MIKE KILGO & ASSOCIATES, INC. 3118 30TH AVENUE E. TUSCALOOSA, AL 35404-4988,	§	STATE OF ALABAMA ALABAMA TAX TRIBUNAL
	§	DOCKET NO. S. 14-1060
Taxpayer,	§	
v.	§	
STATE OF ALABAMA DEPARTMENT OF REVENUE.	§	

FINAL ORDER

The Revenue Department assessed Mike Kilgo & Associates, Inc. ("Taxpayer") for State and City of Demopolis sales tax for December 2009 through November 2012. The Taxpayer appealed to the Tax Tribunal pursuant to Code of Ala. 1975, §40-2A-7(b)(5)a. The parties submitted the case on a joint stipulation of facts and briefs. Assistant Counsel Mary Martin Mitchell represented the Department. Blake Madison represented the Taxpayer.

The Department audited and assessed the Taxpayer for State and City of Demopolis sales tax for the period in issue. The Taxpayer paid the uncontested City of Demopolis assessment in full, and also the uncontested portion of the State assessment. The issue concerning the disputed portion of the State assessment is whether the Taxpayer is liable for sales tax on freight or transportation charges under the particular facts of this case. The relevant facts, as stipulated by the parties, are as follows:

1. Kilgo is a corporation incorporated under the laws of the State of Alabama.

2. Kilgo is headquartered in Tuscaloosa, Alabama and sells marketing and advertising products such as pens and coffee mugs, personalized office supplies, screen printed merchandise, embroidery garments, etc.

3. Kilgo does not maintain inventory, but rather outsources most customer orders to order-specific vendors and suppliers.

* * *

16. The Department contends that Kilgo failed to collect and remit state sales taxes on freight charges.

17. Kilgo contends that the Department misapplied its Regulation 810-6-1-.179, *Transportation Costs, Sellers*, and that no additional sales tax is due from Kilgo on the freight charges in question when that regulation is correctly read in conjunction with Regulation 810-6-1-.178(2), *Transportation Charges.*

18. In the transactions in question, the goods purchased were delivered by common carrier. Kilgo was invoiced for freight charges by its suppliers. Thereafter, Kilgo passed those charges on to its customers for reimbursement using separate, identifiable line items on the invoices to its customers.

19. In the transactions in question, the items that were ordered were sometimes delivered to Kilgo, but most deliveries were shipped directly to Kilgo's customers.

20. Kilgo did not mark up any freight charges and was only reimbursed by its customers for the exact amount charged by the common carriers.

21. Likewise, Kilgo did not attempt to deduct the freight cost from its taxable gross proceeds. However, Kilgo did not include the freight charges in the taxable measure.

Alabama's appellate courts have addressed in three cases whether transportation charges incurred in delivering tangible person property to the buyer are subject to sales tax. The Department's Administrative Law Division, now the Tax Tribunal, addressed those cases in *State of Alabama v. Emack Slate Co., Inc.*, Docket S. 84-172 (Admin. Law Div. 5/1/1986), as follows:

> The issue in the present case is whether the freight charges prepaid by the Taxpayer, and for which the Taxpayer was subsequently reimbursed by the customer, constitute gross proceeds of sale within the scope of the (definition of "gross proceeds"). The taxability of transportation charges has been the subject of three Alabama appellate court decisions. *Alabama Precast*

Products, Inc. v. State, Department of Revenue, 332 So.2d 160 (1976); *East Brewton Materials, Inc. v. State, Department of Revenue*, 233 So.2d 751 (1970); *State v. Natco Corporation*, 90 So.2d 385 (1956).

In the earliest case on the subject, *Natco*, the taxpayer manufactured and sold clay products. The goods were shipped from one of the taxpayer's plants, located either within or outside of the State, to customers in Alabama. The Department entered a use tax assessment against the company based on the cost of transporting the products to the Alabama customer (place of use).

Delivery was by common carrier f.o.b. origin at the taxpayer's plant. The Supreme Court found that title to the property passed to the buyer at the point of origin and that any subsequent transportation charges were rendered to the buyer and thus not taxable as part of the sales price. The Court stated the general rule under which its decision was rendered as follows:

> . . . It is the general rule of law that where the agreement is to sell goods F.O.B. a designated place, such place will ordinarily be regarded as the place of delivery. *Sandford Service Company v. City of Andalusia*, 256 Ala. 507, 55 So.2d 856. And further the general rule is that delivery of personal property by the seller to a common carrier to be conveyed to the purchaser is a delivery to the purchaser and the title to the property vests in the purchaser immediately upon its delivery to the carrier. *Bank of Guntersville v. Jones Cotton Company*, 156 Ala. 525, 46 So. 971; *Alabama Great Southern R. Company v. H. Altman & Company*, 191 Ala. 429, 67 So. 589.

It should be noted that *Natco* was decided prior to the adoption of the Uniform Commercial Code (UCC) in Alabama. However, as discussed below, under similar facts the same conclusion would be reached under the applicable provisions of the UCC chapter on sales, Code of Alabama 1975, §7-2-101, et seq.

In *East Brewton Materials*, the taxpayer sold sand, gravel and plant mix asphalt. The sales in issue involved deliveries by the taxpayer either in its own trucks or trucks leased for that purpose. As in the present case, the invoice to the customer listed separately the charges for materials and delivery.

The Court of Civil Appeals found that the delivery charges were taxable, holding that title to the goods did not pass until after delivery of the materials

by the taxpayer. The taxpayer argued that *Natco* was controlling. However, the Court distinguished the two cases by pointing out that *Natco* involved delivery by a common carrier f.o.b. origin with title passing prior to delivery, whereas *East Brewton Materials* involved delivery in trucks either owned or leased by the taxpayer, with title passing after delivery. The Court held as follows:

> . . ., we are of the opinion that the legislature intended thereby that sales tax be charged upon the total invoice price, including transportation charges incident to delivery of the material sold to a customer, when such transportation was provided by the seller, not by common carrier, and the sale was not completed or title transferred until delivery to the customer.

The most recent case involving delivery charges is *Alabama Precast*. In that case, the taxpayer sold concrete blocks which were delivered to the buyer by contract carrier. No evidence was presented as to whether the sales were f.o.b. origin or f.o.b. destination. Again, the materials and transportation charges were listed as separate line items on a single invoice.

It was found that the delivery charges were not taxable. In so holding, the Court relied on Department Reg. T18-011, which distinguished between delivery f.o.b. origin (taxable) and f.o.b. destination (non-taxable). However, because the deliveries were by common carrier, with no f.o.b. designation, the Court found that the regulation was by its own language inapplicable.

* * *

From the above cases it can be said that the taxability of delivery charges relating to a sale turns on the question of whether the transpiration services to which the charges apply are completed prior to or after the incident of sale. If delivery is prior to completion of the sale, the charges are taxable. Conversely, if delivery is made subsequent to the sale, the charges are not taxable.

Emack Slate at 3 – 7.

During the tax period in issue in *Emack Slate*, the term “sale” was defined for sales tax purposes at Code of Ala. 1975, §40-23-1(a)(5) as “[i]nstallment and credit sales and the exchange of property as well as the sale thereof for money, every closed transaction constituting a sale.” The Alabama Legislature amended §40-23-1(a)(5) by Act 86-536 in 1986 to read as it currently does, as follows:

> (5) SALE or SALES. Installment and credit sales and the exchange of properties as well as the sale thereof for money, every closed transaction constituting a sale. Provided, however, a transaction shall not be closed or a sale completed until the time and place when and where title is transferred by the seller or seller's agent to the purchaser or purchaser's agent, and for the purpose of determining transfer of title, a common carrier or the U. S. Postal Service shall be deemed to be the agent of the seller, regardless of any F.O.B. point and regardless of who selects the method of transportation, and regardless of by whom or the method by which freight, postage, or other transportation charge is paid. Provided further that, where billed as a separate item to and paid by the purchaser, the freight, postage, or other transportation charge paid to a common carrier or the U.S. Postal Service is not a part of the selling price.

Pursuant to §40-23-1(a)(5), as amended, if goods sold at retail are delivered to the buyer via common carrier or the U.S. Postal Service, the sale is not closed until the goods are delivered by the common carrier or the Postal Service, i.e., the seller's agent, to the buyer. Consequently, pursuant to *Emack Slate* and the cases cited therein, the transportation charges in issue would have been includable in taxable gross proceeds because the delivery by the common carriers, i.e., the Taxpayer's agents, occurred before the sales were closed.

But in addition to making common carriers and the Postal Service agents of the seller, Act 86-536 also added the following language to §40-23-1(a)(5) – "Provided further that, where billed as a separate item to and paid by the purchaser, the freight, postage, or other transportation charge paid to a common carrier or the U.S. Postal Service is not a part of the selling price." Consequently, based on the above provision, even though a sale is not closed until a common carrier or the Postal Service completes delivery on behalf of the seller, the transportation charges are not taxable if separately billed to and paid by the purchaser. It is undisputed that the Taxpayer separately billed the transportation charges

in issue to its customers. The issue is whether the transportation charges were also "paid by the purchaser."

The Department has issued two regulations concerning the taxability of transportation charges. Reg. 810-6-1-.179, effective October 1, 1982, reads as follows:

810-6-1-.179. Transportation Costs, Sellers.

> In no event may a seller deduct costs of bringing property to his place of business or costs of delivering property from factory to his customer when such factory to customer transportation is paid by the seller either to a transportation company, the manufacturer, or by way of credit to this customer for transportation costs paid by the customer and deducted from seller's invoice. (Section 40-23-1(a)(6)) (Readopted through APA effective October 1, 1982)

Reg. 810-6-1-.178, also effective October 1, 1982, was amended in April 1987 to reflect the 1986 amendment to §40-23-1(a)(5). That regulation, as amended, reads as follows:

810-6-1-.178. Transportation Charges.

> (1) Where a seller delivers tangible personal property in his own equipment or in equipment leased by him, the transportation charges shall be considered a part of the selling price subject to sales or use tax. Said transportation charges are taxable even if billed separately.
>
> (2) Where delivery of tangible personal property is made by common carrier or the U. S. Postal Service, the transportation charges shall not be subject to sales or use tax if billed as a separate item and paid directly or indirectly by the purchaser. To be excluded from the measure of tax, these transportation charges must be separate and identifiable from other charges. Transportation charges are not separate and identifiable if included with other charges and billed as "shipping and handling" or "postage and handling". Indirect payment of the transportation charges shall include those instances where the seller prepays the freight to the common carrier or U. S. Postal Service and is reimbursed by the purchaser.
>
> (3) Where a seller contracts to sell and deliver tangible personal property to some designated place and makes arrangements for delivery of the

> property by means other than a common carrier or the U. S. Postal Service, the transportation charges shall be considered a part of the selling price subject to sales or use tax. Said transportation charges are taxable even if billed separately. (Sections 40-23-1(a)(5) and 40-23-1(a)(6)) (Amended August 16, 1974, amended October 29, 1976, readopted through APA effective October 1, 1982, amended April 3, 1987)

The Department argues that the freight charges in issue are taxable pursuant to Reg. 810-6-1-.179, which states that "[i]n no event may a seller deduct . . . costs of delivering property from factory to his customer when such factory to customer transportation is paid by the seller . . . to the manufacturer. . . ." The Department asserts that the above language applies in this case because the Taxpayer paid the transportation charges to its suppliers. It further contends that the Taxpayer's customers did not directly or indirectly pay the freight charges, as required for the charges to be tax-free pursuant to Reg. 810-6-1-.178(2), because the Taxpayer's suppliers and not the Taxpayer prepaid the freight to the common carriers.

> As noted previously, it is undisputed that Kilgo did not pay the common carrier for the freight charges as it merely reimbursed the supplier for such transportation charges that the supplier incurred to direct mail merchandise from the supplier's factory to Kilgo's customers. Accordingly, although it is undisputed that Kilgo billed the freight charges at issue as a separate item when invoicing its customers, the freight charges are not exempt from taxation pursuant to Ala. Admin. r. 810-6-1-.178(2) because the transportation charges were not indirectly paid by the purchaser as required by the rule.

Department's Brief at 5 – 6.

I first disagree with the Department's interpretation of Reg. 810-6-1-.178(2). When the Legislature amended §40-23-1(a)(5) in 1986, it clearly intended to exclude transportation charges from taxable gross proceeds if (1) the charges could be specifically identified, i.e., were billed separately to the purchaser, and (2) the purchaser paid the

charges, i.e., ultimately bore or incurred the financial burden for the charges. Consequently, while the Taxpayer's suppliers directly paid the freight charges to the common carriers, the Taxpayer's customers indirectly paid the charges because the suppliers billed the Taxpayer for the charges, and the Taxpayer billed its customers. The last sentence of Reg. 810-6-1-.178(2) stating that indirect payment of freight charges "shall include" instances where the seller prepays and is reimbursed by the purchaser is not an all-encompassing list of examples of indirect payment. That is, "shall include" should not be construed as "only includes." The transportation charges in issue were clearly indirectly paid by the Taxpayer's customers, i.e., the purchasers, because, as discussed, they reimbursed the Taxpayer and ultimately bore the economic burden for the deliveries. The Legislature clearly intended to exclude such transportation charges paid by the purchaser from taxable gross proceeds.

The above conclusion also is not altered by Reg. 810-6-1-.179. I first note that Reg. 810-6-1-.179 was promulgated in 1982, before the 1986 amendment to §40-23-1(a)(5). The regulation provides that the cost of transporting goods from the factory to the customer is includable in taxable gross proceeds when such cost is paid by the seller. I agree with that statement, but the regulation does not apply in this case because as discussed, the freight charges in issue were ultimately paid by the Taxpayer's customers, not the Taxpayer, as seller.

In summary, the phrase "paid by the purchaser" in §40-23-1(a)(5) should be construed to include instances when the purchaser directly pays the transportation charges, and also when the purchaser indirectly pays, i.e., bears the ultimate economic burden, for the deliveries. This is confirmed by Reg. 810-6-1-.178(2), which correctly

provides that transportation charges are not taxable if "paid directly or indirectly" by the purchaser. When the purchaser pays or reimburses the seller for the transportation charges, and thus bears the ultimate economic burden for those charges, as in this case, the charges are in substance "paid by the purchaser" within the purview and intent of §40-23-1(a)(5), as amended in 1986. The above finding is supported by the rule of statutory construction that substance must govern over form in tax matters. *State of Alabama v. Rockaway Corporation*, 346 So.2d 444 (Ala. Civ. App. 1977).

The disputed portion of the State sales tax final assessment in issue is voided. Judgment is entered accordingly.

This Final Order may be appealed to circuit court within 30 days pursuant to Code of Ala. 1975, §40-2B-2(m).

Entered January 13, 2016.

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BILL THOMPSON
Chief Tax Tribunal Judge

bt:dr
cc: Mary Martin Majors, Esq.
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