REVENUE DISCOVERY SYSTEMS – ADMINISTRATIVE LAW DIVISION

BOISE WHITE PAPER, LLC Petitioners, v. CITY OF JACKSON, ALABAMA CLARKE COUNTY, ALABAMA Respondents,	))))))))	**RDS PID No. 9558**

FINAL ORDER ON REFUND PETITION APPEAL

FACTS AND PROCEDURAL HISTORY

The taxpayer, Boise White Paper, LLC, a Delaware limited liability company doing business in the State of Alabama, is an established manufacturer of commercial paper products. The company produces its products at a paper mill and a converting plant located in the City of Jackson within Clarke County, Alabama. A wide variety of machines and equipment are utilized by the taxpayer in the paper production process at these facilities. The paper mill has two paper producing lines known as the J1 and the J3, the J3 being newer and capable of producing larger quantities of paper. The paper mill process includes the running of raw wood through debarking and chipping machines to produce wood chips necessary for processing into pulp. Chemicals such as caustic soda, sodium hypochlorite, sulfuric acid, defoamers, and carbon dioxide are added and combined in the manufacturing process to regulate and inhibit various chemical reactions pursuant to the conversion of the wood into Kraft paper. Through various chemical reactions in the cooking process, the wood chips are bleached and stripped of non-desirable qualities such as lignin leaving only the necessary components of wood fiber and pulp. The wood fiber or pulp is initially in a liquid state and is then dewatered, dried, and pressed in the paper machines until the final product is obtained. The paper machines also contain certain machine clothing, specifically felts, which are necessary to the operation of the machines during the compounding process. Virtually all of the chemicals at issue are dissipated or intentionally removed, recovered, and recycled by the taxpayer during the process and only minute percentages of common molecular elements of the chemicals are traceable in the final product.

At the end of each machine is a winding stand, where the finished paper is contoured around metal cylinders. Overhead cranes are then used to lower the rolls of paper into another part of the facility where they are placed on stands, unwound, slit to size, and rewound onto smaller paper cores. The metal cylinders are then returned to the paper machines for repeated use. Once the paper is on the paper cores, plugs or headers are placed in the ends of the cores and the rolls are wrapped in plastic to prevent damage and weatherproof the paper rolls during transport and storage. Forklifts are used to move the rolls of paper to a warehouse where they are sold and shipped to customers or transported to the converting or sheeting plant a mile or two away from the paper mill. Once transported to converting plant, the paper cores are once again unwound and fed into a slicer and a cutter to convert the paper into eight and one-half by eleven

inch sheets and packaged into reams for sale to the public. Members of the taxpayer's personnel provided that approximately fifty-four percent of the rolls are transported to the converting plant, while the remaining forty-six percent are sold directly to customers. Once the paper is removed from the paper cores and cut to size at the converting plant, the undamaged cores are returned to the paper mill for reuse in transporting the product between facilities.

On or about July 15, 2008, a representative for the taxpayer mailed a letter to the Clarke County Revenue Office stating that the taxpayer had inadvertently overpaid use taxes to Clarke County and the City of Jackson in the amount of $307,248.12 throughout the period of June 1**,** 2005 through June 30, 2008. No such letter was provided to any office related to the City of Jackson. On or about October 6, 2008, the taxpayer's representative filed an official petition for refund with Revenue Discovery Systems ("RDS") requesting a refund of use taxes paid to Clarke County, and referencing the City of Jackson, in the amount of $393,500.77 for the period of June 1, 2005 through June 30, 2008. On December 3, 2009, the taxpayer's representative filed a refund petition with RDS requesting a refund of use taxes paid to the City of Jackson in the amount $291,053.06 for the period of June 1, 2005 through June 30, 2008, and for Clarke County in the amount of $118,862.26 for the same period. It is acknowledged that the taxpayer effectively filed the petition for refund of Clarke County taxes on July 15, 2008, establishing an allowable refund period of June 1, 2005 through June 30, 2008, and for taxes paid to the City of Jackson on October 6, 2008, establishing the allowable refund period of September 1, 2005 through June 30, 2008.

The refund petitions were subjected to examination by RDS under contractual authority from the self-administered taxing jurisdictions of Jackson and Clarke County, Alabama. The examination resulted in the denial of the portion of the refund petitions pertaining to two classes of claims; (1) the machine clothing, specifically felts, and certain chemicals claimed to be exempt as ingredients or components of the finished paper products, and (2) the paper cores which the taxpayer claimed as machinery used in the compounding, processing and manufacturing of tangible personal property by reason of their function of protecting, storing, and transporting the product during the preparation of the product for market. The taxpayer timely appealed the denial of these portions of the refund petitions by filing a notice of appeal with the administrative law judge of RDS in accordance with ALA. CODE § 40-2A-7(c)(5)a (1975), and a hearing was conducted on February 23rd, 2012.

ANALYSIS

In Alabama, tangible personal property or products sold to a manufacturer or compounder which enter into and become an ingredient or component part of the products which they sell at retail are exempt from sales and use taxes whether or not such property used in the manufacturing process is used with the intent that it becomes a component of the finished product. ALA. CODE § 40-23-1(a)(9)b & § 40-23-60(4)b. This statute provides a well-intended effort by the legislature to prevent Alabama citizens from being subjected to double taxation. The purpose of the exemption is clear, and simply paraphrased, the statute provides that a taxpayer will not be charged sales tax on the individual items that make up the ingredients or component parts of their finished products for the underlying reason that the sales tax will be collected upon the ultimate retail sale of the finished product. *Robertson & Assoc. (Ala.), Inc.* v. *Boswell*, 361 So.2d 1070 (Ala. 1978). In other words, the transaction is considered a tax-exempt

wholesale sale or sale-for-resale. .

It has been held that Section 40-23-1, or at least its predecessor, which provides the definitions of transactions which are considered taxable and non-taxable sales, deals with coverage, not with exemptions, and accordingly, is a taxing statute which is construed strictly against the taxing power and with favor indulged toward the taxpayer. *Holloway v. State*, 79 So.2d 40, 42 (Ala. 1955). *But see State v. Wertheimer Bag Co.,* 43 So.2d 824, 826 (Ala. 1949) & *Carlisle Engineered Products, Inc. v. State Dep't of Revenue,* 2000 WL 521109 *6 (Ala. Dept. Rev.) (2000) (Both providing that the ingredient and component part statute is an exclusion, and should be strictly construed against the taxpayer as an exemption from tax). But the rule that taxing statutes are to be construed in favor of the taxpayer does not impinge on the all-prevailing rule that a statute is to be construed in accordance with its real intent and meaning, and not so strictly as to defeat its legislative purpose. *Holloway,* 79 So.2d at 42.

Generally, where the purpose of a legislative Act is clear, its application should pose no practical difficulty. However, amendments to this particular statute by the Alabama Legislature in 1981 and 1997 have resulted in various and conflicting applications of the exemption. Indeed, when the legislature removed the aspect of intent from the statute, it must have intended to remove a certain level of strict application which precluded deserving taxpayers from receiving the benefit; however, the underlying intent of the provision remains to avoid the imposition of double taxation on property which is not purchased for consumption, but rather for resale in the form of a final manufactured product. *Robertson,* 361 So.2d at 1073.

Prior to the Alabama legislature's 1981 amendment removing the element of intent from the statute, the pivotal Alabama case defining the ingredient or component issue was that of *Robertson, supra.* In *Robertson,* the taxpayer sought exemption for explosives used in the taxpayer's mining operations contending that small traces of the materials became embedded in the finished coal product. The purpose of the explosives was to remove and loosen the dirt and rock from above the coal seam thereby allowing the coal to be mined. *Id* at 1073. The Alabama Supreme Court held for the first time that although microscopic particles of a material used in the manufacturing process became chemically traceable in the finished product, the materials did not meet the test of "wholesale sales" as defined by the statute if their presence was unintentional or merely the incidental result of their primary purpose in the manufacturing process. The court reasoned that to allow such materials the classification of "wholesale sales" would contravene the legislative intent to prevent double taxation and replace it with an interpretation permitting avoidance of tax on the materials altogether. *Id* at 1074.

In its interpretation of the statute, the Court emphasized that it is not irrelevant in seeking to execute the intent and purpose of the statute to look to the purpose for which the material was used. *Id.* at 1073. Consequently, "the test is whether the manufacturer used the material with the intent *and* purpose of making it an ingredient or component part of the finished product; or conversely, was its presence in the finished product merely incidental to its primary function." *Id.* The test requires emphasis on both the intent and purpose for which the material was used, and discounts the abstract detail that microscopic traces may become scientifically discernible in the final product due to the material's proximate function in the manufacturing process.

Subsequent to the issuance of the Supreme Court's 1978 opinion in *Robertson,* the Alabama Legislature amended section 40-23-1(a)(9)b in 1981 eliminating intent as a factor in applying the exemption, and again in 1997 to revise the phrasing in relation to machine parts. No

direct appellate court decisions have followed under the revised coverage; however, the Alabama Department of Revenue's Administrative Law Division ("ALD") rendered a recent decision applying the current statute in *Wayne Farms LLC* v. *State Dep't of Revenue.,* 2008 WL 347672 (Dept. Rev. Admin. Law Div.) (2008), overturning the ALD's prior decision on rehearing in *Carlisle Engineered Products* v. *State Dep't of Revenue,* Admin. Law Div., Dkt. No. U. 99-524 (August 28, 2000). In *Wayne Farms,* the taxpayer sought to exempt as an ingredient or component carbon dioxide which was used in the manufacturing process to cool chicken after it is cooked so that it could be efficiently cut into pieces for commercial retail sale. In concluding that the materials did not become an exempt ingredient or component of the finished product, the ALD ruled that whether the carbon dioxide remains in the chicken or not, to be nontaxable it must still serve a substantial purpose in the finished product. The purpose of the carbon dioxide is to cool the chicken during manufacture, and its subsequent presence in the chicken is merely incidental to that primary function pursuant to the rationale of *Robertson.* Requiring the taxpayer to pay tax on the carbon dioxide would not result in double taxation because the taxpayer is in no way selling particles of it at retail. The carbon dioxide is virtually consumed in the manufacturing process, and thus should be subject to the reduced manufacturing sales tax rate under ALA. CODE § 40-23-2(3). The ALD represents the highest level of legal interpretation within the Alabama Department of Revenue, and when the highest administrative officials charged with the duty of administering the tax laws have construed a tax statute, that construction should be given great weight and favorable consideration. *Bean Dredging, L.L.C. v. Alabama Dep't of Revenue,* 855 So.2d 513, 517 (Ala. 2003).

The taxpayer here claims that certain synthetic machine felts used to manufacture paper products are exempt from taxation because microscopic remnants are occasionally present in or on the final product. In support of their assertions, the taxpayer had two separate laboratories examine paper samples to test for evidence of the materials remaining. The initial test, performed by the Department of Chemical & Biological Engineering at the University of Maine with the objective of detecting felt fibers, examined two sets of paper samples which had been self-selected and marked by the taxpayer's personnel for possible felt contaminations. The samples were analyzed using a low-angle light and a stereo-zoom microscope and concluded that the marked portions contained miniscule instances of contamination consistent with properties of felt fibers. In the second test, performed by Integrated Paper Services, Inc., eighteen samples selected by the taxpayer were analyzed by cutting out the suspected defect areas, placing them on glass microscope slides, and examining them under a light microscope. Only one out of eighteen defects examined was found to contain actual nylon fiber. The lab emphasized that in paper making systems, nylon fiber contamination is almost only caused by deteriorating paper machine felts. In fact, the nylon fiber found was determined to have a slightly different staining likely caused from a chemical corrosion wash used on the machine felts. All remaining defects were found only to contain highly lignified fibers from softwood mechanical pulp and Kraft, or nothing distinctive at all.

Although the first test determined that an instance of contamination existed within the sample, the second test indicates that this occurrence would be extremely rare, and likely only found within specifically identified samples, one of eighteen of which *may* contain nylon fibers consistent with deteriorated felt from the paper pressing machines. Furthermore, the test also supports that the felt contaminations serve only to diminish the quality and value of the finished paper, and that the presence of such defects is the result of extended use and deterioration of the synthetic pressing felts in the manufacturing process. To say that an occasional remnant of felt found on the surface of paper justifies a finding that all machine felts constitute an ingredient or

component of the paper, inasmuch as they are referred to as "defects" or "contaminants", contradicts the logical reality that their presence in the finished product would be eliminated entirely were it more economically practical to regularly replace deteriorating machine felts.

In any sense, the tax treatment of these materials has been construed by the Alabama Department of Revenue under ALA. ADMIN. CODE r. 810-6-2-.108 (2012) which identifies tax rates applicable to paper manufacturers, and specifically provides the applicable tax rate for these exact types of machine clothing, specifically felts, screen plates, and wire is the reduced machine rate of sales and use tax levied in ALA. CODE § 40-23-2(3) and § 40-23-61 (b). The Alabama regulation was enacted in 1998 subsequent to both the 1981 and 1997 amendments to Sections 40-23-1(a)(9)b and 40-23-60(4)b, and the considerable weight given to the long-standing administrative interpretation that the machine clothing is subject to the manufacturing rate is increased when the legislature, in reenacting the law without change through 2012, fails to indicate disapproval of the settled administrative construction. *Pilgrim* v. *Gregory*, 594 So.2d 114, 118 (Ala. Civ. App. 1991); *East Brewton Materials, Inc.* v. *State. Dep't of Revenue, 233* So.2d 751, 754 (Ala. Civ. App. 1970). Thus, the paper machine felts should be taxed as an identifiable separate material used in the manufacturing process specified under the Department's regulation as subject to the reduced machine rate, and no refund is due the taxpayer on these requested items.

The taxpayer also seeks an exemption under the ingredient and component provision for certain chemicals used in the manufacturing process, specifically defoamers and sodium hypochlorite.[1] The chemicals in question serve various purposes in the manufacturing process, and the taxpayer asserts that because trace amounts of the chemicals, or at least elements common to the molecular composition of the chemicals, remain in the finished paper product that all purchases of the chemicals are exempt from tax. In support of their claim that the chemicals remain in the finished product, the taxpayer had the University of Maine perform chemical analysis on the paper using a milligram per kilogram unit ratio which revealed that the finished paper contained trace amounts of bromine (0.000045%), aluminum (0.0426%), ammonium (0.000014%), phosphorous (0.0000347%), sodium (.0813%), chloride (0.1189%), silicon (0.1045%) and magnesium (0.1025%), and was thirty-seven percent (37%) composed of carbon.

The molecular compositions of the chemicals used in the manufacture of paper contain elements common to those revealed in the test results. Indeed, over sixty chemicals are said to be used within the manufacturing process of paper, many of which contain elements common to one another and to the primary ingredients of paper such as wood and water. Under the circumstances, it would be impossible to determine at which specific stage of manufacture the chemicals entered into the product, and practically impossible to determine which specific

[1] The taxpayer's original petition for refund included claims seeking exemption of other chemicals including caustic soda, sulfuric acid, and carbon dioxide. The taxpayer has since withdrawn their claims for refund on the caustic soda and sulfuric acid after determining they had reported tax on certain percentages of their purchases of the chemicals in accordance with a previous Alabama Department of Revenue audit from 2007. The rationale of Department's determination of the taxable and non-taxable percentages of purchases of these chemicals remains uncertain; however, it is important to acknowledge that the Department's position on the ingredient and component provision decisively changed with the ALD's issuance of the *Wayne Farms* decision in 2008, subsequent to the Department's previous audit. It is the opinion of this administrative law judge that the rationale applied herein should be applicable to all other relative chemicals alike which are used in the manufacturing process, whose sole purpose is served within the manufacturing process, and whose miniscule presence in the finished product serves no purpose and is merely incidental to their primary function.

chemicals compose the trace elements. The only element which comprised a significant portion of the paper was carbon at thirty-seven percent, which coincidentally comprises nearly fifty-percent of the composition of wood, the primary ingredient in Kraft paper. During the processing, almost all of the chemicals are either consumed or intentionally removed for reuse. Moreover, the chemical substances cannot be said to be physical components of the finished paper essential to its completeness because they add nothing to the quality of the paper. Rather, they are found in the paper only because it is not economically practical to remove them. The chemicals are purchased for the primary purpose of aiding in the manufacturing process, and not for resale or inclusion in the final product.

A statute must be read in context, and should be given a sensible and practical construction, and when a strict, literal reading would defeat the purpose of the statute, or lead to absurd consequences, that interpretation should not be adopted if any other reasonable construction can be given to it. *Sizemore* v. *Franco Dist. Co., Inc.,* 594 So.2d 143, 147 (Ala. Civ. App. 1991). While both the 1981 and 1997 amendments eliminated intent as a factor in determining an ingredient or component part, the remainder of the *Robertson* test is still valid. That is, material does not become an ingredient or component part within the scope of the statute if its presence in the finished product is not necessary and is only incidental to its primary purpose in the manufacturing process. *Robertson,* 361 So.2d at 1073. The legislature is presumed to be aware of existing law and judicial interpretation when it adopts or amends a statute, and all presumptions favor that the legislature does not intend to make any alteration in the law beyond what it explicitly declares. *City of Pinson* v. *Utilities Bd. of the City of Oneonta,* 986 So.2d 367, 373 (Ala. 2007).

A rule of statutory construction which a court must employ when resolving a tax matter is that the substance of a contentious transaction must prevail in determining the taxability, and not the form in which it is cast. *Rust Engineering Co.* v. *State*, 246 So.2d 695, 700 (Ala. 1971); *Ex parte State Dep't of Revenue,* 624 So.2d 582, 585 (Ala. 1993). In the present case, the taxpayer is casting the purchase of manufacturing and other materials such as chemicals and pressing felts in the form of acquiring ingredient and component parts of the paper. In substance, the taxpayer's purchase of these materials is solely for the purpose which they serve in the manufacture of paper, or for other indirect facility purposes. The taxpayer's own witness testified to the fact that felts remaining in finished paper are considered defects or contaminants in the finished product, and will decrease the quality and value of the paper. (Hearing transcript at p. 253). Moreover, the chemicals which are used in the manufacturing process are said to remain because trace amounts of common molecular elements are found in the finished product.[2] To permit the nature of a transaction to be disguised by such trifles, which are revealed solely in an effort to alter tax consequences, would seriously impair the effective administration of the tax policies of the state. *C.I.R.* v. *Court Holding Co.,* 324 U.S. 331, 334 (U.S. 1945).

The overall purpose of the ingredient and component part exemption is to avoid double taxation. That purpose is not served when manufacturing or plant maintenance materials are

[2] Notably, the tests submitted into evidence by the taxpayer reveal only that trace amounts of ammonium, bromine, silicon, magnesium, sodium, chloride, aluminum, and phosphorous remain in the finished product, altogether amounting to less than 0.5% of the final product. Therefore, the percentages of the actual chemicals sought to be exempt, which contain only percentages of these elements, would be significantly more trivial, if discernible at all. This detail alone casts doubt as to whether the actual chemicals themselves do in fact remain in the final product, a threshold test which must be met in order to qualify as an ingredient or component part of the manufactured product. *Stauffer Chemical Co. v. State Dep't of Revenue*, 628 So.2d 897 (Ala. Civ. App. 1993).

purchased tax-free, thus escaping taxation altogether, simply because scientific testing reveals that microscopic traces of their common elements insignificantly remain in the final product. *Sizemore* v. *Franco Distributing Co. Inc.*, 594 So.2d at 147[3]; *Spencer* v. *West Alabama Properties, Inc.,* 564 So.2d 425, 427 (Ala. 1990)[4]. Such is the very rationale behind the existence of a reduced manufacturing rate of sales and use taxes, to which all chemicals purchased solely for manufacturing purposes, which serve no substantial or relevant purpose in the final product, should be subject. Other chemicals used by paper manufacturers which serve functions related to plant maintenance or those not directly used in the manufacturing process are taxed at the general rate. ALA. ADMIN. CODE r. 81 0-6-2-.1 08(2)(bb), (cc), & (dd). (i.e. defoamers, fuels, antimicrobials, adhesives, water treatment solutions, etc.). Therefore, the taxpayer's petition for a refund with respect to taxes paid on sodium hypochlorite and defaomers is denied based upon the finding that they do not constitute ingredients or component parts of the finished paper pursuant to the rationale in *Robertson.*

The next issue on appeal is whether the paper cores used by the taxpayer while transporting the paper rolls between the mill and converting plant are eligible for the reduced machine rate of use tax levied under ALA. CODE § 40-23-61(b). That section provides that any machines used in mining, quarrying, compounding, processing and manufacturing of tangible personal property shall be eligible for a reduced rate of tax set forth by the state or local law. The taxpayer here contends that it uses the paper cores to manufacture and process its finished product, it following that the cores serve a direct, integral, and necessary function in the overall procedure pursuant to the rationale in *Robertson,* 361 So.2d at 1074. The primary assertion is that the paper cores serve as a base around which the paper is contoured and shaped so that it may be securely transported to the converting plant to be cut, sized, and packaged for retail sale. In other instances, the rolls of paper secured and protected by the cores are stored at the taxpayer's facility in order to maintain an inventory which can readily be transferred to the converting plant to fulfill customer orders. (Hearing transcript at p. 298).

In support of its argument, the taxpayer cites to *State v. Calumet & Hecla, Inc., Alamet Divisions,* 206 So.2d 354 (Ala. 1968), in which the Alabama Supreme Court concluded that paper bags used to shape and hold the geometry of dolomite briquettes while being processed through a furnace into finished magnesium metal served a direct, essential, and integral function in the procedure by which dolomite is processed into magnesium metal so to qualify as machinery subject to the reduced machine rate, then an exemption. The taxpayer further relies on the ALD decision in *Oversees Hardwoods Co., Inc.* v. *State Dep't of Revenue,* Admin. Law Div., Dkt. No. S. 00-664 (Oct. 1, 2001), in which it was held that sticks stacked between layers of raw wooden boards to create uniform air spaces which prevented fungus and rot and allowed the boards to dry at a uniform rate qualified for the reduced machine rate. The raw wooden boards were being dried and shaped prior to being placed in, and while within, a kiln in which they were treated at high temperature in order to achieve an ideal, equilibrium moisture content necessary to

[3] "We find it unreasonable to believe that the legislature in enacting § 40-23-2(3) intended that video game machines, pinball machines, juke boxes, and vending machines should receive the reduced sales tax rate provided for under the statute on the basis that these machines "process" electricity. To find that the legislature intended such a result would be to find that the legislature actually intended that virtually *all* electrical appliances would receive the favorable rate because they also contain transformers, capacitors, voltage regulators, traps, filters, and other components commonly found in electrical products. We find that the legislature did not intend such a result."

[4] "The inartificial manner in which many of our statutes are framed, the inaptness of expressions frequently used, and the want of perspicuity and precision not infrequently met with, often require the court to look less at the letter or words of the statute, than at the context, the subject-matter, the consequences and effects, and the reason and spirit of the law, in endeavoring to arrive at the will of the law giver."

market them as finished lumber. *Id.*

The term "machines used in mining, quarrying, compounding, processing and manufacturing of tangible personal property" in this connection has been given a broad construction. *State* v. *Calumet* & *Hecla Consol. Copper Co.,* 66 So.2d 726 (Ala. 1953); *State* v. *Mine & Contractors Supply Co., Inc.,* 83 So.2d 425 (Ala. 1955); *Alabama Power Co.* v. *State,* 103 So.2d 780 (Ala. 1958): *State v. Nelson Bros., Inc.*, 406 So.2d 425 (Ala. Civ. App. 1981). The general rule of law established by the historical precedent is that the function of the property in the process is controlling, not the material of which it is composed. If the article in question performs an integral function in the procedure by which tangible personal property is produced, then it is part and parcel of the machinery used in production. *State* v. *Newbury Manufacturing Co., Inc.,* 93 So.2d 400 (Ala. 1957). On the other hand, if the article serves merely as an aid, though vital in the enabling of machines or parts in the overall process to operate, but does not itself operate on the product so as to manufacture or make it marketable, then it does not qualify for the reduced rate. *Southern Natural Gas Co.* v. *State,* 73 So.2d. 731, 736 (Ala. 1954). This distinction, although a narrow one, is central to the determination of whether a machine is being "used in" the manufacturing or processing of tangible personal property or is instead being used merely to either enable other machines or to transport such property before, after, or between the various stations of manufacture or processing. *W.E. Richardson Machine Co., Inc.* v. *State Dep't of Revenue,* Admin. Law Div., Dkt. No. S. 96-480 (July 16, 1998).

The term "process" has been held to be synonymous with the expressions "preparation for market" and "to convert into marketable form." *Southern Natural Gas Co.,* 73 So.2d at 735. The paper cores herein question have an independent function in the processing of the taxpayer's finished product into marketable form. Following manufacture, the paper product is contoured around the core which provides the supportive cavity of the roll of paper. The rolls of paper are then either transported directly to the converting plant or stored within the facility. Eventually, all of the rolls of paper in question are sent to the converting plant where they are unwound, slit to size, and packaged for ultimate retail sale to customers. Wrapping the paper around the core is a necessary step in the procedure between the manufacturing and processing stages which plays a vital, physical function directly on the product permitting continuity throughout the steps of the product's preparation for market. The fact that segments of the rolls are temporarily placed into storage at the facility until customer orders are received is of no consequence to their primary function. *State v. Nelson Bros., Inc.,* 406 So.2d at 427.

Accordingly, the taxpayer is due a refund from the taxing jurisdictions on the difference between the general and machine rate of the tax remitted on the purchases of such paper cores during the applicable refund periods. The City of Jackson is ordered to refund the taxpayer an amount of $60,726.26, and Clarke County is ordered to refund an amount equal to $14,532.48, plus applicable interest.

A final issue on appeal deals with a request for refund of taxes paid on reimbursement payments to Specialty Minerals, Inc. ("SMI") for purchases of carbon dioxide pursuant to a purchasing agreement. Under the agreement, the taxpayer agrees to provide an agreed upon quantity of carbon dioxide which is used by SMI to produce precipitated calcium carbonate for subsequent purchase by the taxpayer. In the event that the taxpayer fails to provide SMI with the agreed upon quantity, SMI is entitled to purchase the necessary quantity from a third party subject to reimbursement of the cost thereof by the taxpayer. Evidently, the taxpayer erroneously remitted use tax based upon the reimbursements paid to SMI under the agreement. Under the

terms of the agreement, the title of carbon dioxide is never transferred to the taxpayer, and the taxpayer could not have been subject to a use tax on the carbon dioxide. Therefore, the tax remitted to Clarke County and the City of Jackson in amounts of $577.06 and $1,154.21, respectively, on reimbursements to SMI are due to be refunded with applicable interest.

Either party may file an application for rehearing on this Final Order in accordance with ALA. CODE § 40-2A-9(f) within 15 days from the date of entry. This Final Order may be appealed to the circuit court in accordance ALA. CODE § 40-2A-9(g)(1)a within 30 days from date of entry.

Entered May 9th, 2012

Jonathan V. Gerth
Administrative Law Judge

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