B & B INFLATABLE FUN WORLD LLC, AND ITS SOLE MEMBER LISA A. BATSON 29 COUNTY ROAD 527 MIDLAND CITY, AL 36350-3567, Taxpayer, v. STATE OF ALABAMA DEPARTMENT OF REVENUE.	§ § § § § § § §	STATE OF ALABAMA ALABAMA TAX TRIBUNAL DOCKET NO. S. 15-1595

FINAL ORDER

The Revenue Department assessed B & B Inflatable Fun World LLC ("Taxpayer"), and its sole member Lisa A. Batson, for rental tax for October 2011 through September 2014. A hearing was conducted on February 23, 2016. David Johnston represented the Taxpayer. Assistant Counsel Jason Paulk represented the Revenue Department.

The Taxpayer rents inflatables, interactive games, tables, chairs, and various other items from its location in Houston County, Alabama. Lisa Batson has owned and operated the business since 2003.

Batson testified at the February 23 hearing that her customers generally contact her by telephone and tell her what items they want to rent, the date and location they want the items, and also whether they want the Taxpayer to deliver the items to the location and/or pick up the items after the rental period is over.

Batson takes notes concerning the above information after the initial contact with her customers. She explained that customers often change their minds about what items they want to rent, and also whether they want to return the rented items or have the Taxpayer pick them up.

A day or so before the rental date, Batson contacts the customer and confirms the items being rented. She also completes a form document that identifies the items being rented, the rental amount, and when the items are to be delivered ("drop time") and picked up ("pickup time"), if applicable. Batson also writes on the document the words – "pick up fee can apply."

A driver employed by the Taxpayer takes the completed form document when the rented items are delivered to the customer. The customer signs the document upon delivery, and also pays the driver for the items. The driver also provides the customer with an invoice that identifies the items being rented and the amount charged to the customer, which includes a pickup fee unless the customer had previously notified the Taxpayer that they intended to return the items to the Taxpayer.

Batson explained that she never deposits a customer's check before the items are returned to the Taxpayer because in some cases the customer opts, after the items are delivered, to return the items back to the Taxpayer instead of having the Taxpayer pick them up. In that case, the customer writes the Taxpayer another check for the rental, less the pickup fee. Batson then gives the customer a revised form document showing the reduced amount paid by the customer.

The Taxpayer charged its customers for rental tax on the charge for the items being rented, but not on the pickup fees. Batson explained that she did not charge tax on the pickup fees during the audit period because she was told by the Department in a prior audit that pickup fees were not subject to rental tax. An April 3, 2009 email from the Department examiner that audited the Taxpayer in 2009 to the Taxpayer's CPA confirms Batson's claim, see Taxpayer Ex. 1. The Taxpayer thereafter reported its gross receipts on its

monthly rental tax returns, less the pickup fees.

The Department audited the Taxpayer for the period in issue and assessed it for rental tax in issue on the pickup fees. This appeal followed.

The Department's position is that the Taxpayer's pickup fees were taxable because the Taxpayer did not have "a separate, optional agreement for delivery and pick-up," as required for the pickup fees to be nontaxable pursuant to Reg. 810-6-5-.09.01(3)(b).[1]

The Tax Tribunal addressed the above regulation in *Brock Services, LLC v. State of Alabama*, Docket S. 14-1236 (T.T. 9/28/2015). Brock Services rented construction scaffolding to various customers. The issue was whether scaffolding erection labor services performed by Brock for a customer were subject to Alabama's rental tax when Brock also rented the scaffolding to the customer. The Tribunal held that the labor services were separate from the rental of the scaffolding, and thus not subject to rental tax. That part of the Final Order in *Brock Services* that addresses the above regulation is set out below:

> The Department's regulation on the leasing or rental of tangible personal property, Reg. 810-6-5-.09.01, provides in part:
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> > (3)(a) When a lessor engaged in leasing or renting tangible personal property requires maintenance of the item leased or rented as part of the leasing or rental contract, the gross proceeds derived therefrom, including charges for maintenance, will be subject to the tax. When there is a separate, optional contract for maintenance only, the rental or leasing tax will not apply to the gross proceeds derived therefrom.
> >
> > (b) When a lessor engaged in leasing or renting tangible personal property is required to deliver and pick-up the leased

[1] The above quoted language was added when the regulation was amended, effective October 1, 2010, after the Department completed its first audit of the Taxpayer.

> property as part of the leasing or rental contract, the gross proceeds derived therefrom, including the delivery and pick-up charges, will be subject to the tax. When there is a separate, optional agreement for delivery and pick-up of the leased property, the rental tax will not apply to the gross proceeds derived therefrom.
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> (c) When a lessor engaged in leasing or renting tangible personal property is required to provide installation or setup services as part of the leasing or rental contract, the gross proceeds derived therefrom, including charges for the installation or setup, will be subject to the tax. When there is a separate, optional agreement for installation or setup of the leased property, the rental tax will not apply to the gross proceeds derived therefrom. (T*hyssenkrupp Safeway, Inc. v. State of Alabama* (Admin. Law Div. Docket No. S. 08-401, Final Order entered March 18, 2009)).

The above provisions make the same contract versus separate contract issue controlling because they provide that labor services are taxable if included in the rental contract, but not taxable if contracted for separately. But the substance of the transaction or transactions must control in tax matters, not the form. "Substance must govern over form. Otherwise, evasion of the taxing statutes would be permitted by merely affixing a non-taxable label to an otherwise taxable transaction." *State v. Rockaway Corporation*, 346 So.2d 444, 448 (Ala. Civ. App. 1977). If the labor is performed as a direct result of and thus incidental to the leasing of the property, the labor proceeds are in substance derived from the lease transaction, and thus subject to lease tax. In such cases, the taxable proceeds should not become nontaxable simply because the leasing of the property and the labor were required by separate contracts. Conversely, if the labor is not a direct result of and incidental to the leasing of the property, the proceeds are not subject to lease tax, even if the labor is required by the lease agreement.

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In *Thyssenkrupp*, the Division stated that the scaffolding services were "optional, and thus not a required service performed incidental" to the lease. *Thyssenkrupp* at 3. Presumably based on that statement, paragraphs (3)(a), (b), and (c) of Reg. 810-6-5-.09.01 provide that the various services are not taxable if there is "a separate, optional agreement" between the parties for the services. As discussed, I now believe that whether the rental of property and the providing of labor services are required by a single contract or by separate contracts is irrelevant.

Brock Services at 8, 9 and 11, 12.

In this case, the evidence shows that the Taxpayer's customers knew that they had the option of returning the rented items to the Taxpayer's place of business or having the Taxpayer pick up the items. They could also opt to return the items themselves, even after they had prepaid the Taxpayer for picking up the items. The parties thus in substance had an agreement or understanding that the customer had the option of returning the items or having the Taxpayer pick them up. They thus had a separate, optional agreement that the customer could return the rented items and not incur a pickup fee.[2]

The optional pickup services also were not taxable because they were performed after the agreed upon rental period had expired.

For sales tax purposes, services performed by a retail seller incidental to a retail sale, including delivery charges, are subject to Alabama sales tax if the services are performed before or in conjunction with the taxable sale, i.e., before transfer of title upon delivery. See generally, *State v. Service Engraving Co., Inc.*, 495 So.2d 695 (Ala. Civ. App. 1984); *East Brewton Materials v. State*, 233 So.2d 751 (Ala. Civ. App. 1970); *Port City Mobile Homes v. State of Alabama*, Docket S. 05-767 (Admin. Law Div. 11/20/2007).

The above principle also applies for lease tax purposes. Consequently, if a lessor charges a fee for delivering the leased items to the lessee, the charges are taxable, even if separately stated, because the service is incidental to and performed before or in conjunction with the taxable transaction; i.e., the lessor giving the lessee possession and use of the leased property for a fixed period.

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[2] The regulation does not require that the agreement must be in writing.

In this case, the pickup services performed by the Taxpayer occurred after the fixed rental period. Consequently, the services were not incidental to or performed in conjunction with the rental, and thus were not subject to Alabama rental tax. The Department examiner that initially audited the Taxpayer in 2009 reached the same conclusion in her April 3, 2009 email to the Taxpayer's CPA, Taxpayer Ex. 1. That email reads in part:

> Regarding the pick up fees for rentals. . . Section 40-12-220(4), which defines "gross proceeds", is very broad and was obviously framed in such broad terms so as to prevent taxpayers from designating or allocating various costs under separate labels so as to render the receipts derived therefor non-taxable as not being receipts derived from the leasing of tangible personal property. With that being said however, the department looks at ruling made on specific issues when determining how to handle items in question. According to the court case that I gave you, *Kambiz Adeli, dba Arthur's Conference Center/Audio Visual Express vs. the State of Alabama Department of Revenue*, the judge agreed that "charges for delivery after a sale or lease of tangible person property has occurred are <u>not including in taxable gross proceeds</u>, (however), a lease transaction is not closed until the lessor transfers possession and use of the leased item to the lessee" (which is why delivery & setup fees charged initially by the taxpayer are considered taxable as part of gross receipts). (emphasis in original)

The final assessment 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 July 20, 2016.

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BILL THOMPSON
Chief Tax Tribunal Judge

bt:dr
cc: Jason C. Paulk, Esq.
G. David Johnston, Esq.