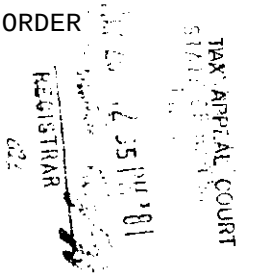
IN THE TAX APPEAL COURT OF THE STATE OF HAWAII

In the Matter of the Tax Appeal of KAISER CEMENT CORPORATION	CASE NO. 1895 DECISION AND ORDER



DECISION AND ORDER

These proceedings involve the assessment by the Director of Taxation of the use tax imposed pursuant to the provisions of HRS Chapter 238, the Hawaii Use Tax Law.

The Court will first dispose of the jurisdictional question presented in this appeal.

Although the Director of Taxation has not raised the question the Court notes the Taxpayer in this case has filed a "Notice of Appeal to Tax Appeal Court under HRS 540-35." The pleading is inconsistent. Appeals from the Director's assessment of taxes are governed by the applicable provisions of HRS Chapter 232 and are initiated by a "Notice of Appeal to Tax Appeal Court." See Rule 2, Rules of the Tax Appeal Court and the form of the notice prescribed therein. On the other hand, actions to recover taxes paid under protest pursuant to HRS §40-35 are to be initiated by a complaint to be filed in the Tax Appeal court. All pleadings for the recovery of moneys paid under said §40-35 are to be governed by Rule 7, Hawaii Rules of Civil Procedure. See Rule 2,2A, Rules of the Tax Appeal Court. There are, therefore, no provisions in the statutes or in the rules of the court that will permit the initiation

of a notice of appeal under HRS §40-35. However, inasmuch as both actions are to be heard in the Tax Appeal Court and because of the importance of the questions involved, this Court will assume jurisdiction and hear the matter.

The facts in this case are set forth in the Stipulation of Facts on file with the record of the appeal and are incorporated herein and by reference made a part of this Decision.

Briefly, the facts are as follows:

The Taxpayer is engaged in the business of manufacturing portland cement at its plant in Waianae, Oahu, Hawaii. It manufactures cement by a process of calcination whereby the raw materials (silica, lime and alumina, with lesser quantities of ferrous oxide, magnesium oxide and sulfur trioxide) are combined or heated at very high temperatures. The raw materials comprise approximately 99.5% of the finished cement. Foreign materials or elements other than the basic raw materials not necessary in the manufacture of cement are present in quantities comprising less than one-half of one per cent of the manufactured cement.

The Taxpayer's plant was originally equipped with oil burning furnace but has since been converted to a coal-burning furnace. The conversion was made principally because of the high cost of oil as a fuel. The Taxpayer, having imported the oil for its own consumption as a fuel, had been assessed use taxes at the four per cent rate. Moreover, following combustion, the oil left no residue as a result whereof no residual ash from the combustion was added to the manufactured cement. Following its conversion to a coal-fired kiln, upon combustion, the residual coal ash is

trapped and becomes inseparably mixed with the cement. No part of the coal remains in its perceptible form as coal. The ash is a fine powder which is chemically changed into other elements and is not perceptible to the senses. By their Stipulation of Facts, the parties agree that coal is harmful to the composition of cement. Whenever coal is present in cement, industry practice is to remove the coal by flotation or other separation methods. Coal ash, the residue from combustion, is neither essential nor desirable nor is it harmful as a foreign matter in the cement.

Unless specifically exempted, the State of Hawaii imposes an excise tax upon all business activities within the State. Pursuant thereto, a general excise tax is assessed upon the gross receipts of all persons doing business in the State. HRS Chapter 237. A use tax is imposed upon the importation of all tangible property which is imported for use in the State. HRS Chapter 238. The use tax complements the general excise tax and their complementary nature provides a uniform tax scheme upon the sale or the use of tangible property in this State.

The Taxpayer claims that its coal imports are exempt from the use tax under HRS §238-2(1)(B) which provides for an exemption where "a manufacturer (is) importing or purchasing material or commodities which are to be incorporated by the manufacturer into a finished or saleable product . . . wherein it will remain in such form as to be perceptible to the senses. . . ."

The Director claims the exemption does not apply to the coal imported by the Taxpayer as a result whereof the coal is subject to the use tax at the four per cent rate.

HRS §238-2(3). It is the Director's contention that the coal is consumed by the Taxpayer as a fuel in the manufacturing process.

The Court agrees with the Director.

The rule of strict construction is applicable in tax matters in this State. Where the Taxpayer seeks an exemption, the statute is to be construed strictly against the Taxpayer. In Re Pacific Marine & Supply Co., 55 Haw. 572 (1974); In Re Otis Elevator Company, 58 Haw. 163 (1977). In this case, the Taxpayer seeks to be exempt from the use tax and, accordingly, the Taxpayer must establish by clear proof that it is entitled to the exemption.

The Court finds that the coal is not a constituent element of the Taxpayer's cement. The Taxpayer uses the coal as a fuel to fire the raw materials of cement in the manufacturing process. By their Stipulation of Facts, the parties agree that coal has long been recognized as being harmful to the composition of cement. Thus, where coal is present in cement, industry practice requires that the coal be removed by flotation or other separation methods. As stated by the court in Union Portland Cement v. State Tax Commission, 170 P.2d 164 (Utah 1946), coal is not an ingredient or component of cement and the determination as to whether or not it is an ingredient or component is to be determined by the manufacturer in the manufacturing process. The Court stated:

> The coal was consumed by burning in the manufacturing process. Its consumption resulted in heat, gases and ashes. The coal was not passed on to other users. The principal use of the coal was to supply heat. Only incidentally to that principal use did ashes from the coal enter into the finished product.

> It is true that all the iron particles resulting from the consumption of the "iron grinding balls" enter into and become an ingredient or component part of the cement and were passed on to the purchasers of the cement. The same is true of three-fourths of what resulted from the consumption of the "firebrick." The same applies to ashes which were left after the coal was burned. However, the "property" plaintiff seeks to exempt from the use tax under subsection (h) of 80--16--4 is "iron grinding balls," "fire brick," and "coal." It does not seek exemption on the use of elements and compounds left after the balls, brick and coal had been used and consumed until they had no value or use whatsoever as "iron grinding balls," "firebrick" or "coal." The Tax Commission did not assess the use of those resultinq elements and compounds. The assessment was for the use and consumption of coal, iron grinding balls and firebrick. These items were used and consumed by the plaintiff until they ceased to have any potential use as coal, iron grinding balls and firebrick. at 171-172.

See, also, Annotations, 30 A.L.R.2d 1439 for further annotations regarding exemptions to be accorded to materials used in the manufacturing process.

The Taxpayer's further contention that the coal is to be exempt because the ash residue is incorporated into cement is without merit. The ash residue is not coal. By their Stipulation of Facts, the parties agree that the coal has been imported for use as a fuel, There is nothing in the facts to substantiate that the coal has been imported for incorporation into the cement. The Court concludes that the coal has not been incorporated into the cement and any argument regarding the incorporation of the ash residue into the cement is irrelevant and immaterial to the assessment of the herein use taxes.

The Court further concludes that the ash residue is not exempt from the use tax. The ash residue is a by-product produced by the combustion of the coal imported

in this State and all of the ash residue, accordingly, are produced in this State. In addition thereto, the ash residue is chemically changed into other elements when incorporated into the cement as a result whereof it has undergone a material alteration in character to the extent that it no longer exists as ash residue. In light thereof, the court concludes the ash residue, upon its incorporation into cement, is not incorporated in a manner "wherein it will remain in such form as to be perceptible to the senses." HRS §238-2. See In Re Taxes, Alexander & Baldwin, Inc., 53 Haw. 450 (1972).

The Taxpayer has also asked this Court to make an apportionment based upon the volume of the imported coal and the volume of the ash residue following combustion and that the use tax be proportionately based upon such apportionment. In light of the conclusions hereinabove reached by this Court, any question regarding apportionment is rendered moot.

IT IS ACCORDINGLY ADJUDGED, ORDERED AND DECREED that the use tax was properly assessed to the Taxpayer at the four per cent rate. The coal has not been incorporated into the cement and any argument regarding the incorporation of the ash residue into the cement is irrelevant and immaterial. The Taxpayer does not fall within the exempt purview of HRS §238-2(1)(B). The use taxes paid herein are properly deemed government realizations.

DATED: Honolulu, Hawaii, _____.

_____ SEAL

Judge of the above-entitled Court