2MC, INC. 2036 KING STABLES ROAD BIRMINGHAM, AL 35242-6413,	§	STATE OF ALABAMA DEPARTMENT OF REVENUE ADMINISTRATIVE LAW DIVISION
Taxpayer,	§	DOCKET NO. S. 07-587
v.	§	
STATE OF ALABAMA DEPARTMENT OF REVENUE.	§	

FINAL ORDER

The Revenue Department assessed 2MC, Inc. ("Taxpayer"), d/b/a Pump It Up, for State sales tax for January 2003 through December 2005. 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 October 26, 2007. The Taxpayer's owner, Frank McDaniel, attended the hearing. Assistant Counsel Wade Hope represented the Department.

ISSUE

The Taxpayer operated a Pump It Up franchise with locations in Pelham and Trussville, Alabama during the months in issue. The locations were open to the public, and offered rooms that were used by customers for birthday and other private parties. The issue is whether the receipts from the rooms were subject to the "public amusement" gross receipts sales tax levied at Code of Ala. 1975, §40-23-2(2). That tax is levied on places of amusement or entertainment where "any exhibition, display, amusement, or entertainment is offered to the public or place or places where an admission fee is charged, . . ."

FACTS

The Taxpayer's facilities both included two large arenas and adjoining "party" rooms. The arenas included inflatable devices and other equipment commonly played on by children. A customer was required to book or reserve an arena and an adjacent party room

in advance. The Taxpayer would then send the customer a specified number of admission tickets. The Taxpayer charged the customer a lump-sum amount, regardless of how many guests actually attended.

The customer's invited guests arrived at the Taxpayer's facility at the specified time and were escorted into the designated arena. The guests, generally children attending a birthday party, would then play on the equipment in the arena for a set period, usually 1.5 hours. After the designated time elapsed, the guests would move into the adjacent party room, where they would be served pizza, cake and ice cream, and/or other food items as ordered by the host. The Taxpayer would also provide goodie bags, balloons, and various other items as ordered by the host. After the group left the arena, the Taxpayer's employees would clean the area and prepare for the next group.

The Taxpayer also offered a "Mommy and Me" child care service during the subject period. A parent could pay $5 for their child to stay at one of the Taxpayer's facilities when the service was offered. The Mommy and Me service was also open to the public. Reservations were not required.

The Taxpayer collected sales tax on the food, goodie bags, balloons, and the other tangible items it sold at the facilities during the months in issue. It did not, however, collect sales tax on the amounts it charged for the rooms or the Mommy and Me service because it had been informed by the parent Pump It Up franchise in California that those amounts were not taxable.

The Taxpayer was audited by Jefferson and Shelby Counties in the Fall of 2005. The private auditing firm that represented the Counties determined that the Taxpayer was

liable for the gross receipts sales tax on the amounts it charged for the rooms.[1] The Taxpayer consequently began collecting and remitting State and local sales tax on the room receipts, beginning in September 2005.

The Department later audited the Taxpayer for the months in issue and also determined that the gross receipts from the rooms were subject to the gross receipts sales tax. It assessed the Taxpayer accordingly.

ANALYSIS

The gross receipts sales tax at §40-23-2(2) is levied:

> Upon every person, firm, or corporation engaged or continuing within this state in the business of conducting or operating places of amusement or entertainment . . . or any other place at which any exhibition, display, amusement, or entertainment is offered to the public or place or places where an admission fee is charged . . . an amount equal to four percent of the gross receipts of any such business.

The Taxpayer concedes that the proceeds from its Mommy and Me program were taxable because the program was open to the public. It argues, however, that the proceeds from the arenas and party rooms were not taxable because those facilities were used for private parties, and thus were not open to the public. It also claims that it was renting the rooms to its customers, and that proceeds from "rentals of real estate" are specifically excepted from the definition of "gross receipts" at Code of Ala. 1975, §40-23-1(a)(8).

The Department asserts that the gross receipts tax applies because the Taxpayer's facilities were not private clubs in the nature of a private country club. The Department's

[1] The Taxpayer paid or otherwise settled the County assessments because, according to the owner, it would have cost him too much in legal fees to contest the assessments. The owner has since sold the franchise.

Answer reads in pertinent part as follows:

> According to Section 40-23-2(2) of the Code of Alabama, and Departmental Rule 810-6-1-.125, Pump It Up is considered a place of "amusement or entertainment" and total receipts are subject to sales tax. It is the position of the Department that the business is open to the general public because its patrons are not considered members as would be the case in a private Country Club that caters to its members and their guests. Private clubs usually charge an initiation fee and monthly dues as set by a Board of Directors or Board of Governors. The patrons of Pump It Up are charged a flat fee, which reserves the facility for a specified period of time and for a limited number of guests.
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> Pump It Up is considered a public facility because its patrons are not members as would be the case with a private golf or country club. The company was not organized as a non profit corporation for the purpose of promoting social activities, games, and physical exercise among its members. Instead, it is a for profit corporation that is in the amusement and entertainment business. Section 40-23-2(2) provides in pertinent part that:
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> > 'Upon every person, firm, or corporation engaged or continuing within this state in the business of conducting or operating places of amusement or entertainment . . . or any other place at which any exhibition, display, amusement, or entertainment is offered to the public or place or places where an admission fee is charged . . . an amount equal to four percent of the gross receipts of any such business.'
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> According to 810-6-1-.125, total gross receipts from the operation of places of amusement or entertainment are subject to sales tax. (Pump It Up's receipts are subject to the tax) [e]ven though people can not walk off the street and attend a function without an invitation or a reservation. The reservation for a private party does not create a private facility. The Pump It Up facility is open to the public to reserve the facility for a fee. The general public can reserve the facility without becoming a member of the organization and assuming liability of ownership. There is no exclusive membership or other factors that create a private facility. Therefore, the gross receipts from the private parties are subject to the sales tax on amusements or entertainments. The taxpayer began collecting and remitting sales tax on the gross receipts from the parties, September 2005.
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> This is a difficult case.
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> To begin, the fact that a small part of the Taxpayer's business, the Mommy and Me

service, was unquestionably open to the public, and thus subject to the gross receipts sales tax, did not per se cause all of the Taxpayer's activities to be subject to the tax. Rather, only proceeds derived from that part of a taxpayer's business that is open or offered to the public are subject to the tax. See generally, *State of Alabama v. Huntsville Baseball Club, Inc. and Birmingham Baseball Club, Inc.*, S. 92-208 and S. 92-170 (Admin Law Div. 2/23/1994) (Revenue received by baseball clubs from selling advertising space on outfield walls, billboards, tickets, etc. was distinguishable from the clubs' taxable admission fees, and thus not taxable, because the revenue was not derived from the public amusement or entertainment offered by the clubs); *Craft Development Corp. v. State of Alabama*, S. 91-142 (Admin. Law Div. 10/22/1991) (Membership dues paid by private country club members were not subject to the tax, even though the club's golf course was open to the public); and *Gerald Garrison v. State of Alabama*, S. 86-108 (Admin. Law Div. 10/16/1986) (A golf pro's fees for giving private golf lessons were not taxable, even though the pro also operated a miniature golf course and driving range that was open to the public.).

The receipts in issue may still be taxable, however, if they were derived from a public place of amusement within the purview of §40-23-2(2).

The Taxpayer argues that "[p]rivate parties at Pump It Up's facilities are not public events, nor are they in a public place. Private activities, even if offered at otherwise public facilities, are not taxable."[2]

The Taxpayer's argument is compelling. However, §40-23-2(2) levies the tax on any

[2] The above quote is from an attachment to the Taxpayer's Petition for Review that was filed with the Department, and which was submitted by the Taxpayer as part of its notice of appeal.

place "at which any exhibition, display, amusement, or entertainment is offered to the public *or* place or places where an admission fee is charged." By using the conjunction "or," the Legislature clearly intended for the tax to apply not only to individual admission fees charged at a public place, but also to receipts derived from any place "offered to the public."

The Taxpayer was in the business of offering its arenas and party rooms to the public. The intent of §40-23-2(2) was to tax "the gross receipts of any such business." The fact that the Taxpayer's customers reserved the rooms in advance did not change the nature of the Taxpayer's business as a place open to the public for entertainment or amusement.[3] As correctly argued by the Department – "The reservation for a private party does not create a private facility. The Pump It Up facility is open to the public to reserve the facility for a fee." Department's Answer at 4. The gross receipts derived from the Taxpayer's business that was open to the public were thus subject to the amusement gross receipts tax.

The Taxpayer also argues that the tax is not owed because it was renting the rooms to its customers, and that "rentals of real estate" are specifically excluded from the definition of "gross receipts" at §40-23-1(a)(8). It cites *Huntsville Baseball Club*, *supra*, in support of that argument. The Administrative Law Division held in the above case that the proceeds from the leasing of stadium suites were not taxable because they were derived

[3] If a group of individuals had gone to the Taxpayer's business without a reservation, the Taxpayer presumably would have allowed them access to an arena and adjacent party room if the rooms were available. The admissions paid by those individuals to use the rooms clearly would have been subject to the gross receipts tax. There would have been no substantive difference between the proceeds from a group that reserved the rooms beforehand and the admissions paid by a group that walked in off the street without a reservation. The proceeds would have been taxable in both cases.

from “rentals of real estate.” See, *Huntsville Baseball*, Opinion and Preliminary Order at 6, 7. That case can, however, be factually distinguished.

The lessees (actually sub-lessees) in the above case all signed written lease agreements that allowed them to use the stadium suites for a number of years. The suites thus became private suites controlled by the lessees that were not available or open to the public. In this case, the Taxpayer’s customers did not sign a lease agreement or otherwise agree to lease the Taxpayer’s rooms. Also, while the Taxpayer’s customers paid a fixed amount to use the rooms for a fixed period, the transactions were not in the nature of true leases. Rather, the transactions were analogous to when an individual (or a group of 25 children celebrating a birthday) pays an admission to view a movie at a public movie theater. The individual (or group) pays a fixed amount and will use the theater and theater seat for a fixed period, i.e., the length of the movie. It cannot be reasonably argued, however, that the individual is leasing his or her seat in the movie theater. If the individual reserved the entire movie house beforehand and paid for every seat in the house, which is analogous to what the Taxpayer’s customers did, the movie house would still be a place of public amusement, and the proceeds from the “private party” would still be subject to the gross receipts tax.

Allowing a business that is otherwise open to the public to treat a group of customers as private guests, and thereby avoid the gross receipts tax, could also open the door to widespread avoidance of the tax. For example, a public bowling alley could allow a group of bowlers to reserve and have exclusive use of a set number of lanes for a fixed price and a fixed period. Applying the Taxpayer’s rationale, the bowling alley could argue that the proceeds from the “private party” were not taxable because the reserved area was not

open to the public. It could also assert that the bowlers were renting the designated lanes and adjacent sitting area, i.e., real estate, and consequently, that the proceeds were excluded from the definition of "gross receipts" at §40-23-1(a)(8).

The gross receipts in the above bowling alley example would, however, clearly be subject to the public amusement gross receipts tax.[4] Again, the fact that a business that offers entertainment or amusement to the public may allow a customer or group of customers to have exclusive use of a portion of the business' physical facility for a fixed period does not change the public nature of the business. Allowing a customer the exclusive use of a room or any other designated area within a public entertainment facility also does not constitute the rental of real estate to the customer.

It must also be noted that while "rentals of real estate" are excepted from the definition of "gross receipts" at §40-23-1(a)(8), that definition only applies concerning sales of tangible property – "(8) Gross receipts. The value proceeding or accruing from the sale of tangible personal property, including. . . ." It thus could be argued that the definition does not technically apply to the public amusement tax levied at §40-23-2(2) because that tax is not on the sale of tangible property. Consequently, for purposes of the §40-23-2(2) tax, the term "gross receipts" must be given its commonly accepted definition, which would not include an exemption for receipts from rentals of real estate. [5]

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[4] "Bowling alleys" are listed in §40-23-2(2) as a specific type of business subject to the tax. The Taxpayer's facilities, which included inflatable slides and other child-friendly devices on which children entertained themselves, were also clearly public "places of amusement or entertainment" within the purview of the statute.

[5] If it was determined that the Taxpayer had been renting the rooms, it could be argued that the proceeds from the rentals were subject to the 4 percent transient occupancy tax levied at Code of Ala. 1975, §40-26-1, et seq. That tax is levied on every person, corporation, etc., "in the business of renting or furnishing any room or rooms, . . . or any other place in

I sympathize with the Taxpayer in this case. The owner did not willfully fail to collect the tax on the admission receipts because he had been informed, and thus reasonably believed, that the receipts were not taxable. But ignorance of the law cannot relieve the Taxpayer of the tax due, and the Department cannot otherwise be estopped from collecting the amount due under the circumstances. *Community Action Agency of Huntsville, Madison County, Inc. v. State*, 406 So.2d 890 (Ala. 1981).

The final assessment is affirmed. Judgment is entered against the Taxpayer for State sales tax and interest of $69,056.88. Additional interest is also due from the date the final assessment was entered, May 14, 2007.

This Final Order may be appealed to circuit court within 30 days pursuant to Code of Ala. 1975, §40-2A-9(g).

Entered March 11, 2008.

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BILL THOMPSON
Chief Administrative Law Judge

bt:dr
cc: J. Wade Hope, Esq.
Frank McDaniel
Joe Cowen
Mike Emfinger

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which rooms, lodgings, or accommodations are regularly furnished . . . to transients for a consideration, . . .” Section 40-26-1(a). While the §40-26-1 tax generally applies to non-residents that stay in hotel or motel rooms overnight or otherwise for short periods, the Taxpayer’s renting of its rooms would have technically come within the language of the levy. That is, the Taxpayer would have been in the business of regularly renting the arenas and party rooms to its customers for a consideration. The customers also would have technically qualified as transients because they only used the facilities for a short period. See generally, *Mitchell Investments, LLP v. State of Alabama*, S. 07-501 (Admin. Law Div. 12/3/2007). The proceeds were in fact exempt from the §40-26-1 occupancy tax, however, because they were subject to the gross receipts sales tax levied at §40-23-2(2). See , §40-26-1(a).