JOHN GARY ELLIS SOUTHERN BREEZE, LLC 175 NORTHSHORE PLACE GULF SHORES, AL 36542-2736,	§	STATE OF ALABAMA DEPARTMENT OF REVENUE ADMINISTRATIVE LAW DIVISION
Taxpayer,	§	DOCKET NO. S. 07-834
v.	§	
STATE OF ALABAMA DEPARTMENT OF REVENUE.	§	

OPINION AND PRELIMINARY ORDER

The Revenue Department assessed John Gary Ellis, d/b/a Southern Breeze, LLC ("Taxpayer"), for State sales tax for February 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 June 9, 2008. Blake Madison represented the Taxpayer. Assistant Counsel Duncan Crow represented the Department.

The Taxpayer is headquartered in Gulf Shores, Alabama. It conducted a Coastal Wine Tour (the "Tour") in Baldwin County, Alabama in May 2004 and May 2005.[1]

The Tour is a weekend event that includes a winemakers dinner on Friday night, a wine tasting on Saturday, and a brunch on Sunday. The Tour is open to the public. A single ticket can be purchased for all three events, or individual tickets can be purchased for each separate event. Individual tickets for the Friday dinner, the Saturday wine tasting, and the Sunday brunch were $150, $55 and $35, respectively.[2] There is no evidence showing the price for the single ticket for all three events in the subject years.

[1] The Taxpayer also conducted Tours in other states along the Gulf Coast in the subject years.

[2] Without evidence to the contrary, it is assumed that the above ticket prices applied at both the May 2004 and May 2005 events.

The Taxpayer also sold sponsorships for the Tour. Sponsors paid different lump-sum amounts for various sponsorship packages. They received advertising and various tangible items in return. For example, the most expensive $15,000 platinum sponsorship allowed the sponsor to have its name associated with one of the events. The sponsor also received a full page ad in the Official Tour Event Guide, a 2/3 page ad in *Southern Breeze* magazine, and advertising in the various newspapers that advertised the Tour.[3] The usual charge for a 2/3 page ad in *Southern Breeze* is $3,750.

A platinum sponsor also received three banner ads that were linked to the sponsor's website, and also ads on the homepage of CoastalWineTour.com and in the Orange Beach section of CoastalWineTour.com.

On-site benefits included exhibit space for sampling, greeting, merchandizing, sponsor logo signage at various on-site locations, a promotional flyer included in gift bags given to participants, and a commemorative print. A platinum sponsor also received eight tickets to the dinner, forty tickets to the wine tasting, and twelve tickets to the brunch.

Finally, a platinum sponsor received fifty gift subscriptions to *Southern Breeze* magazine, eight commemorative t-shirts and signed posters, and the option to buy additional tickets at a twenty percent discount.

Sponsors below the platinum level paid less for the package, and received proportionately less in advertising and other benefits.

[3] The Taxpayer is a subsidiary of Compass Marketing, Inc., which publishes *Southern Breeze* magazine.

The Taxpayer filed sales tax returns for the months in issue and reported and paid sales tax on (1) the merchandise it sold at retail, and (2) the gross receipts from the ticket sales for the Tour events.

The Department audited the Taxpayer and determined that the sponsorship fees paid by the sponsors were also subject to the gross receipts sales tax levied at Code of Ala. 1975, §40-23-2(2). The Department's position is based on Dept. Reg. 810-6-1-.125. That regulation states that amounts paid by promotional sponsors for the right to give away tickets or passes to a taxable activity are subject to the gross receipts sales tax. The Department argues that because the Tour sponsorship packages included free tickets to the Tour events, the entire sponsorship fee was taxable.

The Department also taxed a $1,797.82 entry on the Taxpayer's books for "merchandise sales – miscellaneous" because the Department examiners could not determine if the Taxpayer had reported and paid sales tax on that amount. The Taxpayer concedes in its post-hearing brief that the amount should be taxed because it cannot locate records showing otherwise.

ANALYSIS

The Administrative Law Division addressed the applicability of the gross receipts sales tax in *State of Alabama v. Huntsville Baseball Club, Inc. & Birmingham Baseball Club, Inc.*, Docket Nos. S. 92-208 & S. 92-170 (Admin. Law Div. O.P.O. 2/23/1994). The taxpayers in that case operated minor league baseball teams. At issue was whether the taxpayers were liable for sales tax (1) on the receipts derived from selling advertising space on outfield walls, billboards, tickets, etc., and (2) on the amounts paid by sponsors for the

right to give away general admission passes to the public for a specific game.

The Department's position was that because the taxpayers operated a public place of amusement, all of their receipts from whatever source were taxable, including the advertising receipts and the sponsor fees.

The Administrative Law Division first held that the advertising receipts were not taxable because they were not "paid for attending or engaging in the public activity or amusement offered by a taxpayer." *Huntsville Baseball Club* at 3 – 4. The Order reads in pertinent part as follows:

> The Department argues that because the Taxpayers operate public places of amusement, their gross receipts derived from all sources, including the advertising revenues in issue, are taxable. I disagree.
>
> The gross receipts tax is levied on taxpayers that operate public places of amusement or entertainment and is based on "an amount equal to 4% of the gross receipts of <u>any such business</u>." See, §40-23-2(2). "Any such business" relates only to the public business or activity engaged in by a taxpayer. Consequently, the tax is levied only on the gross receipts paid for attending or engaging in the public activity or amusement offered by a taxpayer. Just as the true sales tax levied by §40-23-2(1) is levied on the gross proceeds paid by the consumer of tangible personal property, the gross receipts tax levied at §40-23-2(2) is levied only on the gross receipts paid by the "consumer" of the public amusement. Thus, admission fees paid to attend public athletic or entertainment events should be taxed, as should the amounts paid to engage in a specific activity in a public place, i.e., bowling alley fees, pool table fees, video game receipts, etc.
>
> However, the public amusement tax does not apply to gross receipts that are not paid by the public to attend or engage in the specific public activity offered by a taxpayer. The sale of advertising time and space by the Taxpayers in this case to third-party advertisers is not a public amusement, and thus the gross receipts derived from those activities are not taxable. The fact that the Taxpayers would probably not have received any of the advertising revenues in question "but for" the public baseball games is not relevant.

The Administrative Law Division next held that the amounts paid by the sponsors for the free passes were taxable because the amounts were for admission to the public amusement, i.e., the baseball games, being offered by the taxpayers.

> While advertising revenues derived from third-party advertisers cannot be taxed, the amounts paid by promotional night sponsors can be taxed because those receipts are paid for admission to a game. That is, the sponsor is paying for general admission passes to a particular game, and consequently, the gross receipts paid by a sponsor are derived from the public amusement offered by the Taxpayers and are taxable, even though the sponsor purchases the passes for promotional or advertising purposes.

Huntsville Baseball Club at 7.

The Department amended Reg. 810-6-1-.125(1) after the *Huntsville Baseball Club* decision to include the following:

> Taxable gross receipts shall also include advertising receipts received from promotional sponsors where the sponsor purchases the right to give away general admission tickets or passes to a specific activity. Receipts received from third party advertisers relating to advertising space on billboards, scoreboards, fences, programs or tickets, or to radio or television time not in conjunction with the right to give away general admission tickets or passes would not be subject to sales tax.

The Department relies on the first sentence in the above regulation in support of its position in this case. That is, because the Tour sponsors received tickets to the Tour events, the entire sponsorship fee is taxable. I disagree.

In *Huntsville Baseball Club*, the sponsors paid for the tickets and then gave the tickets away to the public. The act of giving away the tickets was itself the promotional or advertising activity engaged in by the sponsors. Nonetheless, the amounts paid by the sponsors were for admission to the public amusement being offered by the taxpayers, and were thus taxable.

The *Huntsville Baseball Club* rationale does not apply in this case because this case can be factually distinguished. The sponsor fees in *Huntsville Baseball Club* were paid solely for the right to give away tickets to the baseball games. In this case, however, the tickets given to the Tour sponsors were only a small part of the benefits received by the sponsors. A platinum sponsor paid $15,000, but received tickets with only a total face value of $3,820.[4] The 2/3 page ad in *Southern Breeze* had a value of $3,750 by itself. The remainder of the $15,000 fee was for the various other advertising and promotional benefits provided to the sponsor, with some inconsequential amount attributable to the few miscellaneous tangible items, i.e., t-shirts, posters, etc., given to the sponsors.

The Taxpayer argues that the sponsors were in effect buying non-taxable advertising services, and that the free tickets "were merely incidental to the advertising services provided to those advertisers by *Southern Breeze*." Taxpayer's Brief at 3. The Taxpayer thus asserts that none of the sponsorship fee was taxable. I also disagree with the Taxpayer's position.

The sponsors paid the lump-sum sponsorship fee primarily for the advertising, but some part of the fee was for the "free" tickets and the miscellaneous other tangible items provided by the Taxpayer. An analogous situation would be if the third party advertisers in *Huntsville Baseball Club* had paid a lump-sum amount for both the right to advertise at the game, and also for the right to give away tickets to the game. In that case, that part of the lump-sum amount attributable to the tickets would have been taxable, but that part

[4] The 8 dinner tickets at $150 each totaled $1,200. The 40 wine tasting tickets at $55 each totaled $2,200. The 12 brunch tickets at $35 each totaled $420. The combined total is $3,820.

attributable to the advertising would not have been taxable. The same applies in this case.

The applicable legal principle can be stated as follows – where a lump-sum amount is paid for both a taxable activity and a separate non-taxable activity, and the value of the taxable and/or non-taxable activity can be reasonably determined, only the amount attributable to the taxable activity should be taxed.

The Administrative Law Division applied the above principle in *Laser Vision Centers, Inc. v. State of Alabama*, S. 03-1161 (Admin. Law Div. O.P.O. 10/7/2004). In that case, the taxpayer provided ophthalmologists with laser machines and also with laser technicians and other support personnel that assisted the ophthalmologists in operating the machines. The ophthalmologists paid a lump-sum fee for the use of the machines and the personnel provided by the taxpayer. The issues were whether the taxpayer was leasing the lasers to the ophthalmologists, and if so, was lease tax due on the entire lump-sum amount paid by the ophthalmologists.

The Administrative Law Division held that the taxpayer was leasing the machines, and thus liable for lease tax on the proceeds derived from the leasing of the machines. Concerning the taxable measure, the Administrative Law Division held that the providing of the technicians and support personnel was separate from the leasing of the machines, and that only that part of the lump-sum fee attributable to or paid for the machines was taxable.

> 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. (footnote omitted)

Laser Vision at 6 – 7.

The above rationale also applies generally to Alabama's gross receipts sales tax, and specifically to the sponsorship fees in issue in this case. The sponsors paid the lump-sum fees for both the non-taxable advertising and the taxable tickets.[5] The value of the tickets given to the sponsors can be readily determined because the number of tickets provided at each sponsor level was fixed and the ticket price for each Tour event is known. The Taxpayer is thus liable for the gross receipts sales tax on the value of the tickets provided to the sponsors at the May 2004 and May 2005 Tour events in Alabama.[6]

The burden is on a taxpayer to provide records from which its taxable and non-taxable receipts can be identified. See generally, *State v. Ludlum*, 384 So.2d 1089 (Ala. Civ. App.), cert. denied 384 So.2d 1094 (Ala. 1980). The Taxpayer should provide the Department with the number of tickets it provided to the sponsors to the Friday, Saturday, and Sunday Tour events in issue. It should also notify the Department if the sales price for

[5] The sponsors also received t-shirts and other miscellaneous tangible items. The evidence indicates that the Taxpayer was assessed for and paid use tax on those items. See, T. at 71, 72. Consequently, the value of those items should not be also included as subject to the gross receipts sales tax.

[6] It is irrelevant that the sponsors may not have redeemed or used some of the tickets. If an individual buys a ticket to a public concert or sporting event, but decides not to attend, the proceeds from the ticket are still subject to the gross receipts sales tax.

the individual tickets to the events was different than the amounts stated above in either year. The information should be provided by September 19, 2008. The information will be forwarded to the Department with instructions to recompute the Taxpayer's liability accordingly.

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 August 25, 2008.

_____
BILL THOMPSON
Chief Administrative Law Judge

bt:dr
cc: Duncan R. Crow, Esq.
Blake A. Madison, Esq.
Joe Cowen
Mike Emfinger