BOYD BROS. TRANSPORTATION, INC. 3275 HWY. 30 CLAYTON, AL 36016-3003,	§	STATE OF ALABAMA DEPARTMENT OF REVENUE ADMINISTRATIVE LAW DIVISION
Taxpayer,	§	DOCKET NO. S. 08-329
v.	§	
STATE OF ALABAMA DEPARTMENT OF REVENUE.	§	

OPINION AND PRELIMINARY ORDER

The Revenue Department assessed Boyd Brothers Transportation, Inc. ("Taxpayer") for State sales tax for October 1997 through March 2003. 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 August 13, 2008. Jim Sizemore represented the Taxpayer. Assistant Counsel Margaret McNeill represented the Department.

ISSUES

This case involves two issues: (1) Did certain transactions between the Taxpayer and its drivers constitute retail sales by the Taxpayer; and (2) if the transactions were sales, were they nontaxable casual sales?

FACTS

The Taxpayer operates a long-haul trucking business headquartered in Clayton, Alabama. The Taxpayer provided trucks to some of its drivers during the subject period pursuant to two types of "lease-purchase" agreements. The agreements required the drivers to pay the Taxpayer a monthly amount over a fixed period, usually three to five years. The drivers subsequently used the trucks to haul goods for the Taxpayer.

Some of the agreements allowed the driver the option of returning the truck or purchasing it for its fair market value at the end of the contract period. On audit, a

Department examiner determined that those agreements constituted leases, and that the Taxpayer was liable for lease tax on the monthly lease payments received from the drivers. The Taxpayer presumably paid the lease tax assessed by the Department because lease tax is not in issue in this case.

The second type of lease-purchase agreement entered into by 70 drivers during the subject period allowed the driver to purchase the truck at the end of the contract period for $1.00. The monthly payments concerning those agreements were based on the fair market value of the trucks when the agreements were executed divided by the number of months in the agreement period. For example, if the fair market value of a truck was $60,000, and the parties agreed to a 5-year contract period, the driver would pay the Taxpayer $1,000 per month over the 60-month period. The driver could then purchase the truck for $1.00 at the end of the period. The Taxpayer did not assign or transfer the certificate of title for the truck to the driver until the driver made all the monthly payments and paid the final $1.00.

Only four of the drivers that entered into the "$1.00 purchase" agreements actually made all of the monthly payments and paid the final $1.00. The Taxpayer transferred the certificates of title for the vehicles to the drivers in those instances. The remaining drivers defaulted on the agreements, usually within the first year, in which case the Taxpayer either returned the subject vehicles to its fleet for subsequent use or traded them.

The Department examiner determined that the $1.00 purchase agreements constituted conditional retail sales by the Taxpayer. She thus assessed the Taxpayer for sales tax on the approximately 2,300 monthly payments it received on those transactions during the subject period. That is the sales tax in issue in this case.

The examiner also initially determined that the Taxpayer owed sales tax on 75 trucks it sold to a subsidiary, Wellborn Transport, Inc., during the subject period. She later removed 74 of those trucks from the audit because the Taxpayer established that the subsidiary had paid the applicable sales tax when it registered the trucks in Alabama. Consequently, only one of those trucks was included in the final assessment in issue. That truck should also be removed because the Taxpayer presented evidence at the August 13 hearing that the applicable sales tax has also been paid on that truck.

ANALYSIS

Issue (1). Did the $1.00 purchase transactions constitute retail sales by the Taxpayer?

The Taxpayer argues that the agreements that allowed the drivers to purchase the trucks for $1.00 at the end of the agreement period were not sales because title never passed to the drivers, except in the four instances where the drivers made all of the payments and received the certificates of title for the vehicles from the Taxpayer. The Taxpayer cites Code of Ala. 1975, §40-23-2(a)(5), which defines a "sale" as "every closed transaction constituting a sale. Provided, however, a transaction shall not be closed or a sale completed until the time and place when and where title is transferred by the seller or seller's agent to the purchaser or purchaser's agent, ..."

To begin, the Taxpayer was either selling the trucks in issue to the drivers, as argued by the Department, or if not, it was leasing the trucks to the drivers. Consequently, if the transactions were not sales, the Taxpayer would be liable for lease tax on the monthly proceeds from the transactions; provided, that the statute of limitations for assessing the

Taxpayer for lease tax has not expired. The issue in this case, however, is whether the Department correctly assessed the Taxpayer for sales tax on the transactions.

The Administrative Law Division addressed the issue of whether certain transactions constituted leases or conditional sales in *American Ophthalmic, Inc. v. State of Alabama*, S. 96-253 (Admin. Law Div. 4/22/1997). The Final Order in that case reads in part:

> The Taxpayer argues that the agreements are leases because (1) the parties intended the transactions to be leases, (2) the Taxpayer retained title to the equipment, and (3) the Taxpayer depreciated the equipment and the equipment would be obsolete at the end of the five-year period due to technical advances.
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> The only authority submitted by the Department in support of its position was *Lawson State Community College v. First Continental Leasing Corp.*, 529 So.2d 926 (Ala. 1988). See, October 24, 1995 letter from Assessment Officer Joe Cowen to the Taxpayer's representative. *Lawson State* is not a tax case, but rather involved whether the transaction in issue was governed by Article 9 of the UCC, which concerns secured transactions. The case turned on whether the transaction was a true lease or a conditional sale secured by a security agreement. The Alabama Supreme Court relied on Code of Ala. 1975, §7-1-201(37) and §7-9-102 in holding:
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> > These sections establish that a "lease" allowing the lessee to purchase at a "nominal consideration" the subject matter of the lease is to be considered a security agreement rather than a true lease. (cites omitted). In the instant case, the right of the College to purchase the equipment for a mere $1.00 at the termination of the lease constitutes an option to purchase at a "nominal consideration," and hence, the arrangement between these two parties is no mere bailment lease, but is instead a disguised conditional sale secured by a security agreement.
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> *Lawson State*, 529 So.2d at 929.
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> Several other states have also addressed the issue. In *Alzfan et al. v. Bowers, Tax Comm'r*, 194 N.E.2d 852 (Ohio 1963), the Ohio Supreme Court held as follows:
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> > Where, as here, a so-called lessee is obligated to accept and pay for personal property at some future time and has no

> option to return it, the transaction is held to be a conditional sale even though terms commonly used in leases have been used. As stated in 47 American Jurisprudence, 23, Section 836:
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> > The test most frequently applied is whether the so-called '"lessee" is obligated to accept and pay for the property at some future time, or, on the other hand, whether his primary obligation is to return or account for the property to the so-called "lessor" according to the terms of the "lease."

Alzfan, 194 N.E.2d at 854.

On the other hand, if the lessee has only the option to purchase, the transaction is in the nature of a lease, not a conditional sale. *Dollar Bank Leasing Corp. v. Limbach*, 1992 Ohio Tax Lexis 1590 (1992).

The difference between a true lease and conditional sale was discussed in Illinois Department of Revenue, Private Letter Ruling No. 96-0074 (1996):

> A true lease generally has no buy out provision at the close of the lease. If a buy out provision does exist, it must be a fair market value buy out option in order to maintain the character of the true lease.
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> * * *
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> A conditional sale is usually characterized by a nominal or one dollar purchase option at the close of the lease term. Stated otherwise, if a lessor is guaranteed at the time of the lease that the leased property will be sold, this transaction is considered to be a conditional sale at the outset of the transaction, thus making all receipts subject (to the Illinois sales tax).

See also, Illinois Private Letter Ruling No. 93-0240 (1993) and 93-0299 (1993).

In this case, the Taxpayer's standard lease agreement provides that when the lease expires, the lessee shall purchase the equipment for one dollar. The purchase is mandatory, not optional, and is for a nominal amount. The transactions thus constituted conditional sales based on the authorities cited above. Substance over form must govern in tax matters. *Brundidge Milling Co. v. State*, 228 So.2d 475 (1969). Consequently, Alabama sales tax is due on the proceeds received by the Taxpayer from the sales. (footnote omitted)

American Ophthalmic at 3 – 5.

The transactions in issue constituted conditional sales pursuant to the above authorities. The Taxpayer was in substance selling the trucks to the drivers at fair market value over time. In *Lawson State*, *supra*, the Alabama Supreme Court stated that "the right . . . to purchase the equipment for a mere $1.00 at the termination of the lease constitutes an option to purchase at a 'nominal consideration,' and hence, the arrangement between those two parties is no mere bailment lease, but is instead a disguised conditional sale secured by a security agreement." *Lawson State*, 529 So.2d at 929. The same rationale applies in this case. If a driver had made all of the monthly payments as required, I can imagine no situation where the driver would not have paid the final $1.00 and taken title to the truck.

Section §40-23-1(a)(5) does provide that a sale is not completed or closed until title to the subject property is transferred by the seller to the buyer. Title is generally transferred when and where the seller completes the physical delivery of the property to the buyer. "Title passes, unless otherwise specifically agreed, at the time and place of completion of performance by physical delivery of the goods. Section 7-2-401(2), Code of Alabama (1975)." *State of Alabama v. Delta Air Lines, Inc.*, 356 So.2d 1205, 1207 (Ala. Civ. App. 1978); see also, *Oxmoor Press, Inc. v. State of Alabama*, 500 So.2d 1098 (Ala. Civ. App. 1986).

In this case, the Taxpayer physically delivered the subject trucks to the drivers at the beginning of the agreement periods. But technical legal title did not pass to the drivers at that time because Alabama law provides that title to a motor vehicle is transferred only

when the seller assigns the outstanding certificate of title for the vehicle to the buyer. As discussed, the $1.00 purchase agreements specified that the certificates of title would not pass until the drivers made all of the required payments.

But the fact that the Taxpayer did not assign the certificates of title for the trucks to the drivers that defaulted on the agreements does not change the substantive nature of the transactions as conditional sales. Although a sale is not technically closed until title to the subject property is transferred, any sale proceeds paid by the buyer to the seller before transfer of title clearly constitute taxable gross receipts derived from the sale. For example, assume an appliance store sells a refrigerator to a customer at retail for $2,400, plus applicable sales tax. The parties agree that the customer can take possession of the refrigerator, and pay the retailer $100 a month, plus the pro rata tax due, over 24 months. The parties further agree that title to the refrigerator will not pass to the customer until the purchase amount is paid in full.[1] The customer subsequently makes 12 monthly payments. He then defaults on the agreement, and the retailer repossesses the refrigerator. Under those facts, the retailer would clearly owe sales tax on the gross sales proceeds of $1,200 paid by the customer, even though technical legal title to the refrigerator had not passed, i.e., the sale had not technically closed, before the payments were made. The same applies in this case.

[1] As indicated, title passes upon physical delivery of the property, "unless otherwise specifically agreed, ..." Section 7-2-401(2). Consequently, the parties to a sale can control when title to the goods is transferred, regardless of when physical delivery of the goods takes place.

The fact that most of the drivers defaulted on the agreements also does not change the substance of the agreements as conditional sales. The drivers were unconditionally obligated to pay the full purchase price for the vehicles, and the nature of the agreements as initially executed must control. Consequently, just as the proceeds from the conditional sale of the refrigerator in the above example would constitute taxable gross receipts subject to sales tax, the monthly amounts paid by the drivers toward the purchase of the trucks constituted taxable gross receipts derived from the sale of the trucks.

Issue (2). Were the sales by the Taxpayer nontaxable casual or isolated sales?

The Taxpayer asserts that even if the $1.00 transactions are deemed to be retail sales, they were nontaxable "causal" or isolated sales because it is not in the business of selling trucks at retail. The Taxpayer also argues that the four drivers that took title to the trucks were obligated to pay the "casual" sales tax when they registered the vehicles in Alabama, see Code of Ala. 1975, §40-23-100 et seq.

Alabama's sales tax is levied on individuals, corporations, etc., "in the business of selling" tangible personal property at retail. Code of Ala. 1975, §40-23-2(1). Casual or isolated sales by a person or entity not engaged in the business of selling the property in question are not subject to sales tax. *State of Alabama v. Bay Towing & Dredging Company, Inc.*, 90 So.2d 743 (Ala. 1956); Department Reg. 810-6-1-.33.

In *Bay Towing*, the taxpayer, Bay Towing, was in the business of dredging oyster shells from Mobile Bay. It purchased used barges from companies in Louisiana and Texas that were regularly engaged in hauling products by barge. It was undisputed that the out-

of-state sellers were not in the business of selling used barges ("The seller was not a regular dealer in barges, . . . [t]hese (sellers) also had made only incidental sales of barges. . . ." *Bay Towing*, 90 So.2d at 744.

The Department assessed Bay Towing for use tax on its use of the barges in Alabama. The Alabama Supreme Court held that because the casual sales of the barges by the out-of-state sellers would not have been subject to Alabama sales tax if they had occurred in Alabama, Bay Towing's use of the barges in Alabama could not be subject to the complimentary Alabama use tax.

This case can be distinguished from *Bay Towing* because it was undisputed in *Bay Towing* that the out-of-state sellers were not in the business of selling used barges at retail. Not so in this case.

"Business" is defined for Alabama sales tax purposes at Code of Ala. 1975, §40-23-1(a)(11), as follows:

> All activities engaged in, or caused to be engaged in, with the object of gain, profit, benefit, or advantage, either direct or indirect, and not excepting subactivities producing marketable commodities used or consumed in the main business activity, each of which subactivities shall be considered business engaged in, taxable in the class in which it falls.

The Taxpayer routinely sold the trucks in issue to its drivers, "with the object of gain, profit, benefit, or advantage. . . ." The lease purchase agreements, including the $1.00 purchase transactions, were a regular and integral part of the Taxpayer's overall business scheme. The Taxpayer was clearly in the business of selling the trucks in issue pursuant to the broad definition stated above. See also, *Ex parte: State of Ala. Dept. of Rev. (In re: State of Alabama v. Chesebrough Ponds, Inc.)*, 441 So.2d 598 (Ala. 1983), in which the

Alabama Supreme Court, citing a California case, defined "business" as ". . . any activity or enterprise for gain, benefit, advantage, or livelihood . . . (and) any activity which benefits a corporation's organizers or members." *Chesebrough Ponds*, 441 So.2d at 604. The numerous $1.00 purchase agreements entered into by the Taxpayer clearly benefited the Taxpayer's business and its shareholders.

The Taxpayer argues that it was merely disposing of the trucks that it no longer needed in its hauling business. I disagree. The Taxpayer's drivers continued to use the trucks in issue as an integral part of the Taxpayer's hauling business. The Taxpayer profited from the monthly sales proceeds it received from the drivers, and also from the income it received from the drivers' use of the trucks on its behalf. It also returned the trucks to its fleet for subsequent use or traded them for new vehicles when the drivers defaulted on the agreements.

Finally, Code of Ala. 1975, §40-23-101 defines a casual sale as a sale by any person, entity, etc. "that is not a licensed dealer engaged in selling" tangible personal property at retail in Alabama. Citing that statute, the Taxpayer argues that the sales in issue must have been casual sales because it does not have a retail sales tax license with the Department. I again disagree.

All individuals and entities engaged in the business of selling tangible personal property at retail in Alabama are required to obtain a sales tax license with the Department. Code of Ala. 1975, §40-23-6. An Alabama retailer cannot avoid its duty to collect and remit sales tax on its taxable retail sales by failing or refusing to obtain a license from the Department. Because the Taxpayer was engaged in the business of selling the trucks in

issue, it was thus required to obtain a sales tax license from the Department and collect and remit the sales tax due. It failed to do so, but that failure does not relieve the Taxpayer of liability.[2]

The Department is directed to remove from the audit the one remaining truck that the Taxpayer sold to its subsidiary. It should notify the Administrative Law Division of the adjusted amount due. The Taxpayer may also submit evidence by March 2, 2009 showing that the four drivers that completed the $1.00 purchase agreements paid sale tax when they registered the trucks in Alabama. That evidence will be forwarded to the Department to include in its calculations. A Final Order will be entered after the Department responds.

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 February 5, 2009.

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BILL THOMPSON
Chief Administrative Law Judge

bt:dr

[2] It is not known if the four drivers that received the titles to the trucks paid sales tax when they registered the vehicles. If so, the Taxpayer would not owe sales tax on those vehicles. But the fact that the four drivers were liable under the casual sales tax statute does not relieve the Taxpayer of its primary liability to collect and remit the sales tax on all of the sales directly to the Department. Sales tax is, of course, due only once on each vehicle, which explains why the Department removed from the audit the 74 used trucks on which the Taxpayer's subsidiary remitted the casual sales tax when it registered the trucks in Alabama. And while the evidence is not sufficient to finally decide the issue, those sales to the subsidiary may have indeed been true casual sales by which the Taxpayer was only incidentally disposing of trucks that it no longer needed in its business. But the fact that the Taxpayer may have incidentally sold some trucks does not change the nature of the $1.00 purchase agreements as retail sales in the normal course of the Taxpayer's business.

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