STATE OF ALABAMA DEPARTMENT OF REVENUE,	§	STATE OF ALABAMA DEPARTMENT OF REVENUE ADMINISTRATIVE LAW DIVISION
v.	§	DOCKET NO. S. 94-303
CELLULAR PRO CORPORATION 3439A McGehee Road Montgomery, Alabama 36111, Taxpayer.	§	

FINAL ORDER
ON APPLICATION FOR REHEARING

The Taxpayer, Cellular Pro Corporation, sells cellular telephones at retail and also acts as an authorized sales agent for Alltel Mobile Communications of Montgomery ("Alltel"). The Taxpayer sold telephones to customers at below cost during the subject period if the customer also agreed to sign up for Alltel service. The Taxpayer then received a sales commission from Alltel.

The Department entered the final assessment in issue based on the total commissions paid by Alltel to the Taxpayer during the period in question. The Taxpayer appealed to the Administrative Law Division, and a hearing was conducted on October 3, 1994.

An Opinion and Preliminary Order was subsequently entered on January 30, 1995 rejecting the Department's position and holding that the commissions did not constitute "gross proceeds" derived from the sale of the cellular telephones, and thus were not subject to Alabama sales tax. I still believe that clearly the commissions are not subject to sales tax.

However, the Opinion and Preliminary Order did hold that the

sales tax "withdrawal" provision set out at Code of Ala. 1975, §40-23-1(a)(10) applied, and that the Taxpayer owed sales tax on the wholesale cost of the telephones sold at below cost where the purchaser was obligated to subscribe to Alltel service for which the Taxpayer received a commission. The Taxpayer subsequently applied for a rehearing.

After reviewing the Opinion and Preliminary Order and all briefs filed by the parties, I still believe that the withdrawal provision applies to the transactions in issue in this case. The intent of the withdrawal provision is to insure that a retailer that purchases tangible personal property at wholesale and subsequently uses the property in his business is required to pay sales tax on the wholesale cost of the property. The withdrawal and subsequent "sale" of the telephones by the Taxpayer for a nominal or reduced price for the purpose of obtaining commissions from Alltel constitutes a taxable "use" of those telephones by the Taxpayer.

The strongest argument against applying the withdrawal provision is that the Taxpayer technically sells the telephone to the customer. Admittedly, the withdrawal provision has to my knowledge never been applied where there was a subsequent sale of the property to another. However, this is a case of first impression in Alabama. In any case, the below cost sales were not arm's-length transactions. If the Taxpayer had given the telephones away in return for the Alltel commissions, clearly the

withdrawal provision would apply and the Taxpayer would owe sales tax on the wholesale cost. The Taxpayer cannot charge a nominal or otherwise below cost sales price for the telephones and thereby avoid tax on the balance of the wholesale cost.

The Taxpayer states on page three of its brief that it "sold its phones below retail and below cost to increase its sales". I disagree. Certainly the Taxpayer would not have sold the telephones for $.99, $19.00, $49.00, or for any other price below cost without knowing that it would receive a commission from Alltel. The Taxpayer did not sell the telephones at below cost to increase sales, but rather to obtain the Alltel commissions.

The Taxpayer cites both Drennen Motor Co. v. State, 185 So.2d 405 (Ala. 1966) and Montgomery Aviation Corp. v. State, 154 So.2d 24 (Ala. 1963) in support of its case. However, those cases are not on point because they did not involve the same facts as this case - a below cost sale of property bundled with the purchaser having to sign up for a service for which the seller receives a commission. Consequently, they are not relevant in this case.

The Taxpayer claims on page four of its brief that applying the withdrawal provision in this case would result in at least double taxation - "First, a sales tax would become due if these transactions constitute withdrawals, then again when the phone is sold. Then again, when Alltel collects the cellular excise tax on that part of its monthly service charge constituting a recovery of its commission payment to the Taxpayer." I disagree.

The taxable retail sale is the withdrawal and use of the telephone by the Taxpayer to obtain the Alltel commission. Technically, the taxable measure under the withdrawal provision is the "reasonable and fair market value" of the property in question. See, Code of Ala. 1975, §40-23-1(a)(6). The Department reasonably considers fair market value to be the property's wholesale cost. If the Taxpayer also collects tax from the customer on the reduced sale price for the telephone, the Taxpayer should be allowed a credit for that tax toward the tax due on the wholesale cost.[1] Consequently, only one sales tax is levied on the Taxpayer.

The cellular radio communication services tax cited by the Taxpayer is a privilege license tax on service carriers (Alltel) for the privilege of doing business in Alabama. That tax is not a second (or third) sales tax. The sales tax is on the sale of the telephone by the Taxpayer. The cellular excise tax is on the providing of services by Alltel. The two taxes are on different parties and different transactions, and do not constitute impermissible double taxation.

The Taxpayer next argues on page five of its brief that if the

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[1]In Massachusetts Directive 94-2, discussed in the Opinion and Preliminary Order, Massachusetts held that a carrier that uses telephones as promotional items is liable on the wholesale cost. Any tax collected on the nominal sales price charged by the carrier should be credited to the tax due. As stated in the Directive - "In the event that the Carriers collect a sales or use tax from their customers based upon the amount of any nominal consideration (reduced sales price) charged for the telephones, they may claim an offsetting credit for those amounts."

withdrawal provision applies to a sale at below cost tied to receipt of a commission for a related service, then the withdrawal provision should also apply to a sale at above cost where the sale is tied to a related service. Again, I disagree.

The withdrawal provision is intended to insure that a retailer that buys a product at wholesale is required to pay sales tax on at least the wholesale cost of that product if the product is subsequently withdrawn and used by the retailer for his own personal use. As stated, the "use" in this case occurs when the Taxpayer sells a telephone at below cost for the purpose of receiving a tangible benefit, i.e., a commission from Alltel. If a product is sold at above wholesale cost, the seller is not using the product within the context of the withdrawal provision. In that case, sales tax is due on the actual amount received.

The sale of cellular telephones by a dealer at below cost tied to receipt of a commission from a carrier is a relatively new business practice. Different states have taxed the transactions under a number of different theories. For example, if a dealer in Texas sells a telephone in a bundled transaction for less than 25% of its cost, the State of Texas does not recognize the transaction as a "sale", and thus requires the dealer to pay tax on the full wholesale cost.[2] If the sale price is over 25% of the wholesale

[2]A bundled transaction is a transaction where the sale of a telephone at below cost is tied to (bundled with) the customer having to obtain service from a specific carrier. An unbundled

cost, the dealer is allowed to pay on only the actual below cost sales price.

The Taxpayer is correct that Massachusetts DOR Directive 94-2 involves cellular telephone carriers, not dealers. The Taxpayer then cites Massachusetts DOR Directive 93-9, relating to dealers, in support of its case. However, Directive 93-9 also does not support the Taxpayer's case.

In Directive 93-9, the dealer buys a telephone at wholesale for $200.00. He normally sells the telephone at retail (unbundled) for $259.95. If the customer agrees to sign a service agreement with a specific carrier, the dealer will sell the telephone (bundled) for $129.95. The dealer then also receives a commission from the carrier.

Directive 93-9 states that "where a vendor (dealer) receives a non-cash item as part of the consideration for a retail sale, the vendor must include the value of that item in its gross receipts . . . In this instance, the value of the purchaser's non-cash

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transaction is when the sale is a normal, arm's-length sale not tied to the customer having to subscribe to service with a carrier.

consideration in executing the minimum service agreement is the difference between the amount the dealer charges for a particular telephone in a bundled transaction ($129.95) and the price the dealer would charge for that same telephone in an unbundled transaction ($259.95)". The Directive then concludes that for sales tax purposes, "the sale price of a cellular telephone sold in a 'bundled' transaction is the same as the sale price of the telephone sold in an 'unbundled' transaction", that is, $259.95. Thus, instead of paying sales tax on the below cost sale price of $129.95, as argued by the Taxpayer, or even on the wholesale cost of $200.00, as is required under the Alabama withdrawal provision, Massachusetts requires the dealer to pay sales tax on the unbundled sale price of $259.95. If Directive 93-9 was effective in Alabama, the Taxpayer would owe sales tax on the wholesale cost of the telephone, plus whatever mark-up the Taxpayer would normally apply.

Likewise, in the State of Rhode Island regulation attached as Exhibit D to the Taxpayer's brief, the dealer is required to pay tax on the reduced retail sales price charged to the customer and the amount received from the carrier pursuant to the agreement with the dealer. The regulation is unclear as to whether the carrier reimburses the dealer only for the difference between the reduced (bundled) sales price and what would have been charged by the dealer normally (unbundled price), or whether the carrier pays a commission to the dealer, as does Alltel in this case. But in either case, clearly Rhode Island requires the dealer to pay sales

tax on an amount in excess of the dealer's wholesale cost of the telephone.

Finally, the Taxpayer has submitted a non-binding opinion letter from the Florida Department of Revenue dated July 1, 1994. That letter states that the dealer owes tax on the actual retail sales price charged to the customer. (The letter does not specify whether the price charged by the dealer to the customer is below or above the dealer's cost. Rather, it only states that "the agent (dealer) then determines a selling price . . ."). However, Florida apparently does not have a sales tax "withdrawal" provision similar to Alabama's. Thus, Florida's treatment of the subject transactions cannot be considered as authority in deciding how Alabama should tax the transactions.

The transactions in issue present a theoretically difficult tax question. The various states that have addressed the issue have taken dramatically different approaches. As stated in the Opinion and Preliminary Order, at page five, taxing the wholesale cost of the telephones under the withdrawal provision is a practical solution, and, more importantly, is in accordance with Alabama law. A retailer cannot under Alabama law buy an item at wholesale, use the item for a business purpose, and then pay tax on less than the wholesale cost of the item. Selling the telephones at below cost in return for an Alltel commission is a business purpose use by the Taxpayer. Tax should thus be paid on the wholesale cost.

The Taxpayer indicates that this holding can have wide-ranging implications. However, I must emphasize that this holding applies only to the particular fact situation in issue. It does not apply to other transactions such as two-for-one sales, meals given away to a child if an adult buys a meal at regular price, etc. Nor does it apply to items sold at below cost for promotional or advertising purposes, i.e. loss leaders, where the retailer does not receive a direct, additional monetary benefit. The Department to my knowledge has never attempted to tax those transactions, and this holding is not intended to apply to those transactions. Rather, this holding applies only to cases where property is sold at below cost, and in return the purchaser is required to subscribe to some service for which the seller receives compensation.

The next issue is whether this holding should be applied retroactively or prospectively. There is no constitutional provision that requires retroactive application of a judicial decision. The Great Northern Railway Co. v. Sunburst Oil and Refining Co., 53 S.Ct. 145 (1932).

The leading case on whether a new interpretation of a statute should be applied retroactively or prospectively is Chevron Oil Co. v. Huson, 92 S.Ct. 349 (1971); see also, American Trucking Association, Inc. v. Smith, 110 S.Ct. 2323 (1990). In Chevron Oil, at page 355, the United States Supreme Court set out a three-factor test, as follows:

"In our cases dealing with the nonretroactivity question,

> we have generally considered three separate factors. First, the decision to be applied nonretroactively must establish a new principle of law, either by overruling clear past precedent on which litigants may have relied, see *e.g.*, Hanover Shoe, Inc. v. United Shoe Machinery Corp., *supra*, 392 U.S., at 496, 88 S.Ct., at 2233, or by deciding an issue of first impression whose resolution was not clearly fore-shadowed, see *e.g.*, Allen v. State Board of Elections, *supra*, 393 U.S., at 572, 89 S.Ct., at 835. Second, it has been stressed that 'we must * * * weigh the merits and demerits in each case by looking to the prior history of the rule in question, its purpose and effect, and whether retrospective operation will further or retard its operation.' Linkletter v. Walker, *supra*, 381 U.S., at 629, 85 S.Ct., at 1738. Finally, we have weighted the inequity imposed by retroactive application, for '[w]here a decision of this Court could produce substantial inequitable results if applied retroactively, there is ample basis in our cases for avoiding the 'injustice or hardship' by a holding of nonretroactivity.' Cipriano v. City of Houma, *supra*, 395 U.S., at 706, 89 S.Ct., at 1900."

Applying the three-factor Chevron Oil test to this case, the withdrawal provision should be applied to the transactions in issue prospectively only from the date the new interpretation was first announced on January 30, 1995.

Concerning the first Chevron Oil factor, clearly this case involves a new principle of law or interpretation of the withdrawal provision which was not previously established or reasonably foreseeable by the Taxpayer (or the Department). Ignorance of an established interpretation of a statute cannot relieve a taxpayer from retroactive liability for a tax. However, if the interpretation is new and not reasonably foreseeable, Chevron Oil requires that it be applied prospectively only. Prior to the January 30, 1995 Opinion and Preliminary Order, not even the

Department argued that the withdrawal provision should apply in this case.

In addition, due process also "requires fair notice that one's conduct is subject to a law or regulation". Brooks v. Ala. State Bar, 579 So.2d 33, at 34 (Ala. 1990). As stated, ignorance of a recognized rule of tax law cannot excuse a taxpayer from liability. But a taxpayer cannot be expected to comply with a new interpretation or application of a tax statute before it is established.

Concerning the second Chevron Oil factor, applying the new interpretation prospectively will not hinder or retard its future application. It should be applied uniformly to all transactions subsequent to its effective date.

Concerning factor three, clearly retroactive application would cause substantial hardship and inequity to the Taxpayer and all similarly situated cellular telephone dealers. They could not reasonably foresee that the tax was due. If a ruling "could produce substantial inequitable results if applied retroactively, there is ample basis in our cases for avoiding the 'injustice or hardship' by a holding of nonretroactivity". Cipriano v. City of Houma, 89 S.Ct. 1897, at p. 1900 (1969), citing Great Northern Railway Co. v. Sunburst Oil and Refining Co., supra.

Several Alabama Supreme Court cases also support the principle that a new interpretation of a tax statute should be applied prospectively only.

In City of Birmingham v. AmSouth Bank N.A., 591 So.2d 473 (Ala. 1991), the Jefferson County Circuit Court held that the City of Birmingham could not change its long-standing interpretation of a city ordinance levying an occupational license fee. The Alabama Supreme Court reversed, holding that the City's interpretation of the ordinance was contrary to the language of the ordinance and thus must be rejected. However, the Supreme Court affirmed the trial court's holding that the new interpretation could not be applied retroactively. City of Birmingham, at p. 477. See also, Ex parte Sizemore, 605 So.2d 1221 (Ala. 1992), in which the Alabama Supreme Court's new interpretation of the same withdrawal provision in issue in this case was given prospective application only.

The remaining issues in dispute are rendered moot by the above holding. The Opinion and Preliminary Order previously entered is affirmed to the extent that sales tax is due on the wholesale cost of tangible personal property sold at below cost where the reduced selling price is linked to an obligation by the customer to purchase or subscribe to some form of service for which the retailer receives compensation. However, because the above holding is a new application or interpretation of the withdrawal provision, it should be applied prospectively only from the date the Opinion and Preliminary Order was entered on January 30, 1995. Accordingly, because sales tax is not otherwise due, the final assessment in issue must be dismissed because it involves a period before the effective date of the new interpretation.

This Final Order on Application for Rehearing may be appealed by either party to circuit court within 30 days pursuant to Code of Ala. 1975, §40-2A-9(g).

Entered June 14, 1995.

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BILL THOMPSON
Chief Administrative Law Judge