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ALABAMA DEPARTMENT OF REVENUE REVENUE RULING 2016-001

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

TO: REQUESTOR

FROM: Julie P. Magee
Commissioner of Revenue

DATE: February 6, 2017

FACTS¹

REQUESTOR (hereafter "RRR") is an Alabama manufacturer of PRODUCT. In technical speak, PRODUCT is an elemental chemical in the form of colloidal particles produced by thermal decomposition of FEEDSTOCK, under controlled conditions. It is an interesting product. It was called "___" until it was first manufactured in the United States in the 1740's when it became known as "____" - a name based on its production method. Later, in the 1870's when this product was manufactured from ___ it was called "PRODUCT" and the name of this product stuck. PRODUCT is used in the manufacture of ___, ___ and ___ products, ___ and ___.

There are primarily two methods for manufacturing PRODUCT in the United States. RRR uses the more prevalent method called the "furnace ___" process. The furnace ___ method uses heavy ___ (a hydro___) as feedstock. The feedstock is heated, atomized, and injected into a furnace under carefully controlled temperature and pressure conditions. In the furnace the feedstock vaporizes, and the PRODUCT and hydrogen microscopically separate. As the output is cooled the PRODUCT is separated by collection into bag filters while the byproduct residual gases consisting primarily of hydrogen, sometimes referred to as "tail gas," remains. The tail gas is not a worthless byproduct. To maximize profits, PRODUCT manufacturing facilities can use the tail gas to fire a boiler to produce steam that can be used for heating needs or in the production of electricity.

¹ The facts upon which this revenue ruling is based are stated herein. To the extent that any relevant facts asserted by the requestor were omitted or were misstated or if stated, were misleading, this revenue ruling may be invalidated by the Department in whole or in part or withdrawn as the circumstances may require.

RRR currently uses a thermal oxidizer to combust the tail gas for release into the environment. This outdated process is inefficient and no longer meets emissions requirements established by the United States Environmental Protection Agency (hereafter the "EPA"). As a part of a national enforcement initiative the EPA brought an action against RRR alleging excess emissions from its plants in Alabama, ____ and _____. The parties entered into a Consent Decree which requires RRR to take actions for certain air pollution results at its CITY plant by DATE.

RRR in an effort to comply with the Consent Decree plans to remove its existing thermal oxidizer and replace it with a higher combustion efficiency waste heat recovery (hereafter "WHR") boiler, which will combust the tail gas as a heat source for a steam turbine that will produce electricity. The electricity, to the extent not used in its manufacturing facility would be sent into the power distribution and transmission power grid and purchased by Alabama Power. The emissions from the co-generating steam turbine would be cooled and processed through a scrubbing system. The scrubbing system will require the installation of various equipment, including a Selective Catalytic Reduction (hereafter "SCR") system to remove nitrogen oxides (NO_x), a Circulating Dry Scrubber (hereafter "CDS") system to remove sulfur dioxide (SO₂), a Pulse Jet Fabric Filter (hereafter "PJFF") system to remove particulate matter (hereafter "PM"), an induced draft fan that draws gas through the upstream equipment, and a stack from which gas will be exhausted.

REQUESTED REVENUE RULING

RRR asserts that in compliance with the Consent Decree it will remove its old thermal oxidizer at the CITY plant and replace it with a new WHR boiler. It will then use a co-generating steam turbine to reduce the temperature of the emissions so that the emissions can then be subjected to a scrubbing system that will reduce emissions to levels acceptable to the EPA. RRR requests a ruling that the following purchases for the CITY project will qualify for the pollution control exemption from Alabama sales and use tax:

- (1) Scrubbing system,
 - a. Selective Catalytic Reduction (SCR) system
 - b. Circulating Dry Scrubber (CDS) system
 - c. Pulse Jet Fabric Filter (PJFF) system,
 - d. An induced draft fan, and
 - e. A stack
- (2) Waste heat recovery boiler,
- (3) Co-generating steam turbine,
- (4) Concrete and other materials to install the new equipment
- (5) Pipes, valves, pipe fittings, and pipe fitting supplies attached to the pollution control equipment,
and
- (6) Materials and equipment used to construct the collection system from the co-generating steam turbine to the grid.

GENERAL DISCUSSION

Alabama provides an exemption from Sales Tax in Ala. Code, 1975 §40-23-4(a)(16) which provides that:

(a) There are exempted from the provisions of this division and from the computation of the amount of the tax levied, assessed, or payable under this division the following:

...

(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 the Use Tax is found in Ala. Code, 1975 §40-23-62(18) as follows:

The storage, use, or other consumption in this state of the following tangible personal property is hereby specifically exempted from the tax imposed by this article:

...

(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.

Both statutory provisions are referred to collectively herein as the “pollution control exemption” and read together provide that tangible personal property that is acquired or placed into initial operation primarily for the control, reduction, or elimination of air or water pollution will be exempt from sales and use taxation by the State of Alabama.

As evidenced by the clear wording of the above-mentioned statutes, the acquisition of pollution control equipment is not exempt from sales and use taxation unless the primary purpose of the property acquired is the control, reduction or elimination of air or water pollution. Reg. 810-6-3-.46(8) provides that:

“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.”

Several cases have been decided interpreting the limitations of this exemption where the pollution control equipment served an additional purpose with similarities to the expansion planned by RRR. The most recent cases are discussed below.

In Nelson Service Group, Inc., Docket No. S. 03-1101 (October 7, 2004) the petitioner was a commercial coatings and painting contractor. The petitioner had contracted with Occidental Chemical to remove mercury contaminated rubber coatings from equipment owned by Occidental. To perform the job, the petitioner purchased a hydro-blaster and related equipment. By using this equipment the mercury imbedded in the rubber linings was removed without polluting the environment. The Administrative Law Division judge disallowed the exemption explaining that:

“by using the hydro-blaster in lieu of sandblasting, the [petitioner] prevented mercury from entering the environment. Unfortunately for the [petitioner], 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. ... 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.”

In Lesaffre Yeast Corp., Docket No. S. 03-1130 (June 16, 2004) the petitioner operated a yeast manufacturing facility in Dothan, Alabama. The petitioner’s wastewater byproduct, containing molasses, ammonia, chlorine, and phosphorous, was pumped to a lined holding pond and then piped to irrigate hay fields thereby legally disposing of the wastewater and producing a viable food source for cattle. The petitioner asserted that the piping used to transport the wastewater to the fields for agricultural wastewater purification qualified for the pollution control exemption. The Administrative Law Division denied the exemption and held that the pollution control equipment had been used as an integral part of the petitioner’s profit motivated agricultural business thereby precluding the exemption under the authority of Chemical Waste Management, Inc. v. State, 512 So.2d 115 (Ala. Civ. App.1987).

In McCain Engineering Co., Docket S. 96-359 (June 3, 1997) the petitioner manufactured incinerators for hospitals to dispose of hazardous medical waste. The issue was whether the Alabama hospitals had purchased the incinerators manufactured by the petitioner under circumstances where they were “acquired primarily for the control, reduction, or elimination” of pollution. The exemption was allowed by the Administrative Law Division judge under the following analysis:

“In this case ... the incinerators were not used for or necessary to the hospitals' profit-motivated business of treating patients. Rather, they were acquired solely to treat the hazardous waste as required by ADEM. But for the ADEM regulations, the hospitals could have disposed of the untreated waste at one-tenth the cost through normal methods. Infectious medical waste is pollution. ... The incinerators in issue were used exclusively to treat medical waste, and clearly constitute the non-productive, government mandated pollution control equipment that the Legislature intended to exempt from sales tax.”

In Air Products & Chemicals, Inc., Docket No. U. 95-359 (December 14, 1995) the petitioner contracted with Alabama River Pulp Company, Inc. to supply oxygen to speed-up the breakdown of wastewater pollutants flowing from the facility to meet water pollution standards. The Administrative Law Division judge explained the disallowance of the exemption 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.

In Industrial Safety Products, Inc., Docket No. S. 90-257 (September 17, 1992) the petitioner had sold materials to asbestos removal contractors for use in asbestos removal projects. The Administrative Law Division judge denied the exclusion and explained that:

“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... 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.”

In Wastewater Disposal Services, Inc., Docket U.91-144 (August 23, 1991) the petitioner operated a commercial wastewater disposal site to dispose of toxic wastewater produced by oil and gas wells in the area. Again the exemption was denied and the Administrative Law Division judge explained his decision as follows:

“The Taxpayer's facility in this case obviously controls pollution in one sense because it disposes of the toxic wastewater 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. Taxation is the rule and exemption the exception, and an exemption must be strictly construed in favor of the Department and against the taxpayer. Brundidge Milling Company v. State, 228 So.2d 475; Community Action Agency of Huntsville v. State, 406 So.2d 890.”

The Administrative Law Division cases above illustrate a consistent interpretation of the pollution control tax exemption. Here RRR manufactures PRODUCT as its primary business. However, its plans to replace its thermal oxidizer with a WHR boiler and process this salvaged heat in the production of electricity constitutes a secondary business. While the WHR boiler and co-generating steam turbine used in electricity production arguably have some pollution control functions, they constitute integral parts of a profit-motivated business. This equipment is not the non-productive, government mandated type pollution control equipment that the Legislature intended to exempt from sales tax. The WHR boiler and the co-generating steam turbine, as profit motivated production equipment thus do not qualify for the pollution control exemption. The pipes, valves, pipe fittings, and pipe fitting supplies used for the operation of the WHR boiler and the co-generating steam turbine, and the materials and equipment used to construct the collection system from the co-generating steam turbine to the electricity grid, will likewise not qualify for the pollution control exemption. However, the scrubbing system, to the extent it is used to process the combusted tail gas for pollution control purposes subsequent to its use in production of electricity, would appear to qualify for the exemption. Additionally, the pipes, valves, pipe fittings, and pipe fitting supplies necessary to the operation of the equipment of scrubbing system, and which were not excluded above, will also be considered exempt pollution control equipment.

CONCLUSION

The Commissioner of the Department of Revenue grants in part and denies in part the Taxpayer's requested ruling as set forth above.

Julie P. Magee
Commissioner of Revenue