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| HALLMAN ENTERPRISES, LLC<br>1920 SPARKMAN DR. NW, STE 2<br>HUNTSVILLE, AL 35816, | § | STATE OF ALABAMA<br>ALABAMA TAX TRIBUNAL |
| Taxpayer, | § | DOCKET NO. S. 15-1210 |
| v. | § | |
| STATE OF ALABAMA<br>DEPARTMENT OF REVENUE. | § | |

**FINAL ORDER**

The Revenue Department assessed Hallman Enterprises, LLC ("Taxpayer") for State sales tax for August 2011 through June 2014. The Taxpayer appealed to the Tax Tribunal pursuant to Code of Ala. 1975, §40-2A-7(b)(5)a. A hearing was conducted on January 6, 2016. Mike Wisner represented the Taxpayer. Assistant Counsel Mary Martin Mitchell represented the Department.

The Taxpayer operated Hallman's Music Store in Huntsville, Alabama during the period in issue. The Department audited the Taxpayer for the subject period and thereafter entered the sales tax final assessment in issue. According to the Department's audit report, "[t]he store sells musical instruments and accessories, as well as, sheet music. Repair services are also offered at the store. In addition to cash and credit card sales, Hallman's Music Store offers its customers a contractual installment plan for payment." Taxpayer Ex. 1 at 1.

As indicated, the Taxpayer made some cash and credit card sales during the audit period. The Taxpayer charged, collected, and remitted sales tax to the Department on those sales, which are not in issue. Some of the Taxpayer's customers also entered into written "lease to own" agreements with the Taxpayer whereby the customers agreed to make monthly payments over a period of months. The written agreement, Taxpayer Ex. B,

specified that "[a]fter the final lease payment is made and only then, the instrument becomes (the) property of the lessee (person making the payments). Otherwise, the instrument remains the property of HALLMAN'S MUSIC." The agreement also provided that a "Comprehensive Maintenance Agreement is included in the (monthly lump-sum) payments." The Taxpayer thereafter provided a copy of the lease to own agreement to the customer, and also a separate maintenance agreement, signed by the Taxpayer's owner, identifying what was covered by the agreement.

The Taxpayer also provided its customers with a sales invoice, which also included only a lump-sum amount. The Taxpayer's owner thereafter broke out or separately stated on his copy of the sales invoice the separate amounts charged for the instrument, for the maintenance agreement, and for sales tax.

The Taxpayer also posted price lists on the counters inside its store, which included the list price and the monthly "rental" amount for the various types of instruments the Taxpayer offered to its customers. The lists specified that the amounts "Includes CMA and Sales Tax."

On audit, the Department examiner determined that "[s]ince the maintenance fees were not listed separately at the time any of the contracts were signed nor originally in ink on the Sales Invoices, the fees are part of the gross receipts of sale, and thus are taxable." Taxpayer Ex. 1. Whether the maintenance fees are subject to sales tax is the sole issue in this case.[1]

[1] Both parties addressed in their briefs the issue of whether the Taxpayer had a sign in its store stating that sales tax was included in the lump-sum price charged by the Taxpayer. Whether there was such a sign is not an issue, however, because the Department examiner testified that there was a sign in the store, and that she backed out (continued)

Concerning the sales tax due on the items removed from inventory and used by the Taxpayer to repair instruments pursuant to the comprehensive maintenance agreements, the examiner determined that "[t]his portion of the examination was not attempted due to the difficult and time-consuming steps necessary to determine the tax due and the unlikelihood of significant tax due." Taxpayer Ex. 1 at 3.

The Department examiner initially determined that the lump-sum proceeds from the Taxpayer's lease to own agreements were subject to rental tax. After she submitted her rental tax audit to the Department in Montgomery for review, however, she was instructed to convert the audit to a sales tax audit. The examiner did so, which resulted in the sales tax final assessment in issue.

The examiner nonetheless concluded that the Taxpayer's lease to own agreements constituted leases, and not sales. "During the examination, it was determined that Hallman's contractual sales did not meet the requirements for sales . . . . These transactions were rentals." Taxpayer Ex. 1 at 5. The examiner consequently opened the

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sales tax from the Taxpayer's gross receipts before computing the tax due.

> Judge Thompson: Oh, okay. Okay. I thought an issue was the fact that he didn't separately state the tax on the invoice?
>
> A. No, sir. No, sir. He had a sign in his store that stated –
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> Judge Thompson: Okay. I thought that was an issue. But apparently it's not, then.
>
> A. No, not to the State.
>
> Judge Thompson: Okay. So you back out the tax.
>
> A. Yes.

(T. 18).

Taxpayer a rental tax account with the Department and explained to the owner how rental tax should be reported and paid on the lease to own agreements in the future.

I agree with the examiner that the proceeds from the lease to own agreements were subject to lease or rental tax, not sales tax. In *State, Dept. of Rev. v. Boyd Brothers Transportation, Inc.*, 56 So.3d 701 (Ala. Civ. App. 2010), one of the issues was whether certain lease purchase agreements between Boyd Brothers and its drivers constituted sales or leases. The drivers agreed to make monthly payments to Boyd Brothers for the use of a Boyd Brothers' truck, and after the agreed price was paid in full, the driver had the option of purchasing the truck for a final payment of one dollar. Sixty six drivers defaulted on the agreement before paying the full amount due, but four paid the full amount and purchased the trucks.

The Revenue Department determined that the transactions constituted conditional sales. It accordingly assessed Boyd Brothers for sales tax. The Court of Civil Appeals disagreed, holding that the transactions were leases, not sales.

> Assuming, without deciding, that the 66 agreements on which drivers defaulted were actually conditional-sales agreements, the Department has not established that Boyd Brothers is liable for sales taxes on the transactions arising from those agreements. "Alabama sales tax applies only to sales that are 'closed' within the State. Sections 40-23-1(a)(5), -2 (1), Code of Alabama (1975)." *State v. Delta Air Lines, Inc*., 356 So. 2d 1205, 1207 (Ala. Civ. App. 1978). Section 40-23-1 (a) (5), Ala. Code 1975, provides that "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." In this case, it is undisputed that, regarding each of the 66 agreements on which a driver defaulted, no title to any truck was transferred from Boyd Brothers to any driver. Because there was no transfer of title, there was no completed sale; therefore, no sales taxes are due regarding transactions stemming from those 66 agreements.

*Boyd Brothers*, 56 So.3d at 705.

The above rationale applies in this case. The Taxpayer retained title to the instruments involved in the lease to own agreements until the customers made all of the monthly payments. The customers could also return the instruments before all of the monthly payments were made and would not be liable for the remaining payments. Both of the above facts are characteristic of a lease transaction, not a sale. The transactions thus constituted rental or lease transactions, as clearly specified in the lease to own agreements.

As discussed, the issue addressed by the parties in their briefs is whether the receipts from the maintenance contracts were subject to sales tax. The Taxpayer argues that the receipts are nontaxable based on Department Reg. 810-6-1-.186.05(1), which provides that "[w]hen a dealer sells an extended warranty or service contract, no sales tax is due."

The Department contends that the maintenance fee receipts are taxable because the maintenance agreements were required, and also because the maintenance agreement fees were not separately stated on the sales invoices provided to the Taxpayer's customers. "The CMA is a cost that was included in the (lump-sum) selling price of the instruments at issue. Thus, pursuant to Alabama law, a service agreement embedded in the sales price, paid by the (purchaser) is considered gross proceeds to be included in the taxable measure." Department's Brief at 4.

The above issue need not be decided in this case, however, because even if the maintenance agreement receipts were taxable, they would be subject to lease tax, not sales tax, as assessed by the Department.[2]

The Department's Administrative Law Division, now the Tax Tribunal, held on several occasions that a final assessment entered for the wrong tax period or wrong type of tax must be voided. In *Diversified Sales, Inc. v. State of Alabama*, Docket S. 02-458 (Admin. Law Div. 3/13/2003), the Department incorrectly assessed the taxpayer for municipal sales tax, not municipal use tax. The Division voided the erroneous final assessment, as follows:

> Department Reg. 810-14-1-.15 governs the entry of final assessments by the Department. That regulation requires that, among other information, a final assessment must include the "character or type of tax/value of the liability assessed." See, Reg. 810-14-1-.15(3)(c).
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> In *Knight v. State of Alabama*, Inc. 99-431 (Admin. Law Div. 5/23/00), the Administrative Law Division held that a final assessment entered for a wrong tax period must be voided.
>
> > Due process requires that a final assessment must include the name of the taxpayer or taxpayers, the type of tax assessed, the tax period or periods involved, and the amount owed. See also, Department Reg. 810-14-1-.15. The amount of an assessment can be increased or decreased on appeal to

[2] Maintenance or service agreement receipts may or may not be subject to sales or rental tax, depending on the particular facts of the case. As indicated, Reg. 810-6-1-.186.05(1) specifies that receipts from the sale of service contracts are not subject to sales tax. But Alabama's courts have also held that retailers must keep adequate records distinguishing between its taxable and nontaxable receipts, and if the retailer fails to do so, sales tax is due on the total amount. See generally, *State v. Ludlum*, 384 So.2d 1089 (Ala. Civ. App.), cert. denied, 384 So.2d 1094 (Ala. 1980).

For rental tax purposes, Reg. 810-6-5-.09.01 provides that the receipts from a service contract that the lessor requires as a part of the lease agreement is taxable, but that the receipts from a separate service contract or agreement that the lessee has the option of purchasing or not purchasing are not subject to rental tax.

> reflect the correct tax due. Code of Ala. 1975, §40-2A-7(b)(5)d.1. Other than the amount, however, the other substantive components of a final assessment cannot be "corrected" on appeal. Specifically, the listing of a wrong tax period on an assessment is grounds for dismissal of the assessment. *Stallard v. U.S.*, 12 F.3d 489 (1994) ("And accurately ascertaining the correct tax period is more than a mere 'technicality.'") Consequently, the final assessment of 1996 income tax cannot be substantively changed to a final assessment of 1995 tax.

*Knight* at 2.

> The type of tax assessed by the Department is not a mere technicality. Rather, it is as substantively important as the tax period involved. Further, a Department regulation must be followed unless it is unreasonable or contrary to the statute to which it relates. *Adair v. Alabama Real Estate Comm'n*, 303 So.2d 119, 122 (Ala. Civ. App. 1974). The requirement that a final assessment must correctly identify the type of tax being assessed is not unreasonable. The requirement also is not contrary to any statute. "Men must turn square corners when they deal with the government; it is hard to see why the government should not be held to a like standard of rectangular rectitude when dealing with its citizens." *Title Ins. Co. of Minn. v. SBE*, 4 Ca. 4th 715, 732 (Calif. S. Ct. 1992). Consequently, the municipal sales tax final assessment in issue must be voided to the extent it consists of use tax on the materials used on the furnish and install contracts.

*Diversified* Sales at 4 – 5.

Because the lease to own agreements were subject to lease tax, and not sales tax, the receipts from the maintenance contracts associated with those agreements, if taxable at all, would have been subject to lease tax, not sales tax. Consequently, the erroneously issued sales tax final assessment in issue must be 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 March 16, 2016.

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BILL THOMPSON
Chief Tax Tribunal Judge

bt:dr
cc: Mary Martin Mitchell, Esq.
Michael K. Wisner, Esq.