

Alabama: Beverage-Processing Machines Sold to Wholesaler Qualify for Reduced Use Tax Rate

Overview

On April 30, 2020, the Alabama Tax Tribunal issued an opinion that sales of coffee and tea brewing machines, cappuccino mixers, and frozen beverage dispensers by an out-of-state manufacturer to an in-state wholesaler of coffee beans and tea leaves qualify for Alabama's reduced manufacturing use tax rate because such machines are used to process tangible personal property (*i.e.*, the beans and leaves, etc. into consumable drinks), even though the customer does not produce beverages for direct sale to consumers.¹

This Tax Alert summarizes the Alabama Tax Tribunal's decision upholding the application of the reduced manufacturing rate.

Background

In general, Alabama imposes state sales and use tax at the rate of 4% on the sale, storage, use or other consumption of tangible personal property in the state.² However, "machines used in mining, quarrying, compounding, processing and manufacturing of tangible personal property" are taxed at the reduced rate of 1.5%.³ "Processing means to subject to some special process or treatment. To subject, especially raw material, to a process of manufacture, development, preparation for the market, etc.[.]"⁴

In this case, the taxpayer manufactures and sells coffee and tea brewers, cappuccino mixers, and frozen beverage dispensers, as well as related accessories and repair and replacement parts.⁵ It sold its equipment to an Alabama customer that processes green coffee beans and raw tea leaves into a marketable form by roasting the coffee beans and cutting and blending the tea leaves and packaging the products in dry form.⁶ The customer then sold its products to retailers, distributors, restaurants, hotels, and other businesses. Regarding the cappuccino mixers and frozen beverage dispensers, the customer supplies cappuccino mix and juice concentrate but does not process those items at its facilities.⁷ The customer's sales can be characterized in one of two ways: to wholesale customers (e.g. grocery stores, food distributors) who sell the customer's products at retail, or to customers (e.g. restaurants, convenience stores, those in office settings) who serve or consume the products on site.⁸ The sales to wholesale customers do not involve the equipment sold by the taxpayer.⁹ To many of the other customers, the taxpayer's equipment is provided with the packaged coffee, tea, cappuccino mix, or juice concentrate.¹⁰ In situations where the customer provides the

¹ *Bunn-O-Matic Corporation v. State of Alabama Department of Revenue*, Alabama Tax Tribunal, No. S. 17-614-JP, (April 30, 2020) (*Bunn-O-Matic Corporation*). See also Ala. Code § 40-23-2(3).

² Alabama allows local cities and counties to impose and administer their own local sales and use taxes; full and reduced rates for those locally imposed taxes are separate from the state tax and were not addressed in the present case. See also Ala. Code § 40-23-2(1).

³ Ala. Code §§ 40-23-2(3); 40-23-61(b).

⁴ Ala. Admin. Code r. 810-6-4-.17.05.

⁵ *Bunn-O-Matic Corporation* at 2.

⁶ *Bunn-O-Matic Corporation* at 3.

⁷ *Id.*

⁸ *Id.*

⁹ *Id.*

¹⁰ *Id.*

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taxpayer's equipment along with its products, the equipment converts the packages of dry coffee and tea into consumable drinks.¹¹

At issue in the case was whether the taxpayer's tea and coffee brewers and related items that were sold to Alabama beverage processors qualified for the reduced Alabama use tax rate as machines that were used to process tangible personal property.

When the taxpayer sold these products and their related accessories and parts to its customers during the audit period, the taxpayer collected and remitted Alabama use tax at the reduced manufacturing use tax rate of 1.5%.

However, the Department argued that the full rate of tax was due on the sales of coffee and tea brewers to the taxpayer's customers because it was their customers that used the machines for processing, and not the customers themselves.

Tax Tribunal Decision

The Tribunal found that the taxpayer's coffee and tea brewers, cappuccino mixers, and frozen beverage dispensers qualified as machines used to process tangible personal property, and as such, the sales of such equipment were subject to the state's reduced 1.5% tax rate. Specifically, the taxpayer's equipment converted dry coffee and tea, cappuccino base, and pre-mixed base concentrate into the customer's ultimate product, *i.e.*, consumable drinks.¹² The dry and base forms of those items were not consumable prior to the direct operation of the taxpayer's equipment.¹³ The equipment performed "an integral function in the procedure by which the" consumable drinks were produced and played "a direct part in the processing program."¹⁴ The functioning of the equipment was not "merely incidental" to the processing of the dry and base forms of the products, because those products were not "ready for use by the consumer" prior to being acted on by the taxpayer's equipment.¹⁵

Key Takeaway

Purchases of equipment used to process tangible personal property may qualify for Alabama's reduced use tax rate, even if the equipment is used to process property that will be consumed (not sold) by the purchaser.

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¹¹ *Id.*

¹² *Bunn-O-Matic Corporation* at 8.

¹³ *Id.*

¹⁴ *Bunn-O-Matic Corporation* at 6, 8.

¹⁵ *Bunn-O-Matic Corporation* at 7, 9. Furthermore, the court held that if it had been the customer's customers that had used the machines, the use tax would have been due from the customer's customers and the taxpayer would not have to collect any tax from the customer.

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