GRADUATE SUPPLY HOUSE, INC. 1620 N. MILL STREET JACKSON, MS 39202-1535,	§	STATE OF ALABAMA DEPARTMENT OF REVENUE ADMINISTRATIVE LAW DIVISION
Taxpayer,	§	DOCKET NO. S. 05-751
v.	§	
STATE OF ALABAMA DEPARTMENT OF REVENUE.	§	

OPINION AND PRELIMINARY ORDER

The Revenue Department assessed Graduate Supply House, Inc. ("Taxpayer") for State use tax for February 2001 through January 2004; State rental tax for October 2001 through January 2004; and city/county tax for February 1998 through January 2004. 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 December 6, 2005. CPA Ashley Stafford represented the Taxpayer. Assistant Counsel Margaret McNeill represented the Department.

The Taxpayer is located in Jackson, Mississippi, and is in the business of selling and renting graduation gowns, caps, tassels, etc. The Taxpayer does not have a business location in Alabama. It also otherwise has no property or employees in Alabama, although as discussed below, it may rent various items to Alabama customers.

The Taxpayer filed Alabama rental tax returns with the Department during the months in issue. The Department audited the Taxpayer for the subject months and determined that the Taxpayer was liable for additional State rental tax, and also State use tax and local rental and use tax. It assessed the Taxpayer accordingly.

The Taxpayer's representative argues that the Taxpayer was not subject to Alabama's taxing jurisdiction during the periods in issue because it did not have nexus with

Alabama. He also claims that the Department examiner made several errors in the audit.

Issue (1). Nexus.

For sales and use tax purposes, a taxpayer must have some "minimal business nexus" with Alabama to be subject to Alabama's taxing jurisdiction. *State of Alabama v. MacFadden-Bartell Corp.*, 194 So.2d 543, 546 (Ala. 1967). The U.S. Supreme Court has also held that to be subject to tax in a state, a taxpayer must have a "substantial nexus" with the state. *Complete Auto Transit, Inc. v. Brady*, 97 S.Ct. 1076 (1977). And for sales and use tax purposes, the Supreme Court has held that a taxpayer must have a physical presence in the state. *Quill Corporation v. North Dakota*, 112 S.Ct. 1912 (1992); *National Bellas Hess, Inc. v. Department of Revenue of Ill.*, 87 S.Ct. 1389 (1967).

The physical presence mandated by *Quill* does not require that actual employees of a taxpayer must be in the state. Rather, sufficient nexus is established if the taxpayer is conducting or engaging in business activities through independent contractors or agents acting on behalf of the taxpayer in the state. *Scripto, Inc. v. Carson*, 80 S.Ct. 619 (1960); *MacFadden-Bartell*, *supra*. "[T]he crucial factor governing nexus is whether the activities performed in this state on behalf of the taxpayer are significantly associated with the taxpayer's ability to establish and maintain a market in this state for the sales." *Tyler Pipe Indus. V. Washington State Dept. of Revenue*, 107 S.Ct. 2810, 2821, quoting the Washington Supreme Court, 715 P.2d 123, 126 (1986). See also, *State of Louisiana v. Dell International, Inc., et al*, ____ So.2d ____ (2006).

The facts needed to decide this issue are not sufficiently developed. The parties agree that the Taxpayer had no offices or employees in Alabama during the period in issue. The Department contends, however, that "the Taxpayer has representatives operating

within the State of Alabama taking orders and is therefore subject to" Alabama tax. Department's Answer at 2.

The Taxpayer's CPA denies that the Taxpayer had agents or representatives acting on its behalf in Alabama during the period. The CPA claims that the "representatives" referred to by the Department were actually employees of another company, L.G. Balfour. He argues that the Taxpayer sold the items in issue to the Balfour representatives, who in turn resold the items to the ultimate customers in Alabama.

The CPA claims that the Balfour representatives solicited and took orders from the ultimate customers in Alabama, and also determined the price to be paid by those customers. If a customer ordered an item from a Balfour representative, the representative in turn ordered the item from the Taxpayer in Mississippi. The Taxpayer charged the representative its fixed wholesale price for the item. It then delivered the item to the representative, who delivered it to the end customer in Alabama.

The Department introduced the examiner's audit report into evidence at the December 6 hearing. However, the report does not explain or identify the Taxpayer's activities in Alabama, except to state "that the taxpayer sold merchandise to purchasers located within the State of Alabama." Department's September 9, 2004 Revised Confidential Audit Report at 3. The Department also introduced approximately 20 Taxpayer invoices (Dept. Ex. 1) into evidence, all of which show purchasers with an Alabama address.

The Taxpayer's CPA contends that the individuals listed on the invoices are the Balfour representatives that the Taxpayer sold the items to. He submitted an April 28, 2004 letter (Taxpayer Ex. 1) from the Taxpayer to the Department examiner which identified the

various Balfour representatives.[1] The letter also indicated that Balfour had reported and paid Alabama tax to the Department on the items in issue.

If the facts as stated by the Taxpayer's CPA are correct, then the Taxpayer is not liable for Alabama sales tax or use tax because it was selling the items to the Balfour representatives at wholesale for resale. Items sold at wholesale in Alabama are not subject to either Alabama sales tax or Alabama use tax. *Paramount-Richards Theatres v. State*, 55 So.2d 812 (Ala. 1951). The issue of nexus would be irrelevant in that case, but the Taxpayer also would not have had nexus with Alabama because the Balfour representatives were independent purchasers, not representatives or agents conducting business on behalf of the Taxpayer in Alabama.

Again, if the facts as stated by the Taxpayer's CPA are correct, the Alabama Supreme Court's decision in *MacFadden-Bartell*, *supra*, is directly on point. MacFadden-Bartell sold magazine subscriptions. It had no property or employees in Alabama. It sold subscriptions to an Alabama company, EBSCO, for a fixed price. EBSCO then resold the magazine subscriptions to Alabama customers at a price set by EBSCO.

The Department argued that MacFadden-Bartell had the required nexus with Alabama through the activities of EBSCO, acting as its agent. The Alabama Supreme Court rejected the Department's position, holding that EBSCO was not acting as MacFadden-Bartell's agent, and consequently, that MacFadden-Bartell did not have the

[1]The purchasers listed on the invoices are identified as Balfour representatives in Taxpayer Ex. 1. Some of those Balfour representatives are also listed as "salesman" on some of the invoices to the educational institutions. However, no salesman is listed on invoices showing Auburn University and Oxford High School as the buyers. Also, invoices to the Fayette Kiwanis Club and to Gene's Choir Robes, Etc. show the salesman as "House." There is no Balfour representative by that name listed on Taxpayer Ex. 1.

required constitutional nexus with Alabama.

> In the case at hand EBSCO is not being paid a commission on the sales it makes and is not soliciting orders for MacFadden-Bartell. Rather, it is soliciting business for itself for a profit. It seems to us that what EBSCO is in effect doing insofar as its arrangement with MacFadden-Bartell is concerned, is negotiating a price by which it purchases magazines from the publisher. It then resells these magazines to its customers, retaining all income from the sale over and above its cost. Were it not for the very nature of magazine subscription the merchandise bought by EBSCO could be shipped to it in Alabama for later retail sale just as any other merchandise bought might be. It would appear that EBSCO is in effect buying the subscriptions at wholesale for later retail to the public, within the meaning of Title 51, §787(d). Indeed, that is the way EBSCO has treated the matter. When it sells a subscription to a customer, it collects the Alabama sales tax and remits it to the State.
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> We conclude, therefore, that the trial court correctly determined that EBSCO was not the "agent" or "representative" or "independent contractor" for MacFadden-Bartell within the meaning of the Alabama statutes as construed in State v. Lane Bryant, Inc., supra, and that therefore there is the absence of the sufficient business nexus with the State of Alabama insofar as appellee is concerned for the State of Alabama to require it to collect a use tax either as sales made by EBSCO or those made directly with which EBSCO has no connection.

MacFadden-Bartell, 194 So.2d at 390.

The above rationale would apply concerning the Taxpayer's liability for State and local sales and/or use tax, again assuming that the facts as stated are correct.

There is no evidence, however, indicating how the Taxpayer's rental transactions were structured. When asked what would happen if an Alabama customer did not return a rented item, the Taxpayer's CPA stated:

> Mr. Stafford: That's - - I would assume they would have a claim against the representative or the school or - - I'm not sure the rental is done by the rep. I'm not sure they don't sell the caps and gowns to the rep. That's a good - - I need to - - I probably needed to nail that down a little better. I'm not sure they don't sell the cap and gown to the rep.
>
> Administrative Law Judge: Okay. Ms. McNeill, anything in the audit report to specify how they operate.

> Ms. McNeill: No. We've got a bunch of purchase order receipts I probably need to submit into evidence. But they - - Balfour is not listed anywhere. It's listed R.M. Hendrick Graduate Supply House all to Alabama addresses.

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If the Taxpayer sold the items to be rented to the Balfour representatives, who then rented them to the ultimate customers in Alabama, the Taxpayer again would not have nexus with Alabama. However, the Taxpayer would have nexus if it was renting the items in Alabama, either to the Balfour representatives or to the ultimate customers through the Balfour representatives as its agents, in which case it would have nexus pursuant to *Scripto* and *Tyler Pipe*.

The CPA's statements at the December 6 hearing concerning his understanding of the facts are not admissible because he did not have personal knowledge concerning those facts. Consequently, either a second hearing must be conducted at which the Taxpayer and/or the Department can present admissible evidence explaining how the Taxpayer sells and leases the items in Alabama, and also its relationship to the Balfour representatives. The parties may also agree to the facts and submit a joint stipulation without a hearing.

The Taxpayer's CPA should contact the Department attorney for the purpose of determining if the parties can agree to a joint stipulation of fact. The parties should notify the Administrative Law Division by April 28, 2006 if a joint stipulation can be submitted, or if the case should be reset for a second hearing. Appropriate action will then be taken.

Issue (2). The Alleged Audit Deficiencies.

The Taxpayer's CPA also identified several disputes he has with the Department

audit. If it is determined that the Taxpayer has nexus with Alabama, the disputed items will be identified and the Department will be allowed an opportunity to respond.

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 March 31, 2006.

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BILL THOMPSON
Chief Administrative Law Judge