LASER VISION CENTERS, INC. 540 Maryland Center Drive, Suite 200 St. Louis, MO 63141,	§	STATE OF ALABAMA DEPARTMENT OF REVENUE ADMINISTRATIVE LAW DIVISION
Taxpayer,	§	DOCKET NO. S. 03-1161
v.	§	
STATE OF ALABAMA DEPARTMENT OF REVENUE.	§	

OPINION AND PRELIMINARY ORDER

The Revenue Department assessed Laser Vision Centers, Inc. ("Taxpayer") for lease tax for February 1998 through December 2002. The Taxpayer appealed to the Administrative Law Division pursuant to Code of Ala. 1975, §40-2A-7(b)(5)a. A hearing was conducted on June 17, 2004. John Allan, Tim Carlson, and CPA Wayne Danneman represented the Taxpayer. Assistant Counsel Wade Hope represented the Department.

ISSUE

The Taxpayer provided laser machines to ophthalmologists in Alabama that used the machines to perform laser eye surgeries. The primary issue is whether the Taxpayer is liable for lease tax on the machines. That issue turns on whether the transactions constituted leases as defined for Alabama lease tax purposes at Code of Ala. 1975, §40-12-220(5). If the lasers are subject to lease tax, a second issue involves the computation of the taxable lease proceeds.

FACTS

The Taxpayer provides laser machines and related equipment and services to ophthalmologists throughout the United States. The ophthalmologists use the machines to perform eye surgeries. However, the ophthalmologists cannot perform the surgeries without the help of a trained laser technician and other support personnel.

The Taxpayer provides both fixed-site and mobile laser machines. The fixed-site machines remain at a single location, and the ophthalmologists pay for use of the machines on a per procedure (per eye) basis. The laser technicians and all other support personnel at the fixed sites are employed by the ophthalmologists. The Taxpayer concedes that it leases the fixed-site lasers to the ophthalmologists.

The Taxpayer's mobile laser machines are functionally identical to the fixed-site machines, except they are portable. The Taxpayer employs the laser technicians and the other support personnel needed to assist the ophthalmologists with the movable lasers. The technicians are responsible for transporting, setting up, calibrating, testing, and otherwise preparing the lasers for use. They monitor the machines during the surgeries, and may shut down the machines if a malfunction or a warning display occurs. The technicians also remove the lasers from the ophthalmologists' offices after the procedures are finished. The Taxpayer charges the ophthalmologists a lump-sum amount for both the use of the mobile lasers and its support personnel and services.

The actual eye surgeries are performed by the ophthalmologists, who use a manual control on the machine to center and focus the laser over the patient's eye. The ophthalmologists then use a foot switch to activate the laser to complete the procedure.

The Department audited the Taxpayer for the period in issue and billed the Taxpayer for lease tax, penalty, and interest on both the fixed-site and the mobile lasers. The Taxpayer paid the lease tax and interest due on the fixed-site machines. The Department subsequently entered the final assessment in issue for tax, penalty, and interest on the mobile lasers. The final assessment also includes a penalty of $4,597.47 relating to the fixed-site machines.

ANALYSIS

Section 40-12-220(5) defines "leasing or rental" for Alabama lease tax purposes, as follows:

> A transaction whereunder the person who owns or controls the possession of tangible personal property permits another person to have the possession or use thereof for a consideration and for the duration of a definite or indefinite period of time without transfer of the title to such property.

The Taxpayer argues that it does not lease the movable laser machines to the ophthalmologists. Rather, it contends that it is providing nontaxable laser access services.

> Laser Vision is not subject to the Alabama Rental Tax because it does not lease tangible personal property. Rather, Laser Vision provides non-taxable mobile laser services to ophthalmologists. At no time can the VISX laser be operated without a Laser Vision certified and trained Laser Engineer, and at no time does the Laser Engineer relinquish possession or control over the laser devices such that laser access services could be construed as a lease of tangible personal property. The conclusion of this case is controlled by *Alabama v. Steel City Crane Rental, Inc.*, 345 So.2d 1371 (Ala. Civ. App. 1977), and accordingly, the assessment must be abated in full.

Taxpayer's Brief at 6.

In *Steel City Crane*, the taxpayer, Steel City, provided large cranes to construction contractors. The cranes were furnished both with or without crane operators. Steel City conceded that the cranes provided without operators were being leased, and thus subject to Alabama lease tax. The dispute involved the cranes that Steel City provided with operators. The crane operators were employed by Steel City, and retained physical control and use of the cranes at all times.

The Court of Civil Appeals concluded that Steel City was not leasing the cranes.

> The principal characteristic of a rental or lease is the giving up of possession to the lessee so that he, as opposed to the lessor/owner, exercises control over and uses the leased or rented property. The facts of these cases revealed insufficient relinquishment of control over the equipment by the

> "lessor" to sustain a finding that the lessee was in possession of the equipment. Hence, there was no lease or rental.
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> Granted, the contractor/lessee derives a benefit from the completion of the tasks by the crane. However, it is the taxpayers, not the contractor/lessee, who "use" the cranes. The substance of taxpayers' contracts with the contractor-lessee are agreements to provide services for the contractor. Hence, in this instance, this court cannot accept the State's contention that such transactions are subject to the lease tax levied by (§40-12-222).

Steel City Crane, 345 So.2d at 1374, 1375.

In an excellent brief, the Taxpayer argues that the "principal characteristic of a rental or lease is the giving up of possession" of the tangible property in question. Taxpayer's Brief at 9, quoting *Steel City Crane*, 345 So.2d at 1373. It thus contends that because its employees are present during the surgical procedures and never give up possession of the laser machines, the machines are not being leased. "In summary, Laser Vision maintains control and possession of the laser at all times. . . Stated simply, the control of the laser equipment maintained by Laser Vision is inconsistent with having "given up" its possession." Taxpayer's Brief at 10.

The Taxpayer's reliance on *Steel City Crane* is misplaced. As discussed, Steel City's employees had sole control, possession, and use of the cranes. The contractors never physically possessed or used the cranes in any sense of the word.

In this case, the ophthalmologists actually used and controlled the laser machines when they performed the eye surgeries. The American Heritage College Dictionary, 4th Ed. at page 1087, defines "possess" as "to gain or exert influence or control over; . . ." The ophthalmologists clearly exercised control over, i.e. had possession of, and physically used the machines to perform the procedures. To accept the Taxpayer's argument would be to

find that the laser technicians, not the ophthalmologists, used the lasers to perform the medical procedures. That was not the case. The technicians only assisted the ophthalmologists. They did not (and could not) perform the procedures.

With its post-hearing brief, the Taxpayer submitted an affidavit and 24 interrogatory questions and answers of Dr. William Self, Jr., an ophthalmologist in Westminster, Colorado.[1] Dr. Self stated in response to interrogatories 8 and 11 that the laser technician maintains total physical control and possession of the lasers during the eye procedures. But that conclusion is contrary to his responses to interrogatories 18, 19, and 23, in which Dr. Self states that the physician uses and controls the "joystick" on the machine to center and focus the laser, and then uses a foot switch to activate the laser. The technician may take control of the lasers, but only if a warning or malfunction occurs. Otherwise, the ophthalmologist controls, possesses, and uses the laser during the procedure. The giving of possession and use of the laser to the ophthalmologist clearly constitutes a "lease" as defined at §40-12-220(5).

This case can also be distinguished from *White v. Storer Cables Communications, Inc.*, 507 So.2d 964 (Ala. Civ. App. 1987). In that case, the Court of Civil Appeals held that converter boxes provided by Storer to its cable customers were not being leased. Rather, the Court found that the converters were only incidental to the cable services provided by

[1] At the request of the Administrative Law Division, the parties agreed at the June 17 hearing to submit an affidavit from a qualified ophthalmologist explaining the laser procedures. As indicated, the Taxpayer submitted the affidavit and interrogatories of Dr. William Self, Jr. with its post-hearing brief. There is no indication, however, that the Department attorney reviewed or otherwise agreed to the affidavit and interrogatories, although the Department also has not formally objected. Consequently, they have been submitted into the record in the case.

Storer, and thus not subject to lease tax. "The substance of the transaction was cable service; the converters were merely a means serving that end." *White*, 502 So.2d at 968.

In this case, the substance of the transaction was the Taxpayer's leasing of the lasers to the ophthalmologists, and also the separate providing of related services to the ophthalmologists. The lasers clearly were not incidental to the services provided, as were the converters in *Storer*. To the contrary, the ophthalmologists' use of the lasers was the primary object of the transactions.

The Department contends that because the machines were being leased, the entire proceeds received by the Taxpayer are subject to lease tax. I disagree. The various technical assistance and support services provided by the Taxpayer's employees are separate and apart from the leasing of the laser machines to the ophthalmologists. As explained by Professor Walter Hellerstein in his treatise on state taxation, if a seller or lessor of tangible property also provides services that are separate from and not embodied in the tangible property being sold or leased, the proceeds from the sale or lease of the tangible property are taxable, but the charges for the separate services are not. J. Hellerstein & W. Hellerstein, *State Taxation* (3d ed. 2001) at ¶12.07.

In *Advance Schools, Inc. v. Cal. State Bd. of Equalization*, 2 Bankr. 231 (ND Ill. 1980), which is discussed in Professor Hellerstein's treatise, at ¶12.07(1)(c), the taxpayer, Advance Schools, Inc., provided educational services and also books and other tangible property to its students. The taxpayer argued that the true object of the transactions was the rendering of educational services, and that the tangible property transferred was only incidental to those services, and thus not taxable.

The Bankruptcy Court disagreed, holding that the educational services were separate and distinct from the taxpayer's sale of the tangible items, and that tax was due on the tangible items.

> Under California law, where a transaction involves both a transfer of property and the rendition of services, and each is a consequential element of the transaction capable of ready separation, the services and the property may be treated separately for tax purposes, and the transferor may be required to collect and remit a use tax based upon that portion of the consideration paid which is attributable to the sale of tangible personal property.

Advance Schools, 2 Bankr. at 235.

The Court further explained that the true object test does not apply when the services rendered are not embodied in the tangible property.

> The (taxpayer's) reliance on the true object test is misplaced. The test is appropriate where the services rendered are inseparable from the property transferred that is, where the services, so to speak, find their way into the property. All the examples used in Regulation 1501 to illustrate the true object test involve transactions in which the services become an integral part of the property; e.g. , the artist's skill and labor are embodied in his painting; the recordkeeping, tax, and similar services of a firm which performs business advisory are embodied in the forms, binders, and other property transferred during the course of the transaction. The language of the true object test as set out in Regulation 1501 supports this construction ". . . . is the real object sought by the buyer the service per se or the property *produced by* the service. . . ." (Emphasis added.) Thus, the true object test should be used where the services and the property are inseparable and is inapplicable where these two elements are distinct.

Advance Schools, 2 Bankr. at 236.[2]

[2] Alabama does not have a regulation similar to the California regulation cited in *Advance Schools*, Cal. Admin. Code, Tit. 18 §1501, which discusses the taxability of mixed transactions involving both the taxable sale or leasing of property and also the nontaxable providing of services. However, the principles stated therein are equally applicable in Alabama.

As discussed, in this case the services provided by the Taxpayer's employees, while necessary in assisting the ophthalmologists in performing the procedures, are separate and distinct from the leasing of the machines to the ophthalmologists. The separate nature of the laser rentals and the providing of services by the Taxpayer's employees is illustrated by the fact that the Taxpayer leases the fixed-site lasers without providing the separate services.

The Taxpayer is liable for lease tax on the proceeds derived from the leasing of the lasers, but not on the separate services provided to the ophthalmologists. Unfortunately, the taxable lease proceeds cannot be readily ascertained because the Taxpayer charged a lump-sum price to the ophthalmologists, which included both a charge for the laser and also a charge for the Taxpayer's services.[3]

The burden is on a taxpayer to maintain records distinguishing between taxable and nontaxable or exempt proceeds. *State v. Ludlum*, 384 So.2d 1089 (Ala. Civ. App.), cert. denied, 384 So.2d 1094 (Ala. 1980). The Taxpayer is directed to provide any records or other information, if available, identifying the separate charges for the mobile lasers. The Taxpayer should also provide information showing the separate charges for the fixed-site lasers. The Taxpayer concedes that those lasers, which are functionally identical to the mobile lasers, are subject to Alabama lease tax. Consequently, without records identifying the taxable lease proceeds derived from the mobile lasers, tax may be based on the like-kind charges for the fixed-site lasers. The Taxpayer should provide the above information

[3] Advance Schools also charged a lump-sum for its services and the tangible property. The parties had stipulated, however, as to the "deemed retail price" of the tangible property, and also the amount of tax owed by the taxpayer if the tangible property was found to be taxable. *Advance Schools*, 2 Bankr. at 234-235.

by October 29, 2004. Appropriate action will then be taken.

This Opinion and Preliminary Order is not an appealable Order. The Final Order, when entered, may be appealed to circuit court within 30 days pursuant to Code of Ala. 1975, §40-2A-9(g).

Entered October 7, 2004.

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BILL THOMPSON
Chief Administrative Law Judge