Boeing Company, 203 Ala. 310, 216 So.2d 288 (1968), appeal dismissed, 394 U.S. 320, 22, 89 S.Ct. 1194 (1969)(court refused to allow an exemption based upon a "sale for resale" when the facts established that the Boeing Company used the items procured for its own purposes for at least a brief period of time before resale.). This prototype plant is constructed for Company X's personal and private use to further its business purpose. Additionally, the final phase of the project, which would involve constructing a commercial coal refining plant is property acquired and used as a necessary integral part of a profit-making activity.

HOLDING

Based on the particular facts of this case, the proposed coal refining plant described above does not qualify as a "pollution control facility" within the provisions of Ala. Code §§40-23-4(a)(16) and 40-23-62(18). The law clearly states that the structure must be built primarily for the control, reduction, or elimination of air and water pollution. Alabama Sales and Use Tax Rule 810-6-3-.46 further clarifies that the law permits a taxpayer to qualify for the sales and use tax exemption if the profits derived from the goods or services produced are secondary to the primary purpose of pollution control. The coal refining plant is the very property from which Company X profits will be derived. The facility does not qualify as a "pollution control facility" exempt from sales and use taxes.

JULIE P. MAGEE, Commissioner
Alabama Department of Revenue

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