

SOUTHERN BANKNOTE CO., INC. §
3501 7th Avenue South §
Birmingham, AL 35222-3210, §

STATE OF ALABAMA
DEPARTMENT OF REVENUE
ADMINISTRATIVE LAW DIVISION

Taxpayer, §

DOCKET NO. S. 04-423

v. §

STATE OF ALABAMA §
DEPARTMENT OF REVENUE.

OPINION AND PRELIMINARY ORDER

The Revenue Department assessed Southern Banknote Company, Inc. (“Taxpayer”) for State sales tax for July 2000 through June 2003. The Taxpayer appealed to the Administrative Law Division pursuant to Code of Ala. 1975, §40-2A-7(b)(5)a. Bruce Ely and Russell Cunningham represented the Taxpayer. Assistant Counsel Margaret McNeill represented the Department. The Alabama League of Municipalities also filed an amicus brief supporting the Taxpayer’s position.

ISSUES

The Taxpayer prints and sells at retail the various documents required for the issuance of bonds, warrants, and notes by public entities in Alabama and elsewhere. The ultimate issue in this case is whether the Taxpayer is liable for Alabama sales tax on the documents that were invoiced to the public entities during the subject period, but which were paid by checks issued by the investment banking firms that underwrote or brokered the bond issues. Two sub-issues are involved: (1) were the underwriters acting as agents of the public entities when they ordered and paid for the documents; and (2) did the sales comply with the requirements of Dept. Regs. 810-6-3-.69.02 and 810-6-3-.33. As discussed below, those regulations require generally that for a sale to a county, a municipality, or a municipal industrial development board to be exempt from sales and use

tax (1) the subject property must be ordered by or in the name of the exempt entity, (2) the credit of the exempt entity must be obligated, and (3) the property must be paid for with funds belonging to the exempt entity.

FACTS

The Taxpayer is a commercial financial printer headquartered in Birmingham, Alabama. The Taxpayer specializes in printing the documents required for the issuance of bonds, warrants, and notes (collectively "bonds") by municipalities, counties, industrial development boards, and other tax-exempt public entities in Alabama. It also prints and sells documents to public entities outside of Alabama.

Public entities issue bonds to finance capital projects such as schools, roads, jails, etc. Typically, a public official initiates a bond offering by contacting a bond attorney for help in issuing the bonds. The public entity and the bond attorney generally do not enter into a written contract. In some cases, the public official first contacts an investment banking firm that will underwrite or broker the bonds. In that case, the underwriter contacts the bond attorney. In either case, the underwriter and the bond attorney work together in the issuance and sale of the bonds for the public entity.

The bond attorney issues a legal opinion concerning the bonds and also usually prepares the other documents required for the issuance of the bonds. The initial document needed is the preliminary official statement, which provides financial, demographic, and other information about the issuing public entity. The underwriter assists the bond attorney in preparing the preliminary statement, which is ultimately approved by the issuing entity. When the contents of the preliminary official statement are finalized, the bond attorney provides the galley proof to a commercial printer previously selected by the underwriter.

The printer prints the statements, which are then distributed by the underwriter to potential investors.

After the underwriter locates willing buyers, the bonds are “priced” to ensure that the public entity will receive sufficient funds to pay for the proposed infrastructure improvements, and also the costs of issuing the bonds. The public entity also formally approves the transaction by resolution or ordinance, as appropriate. The resolution or ordinance states how the bond proceeds will be used, and specifies that the costs of issuing the bonds will be paid by the public entity from the proceeds.

After the public entity formally approves the bond issue, the entity enters into a written purchase agreement awarding the bonds to the underwriter. The agreement specifies the terms of the transaction, and that all related costs, including the printing costs, will be paid by the public entity.

The underwriter and the bond attorney, in conjunction with the public entity, subsequently finalize the contents of the final official statement. The bond attorney forwards the galley proof to the printer, and also provides the printer with the forms and information needed to print the actual bonds. The printer prints the documents and delivers the printed materials to the underwriter. It then invoices the public entity for the printing costs. In some cases, the printer is instructed to mail the invoice to the underwriter for the convenience of the public entity.

The final step in the process is the bond closing, at which the underwriter receives the sale proceeds from and delivers the bonds to the purchasers. The underwriter also remits the sale proceeds, less the discount or underwriter’s profit, to the public entity at the closing. However, the underwriter withholds and deposits into a dedicated escrow account

an estimated amount of the proceeds sufficient to pay the expenses of the transaction, including the printing costs. The underwriter subsequently pays all expenses with checks drawn on the escrow account. It then gives the public entity an itemized accounting of the costs, and remits any remaining funds to the entity. If the amount withheld is insufficient to pay all costs, the underwriter may absorb the shortage, or, if it is a significant amount, the underwriter will bill the public entity for the shortage.

The transactions in issue in this case were typical transactions as described above. The underwriter and the bond attorney handling each bond sale contacted the Taxpayer, identified the public entity that was issuing the bonds, and verbally ordered the required documents. Neither the bond attorney nor the underwriter issued the Taxpayer a written purchase order for the documents, nor did the Taxpayer enter into a written contract for the job. Once the printing job was finished, the Taxpayer issued an invoice in the name of the public entity. The Taxpayer was instructed in some cases to mail the invoice to the underwriter. In those cases, the underwriter paid the invoice from the special escrow account established to pay the expenses of the transaction. In other cases, the Taxpayer mailed the invoice to and was paid directly by the public entity.

The Taxpayer reported and paid sales tax during the subject period on the printed materials sold to non-exempt individuals and entities. It did not, however, pay sales tax on the documents it printed and sold concerning the bonds issued either by exempt public entities in Alabama or by public entities outside of Alabama.

The Department audited the Taxpayer and assessed it for sales tax on the bond-related documents that were invoiced to a public entity, but which were paid by check issued by the underwriter. The Department did not assess tax on those bond-related

documents invoiced to a public entity in Alabama that were paid directly by the public entity.

ANALYSIS

The Department concedes that sales to counties, municipalities, and IDBs in Alabama are exempt from sales tax. See, Code of Ala. 1975, §§40-23-4(a)(11) and 11-54-96. Department Regs. 810-6-3-.69.02 and 810-6-3-.33 also recognize that sales to an agent of a county, a municipality, or an IDB are also exempt; provided, the requirements of the regulations are otherwise satisfied. Reg. 810-6-3-.69.02 requires that sales to counties and municipalities in Alabama are exempt if (1) the property is ordered by an official of the exempt entity; (2) the exempt entity is obligated to pay for the property; and (3) the property is paid for with funds belonging to the entity. Reg. 810-6-3-.33(1) has similar requirements concerning exempt sales to IDBs in that the property must be purchased in the name of the board, the board's credit must be obligated, and the property must be paid for with funds belonging to the board.

Sub-issue (1). The agency issue.

The threshold issue is whether the underwriters and bond attorneys acted as agents of the exempt entities. The Department argues that an agency relationship did not exist because there was no written agency agreement between the public entities and the underwriters or the bond attorneys. "In other words, there was nothing to show (the examiner) that there was an official agency designation, therefore she had no choice but to conclude that the purchases were not made by the tax-exempt entity." Department's Reply Brief at 2, 3.

I understand the Department's concern that there was no written agreement or paper trail evidencing an agency relationship. However, Alabama law has never required a written agreement for the creation of a principal/agent relationship. Rather, agency is a question of fact to be decided by the circumstances. "The existence and scope of a principal-agent relationship is normally a question of fact. . . ." *Lawler Mobile Homes, Inv. v. Tarver*, 492 So.2d 297 (Ala. 1986). "No writing is essential to the creation of such agency. It may be proven in the same way as other issues of fact; . . ." *Corinth Bank and Trust Co. v. Cochran*, 121 So. 66 (Ala. 1929). "It has been repeatedly decided in this state that writing is not essential to the appointment of an agent. The fact of agency may be proven by circumstances." *Lathrop-Hatten Lumber Co. v. Bessemer Sav. Bank*, 11 So. 418 (Ala. 1892).

An agent's authority to act for the principal may be either express, implied, or apparent. "Apparent authority of an agent arises from the acts of the principal, either by omission or commission, and such authority is implied where the principal passively permits the agent to have the authority to act on his behalf." *Lawler Mobile Homes*, 492 So.2d at 304, citing *Treadwell Ford, Inc. v. Courtesy Auto Brokers, Inc.*, 426 So.2d 859 (Ala. Civ. App. 1983).

The facts in this case establish that the underwriters and bond attorneys acted as agents for the public entities when they ordered the documents in issue and performed the other acts necessary to complete the bond sales. The underwriters and attorneys understood that they were acting as agents of the public entities, as did the Taxpayer. The public entities were aware of and allowed the underwriters and bond attorneys to order the documents from the Taxpayer. The entities also allowed the underwriters to withhold the

money from the sales proceeds and to use that money to pay for the documents. The underwriters and bond attorneys thus had implied or apparent authority to act as agents for the public entities in their dealings with the Taxpayer.

Sub-issue (2). Did the transactions comply with Department regulations?

Department Regs. 810-6-3-.69.02 and 810-6-3-.33 both recognize that an agent of a municipality, a county, or a municipal IDB may purchase property tax-free on behalf of the exempt entity; provided, the technical requirements of the regulations are otherwise satisfied.

The Department argues that the requirements of the regulations were not satisfied in this case because the exempt entities did not issue written purchase orders for the printed materials. “(The examiner) testified correctly, that in order to show that an issuer’s credit is obligated, a purchase order from the issuer was necessary to prove that fact.” Department’s Reply Brief at 3. I disagree.

Reg. 810-6-3-.69.02(3)(i) requires that the purchase must be “made as the result of an order issued by the agent” of the exempt entity. It does not require that a written purchase order must be issued.¹ In this case, the underwriters and/or the bond attorneys, as agents for the exempt entities, verbally ordered the documents from the Taxpayer. Reg. 810-6-3-.69.02(3)(i) was thus satisfied.

Reg. 810-6-3-.33(1) relating to IDBs was also satisfied because it only requires that “the purchases are made in the name of the board. . . .” When the underwriters contacted

¹ Reg. 810-6-3-.69.02(3)(ii), which requires that the credit of the exempt entity must be obligated, refers to “the issuance of the purchase order.” But again, there is no requirement that the purchase order must be in writing.

the Taxpayer concerning the documents needed for an IDB bond issue, they identified the IDB for which the documents were being ordered. The Taxpayer understood that the IDB was the party ordering the documents. It accordingly invoiced the documents in the name of the IDB. The purchases were thus made in the name of the exempt IDBs.

Regs. 810-6-3-69.02(3)(ii) and 810-6-3-.33(1) require that the credit of the county, municipality, or IDB must be obligated. That requirement was satisfied because (1) the ordinances and/or resolutions enacted or passed by the public entities obligated the entities to pay all related costs, including the printing costs, and (2) the written purchase agreements between the public entities and the underwriters obligated the entities to pay all associated costs, again including the printing costs. Also, the underwriters clearly obligated the credit of the public entities when they ordered the documents from the Taxpayer as agents for the public entities. "The legal presumption is, when a known agent deals or contracts within the scope of his authority, that credit is extended to the principal and not to the agent;" *Owens v. Durden*, 440 So.2d 1079, 1080 (Ala. Civ. App. 1983), citing *Anderson v. Timberlake*, 22 So. 431, 433 (1897).

As discussed, the Department concedes that the bond documents paid for directly by the exempt entities were exempt. Those sales were structured the same as the sales in issue, except concerning who wrote the checks. That is, the underwriters and bond attorneys verbally ordered the documents from the Taxpayer. Thus, by conceding that the documents paid for directly by the public entities were exempt, the Department is tacitly acknowledging that the first two requirements of the regulations were satisfied, i.e., that the documents were ordered by or in the name of the exempt entities, through their agents, and also that the credit of the exempt entities was obligated.

The only remaining issue involves the third requirement of Regs. 810-6-3-.69.02(1) and 810-6-3-.33(1), i.e., the property must be paid for with funds belonging to the exempt entities. That requirement was also satisfied in this case.

The underwriters paid for the documents by writing checks on special escrow accounts. The money in the escrow accounts belonged to the exempt entities because the underwriters, as agents for the entities, had withheld sufficient money from the bond proceeds to pay all expenses on behalf of the exempt entities. The documents were thus paid for with funds belonging to the exempt entities.

This case can be distinguished from *Ex parte: State of Alabama; Re: Champion International Corp. v. State of Alabama*, 405 So.2d 932 (Ala. 1980). The issue in *Champion* was whether certain equipment used by Champion on an IDB project was paid for with funds belonging to the IDB, as required by Department regulation.² Champion had paid for the equipment with checks drawn on its own account. The Alabama Supreme Court held that the sales were not tax-exempt because Champion used its own funds to pay for the property, not funds belonging to the IDB.

In this case, while the underwriters wrote the checks to the Taxpayer, the funds in the special escrow accounts on which the checks were drawn belonged to the exempt entities, not the underwriters. Thus, unlike the purchases in *Champion*, the purchases in this case were paid with bond proceeds that belonged to the exempt entities.

² Reg. 810-6-3-.33 is the current regulation governing exempt sales to IDBs. When *Champion* was decided, the regulation was designated as G27-916.

The Department also cites *Champion* as requiring that certain documents are required for sales to IDBs to be exempt. See, Department's Answer at 4, ¶ 5, and 5, ¶ 6. I disagree. The only issue in *Champion* was whether the property was paid for with funds belonging to the IDB. Documentation was not in issue, nor did the Supreme Court otherwise opine that certain specific documents are required before a sale to an IDB can be exempt.

The Department examiner understandably treated the sales in issue as taxable because (1) she was unaware of the agency relationship between the underwriters and the exempt entities, and (2) she did not know that the funds used to pay the checks written by the underwriters belonged to the exempt entities. But the facts establish that the underwriters were agents of the exempt entities, and also that the Taxpayer was paid with funds belonging to the exempt entities. As discussed, the other requirements of Regs. 810-6-3-.69.02 and 810-6-3-.33 were also satisfied. The sales were thus exempt from sales tax.

The above analysis concerns sales to public entities in Alabama, which presumably constitute a majority of the sales in issue. The Department indicated in its Answer, however, at 3, ¶ 1, that the audit schedules also include sales to public entities outside of Alabama that are not exempt from Alabama sales tax. The parties failed to address those sales at the hearing or in their briefs.

If the Taxpayer mailed or sent the printed documents by common carrier to the out-of-state public entities, or to underwriters or other parties located outside of Alabama, the sales were closed outside of Alabama, and thus not subject to Alabama sales tax. See, Code of Ala. 1975, §40-23-1(a)(5); *Oxmoor Press, Inc. v. State*, 500 So.2d 1098 (Ala. Civ.

App. 1986). Also, a case currently pending before the Alabama Supreme Court involves the issue of whether exempting sales to government entities in Alabama while taxing sales to government entities in other states violates the Commerce Clause. *State, Dept. of Revenue v. Hoover, Inc.*, _____ So.2d _____ (March 18, 2005), cert. granted June 27, 2005. Thus, even if the sales were closed in Alabama, there is an issue as to whether the sales to the out-of-state public entities could be taxed.

The sales to the exempt entities in Alabama should be deleted from the final assessment. The Department should notify the Administrative Law Division of the remaining amount due, and its position concerning the sales to the out-of-state public entities. The Taxpayer should also notify the Administrative Law Division of its position concerning the sales to the out-of-state public entities. The parties should respond by October 14, 2005. An appropriate Order will then be entered.

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 September 20, 2005.

BILL THOMPSON
Chief Administrative Law Judge