THYSSENKRUPP SAFEWAY, INC. §
C/O TABOR R. NOVAK, JR., ESQ.
BALL, BALL, MATTHEWS & NOVAK §
2000 INTERSTATE PARK DR., STE 204
MONTGOMERY, AL 36109 §

Taxpayer, §

v. §

STATE OF ALABAMA §
DEPARTMENT OF REVENUE.

STATE OF ALABAMA
DEPARTMENT OF REVENUE
ADMINISTRATIVE LAW DIVISION

DOCKET NO. S. 08-401

FINAL ORDER

Thyssenkrupp Safeway, Inc. ("Taxpayer") petitioned the Department for a lease tax refund for the period June 1, 2003 through May 31, 2006. The Department denied the petition, and the Taxpayer appealed to the Administrative Law Division pursuant to Code of Ala. 1975, §40-2A-7(c)(5)a. A hearing was conducted on October 2, 2008. Tabor Novak and Joseph Pickart represented the Taxpayer. Assistant Counsel Wade Hope represented the Department.

ISSUE

The Taxpayer leased scaffolding to contractors and industrial customers in Alabama during the period in issue. It sometimes also separately contracted to setup or erect the scaffolding for its lease customers. The issue is whether the Taxpayer's fees for erecting the scaffolding for its lease customers constituted taxable gross proceeds derived from the leases.

FACTS

The Taxpayer leases scaffolding to customers in Alabama, and has offices in Birmingham, Alabama and Mobile, Alabama. It also offers setup, maintenance, and other scaffolding-related services to its lease customers and others.

The Taxpayer and its lease customers entered into standard lease agreements during the period in issue. The agreements either required the Taxpayer to deliver the scaffolding to a site selected by the customer, or for the customer to pick up the scaffolding at the Taxpayer's location in Birmingham or Mobile. The customers were responsible for erecting the scaffolding, and were thereafter required to maintain and use the scaffolding in accordance with all safety standards and laws. The customers were also obligated to maintain property and liability insurance relating to the scaffolding.

The Taxpayer also separately contracted to provide setup and other scaffolding-related services during the subject period. It provided those services for some of its lease customers, and also for other customers that owned their own scaffolding or leased it from a third party. The Taxpayer contracted to setup the scaffolding with less than 20 percent of its lease customers during the subject period. The Taxpayer's remaining lease customers either performed the setup services themselves or hired a third party to do the work.

When a lease customer also hired the Taxpayer to erect the scaffolding, the Taxpayer billed the customer for both the lease charge and the separately stated setup charge on a single invoice. In many cases, the setup charge exceeded the amount of the separately stated lease charge.

The Taxpayer collected and remitted lease tax to the Department on its separately stated charges for leasing the scaffolding to its customers. It did not collect and remit lease tax on the separately stated erection fees.

The Department audited the Taxpayer and determined that when the Taxpayer both leased and setup the scaffolding for a customer, the setup charges were derived from the

leasing of the scaffolding, and thus subject to lease tax. It assessed the Taxpayer accordingly. The Taxpayer paid the tax and petitioned for a refund. The Department denied the refund, and this appeal followed.

ANALYSIS

The Alabama lease tax is levied against "the gross proceeds derived by the lessor from the lease or rental of tangible personal property . . . ." Code of Ala. 1975, §40-12-222(a). "Gross proceeds" is defined as "[t]he value proceeding or accruing from the leasing or rental of tangible personal property, . . ., without any deduction on account of the cost of the property so leased or rented, the cost of materials used, labor or service cost, interest paid, or any other expense whatsoever. . . ." Code of Ala. 1975, §40-12-220(4)

The Department claims that the setup services in issue were incidental to the leasing of the scaffolding, and constituted labor charges that cannot be deducted from the gross proceeds derived from the leases. I disagree.

The proceeds from the separately contracted for setup services were not derived from the Taxpayer's rental of scaffolding. Such services were optional, and thus not a required service performed incidental to or as part of the lease agreements. In *Storage Technology Corp. v. State of Alabama*, S. 89-241 (Admin. Law Div. 6/17/1991), the issue was whether proceeds from maintenance services provided by the taxpayer on computers leased by the taxpayer to its customers were subject to lease tax. The Administrative Law Division held that the optional services were not subject to lease tax.

> Independent services provided by a lessor are taxable only if the services are incidental to the lease and the lessor is required to provide the services by the lease agreement. . . . In this case, the taxpayer was not required to perform the maintenance services by the prior lease agreements nor enter

> into the separate maintenance contracts with the lessees. The lessees could choose the taxpayer or any other approved maintenance company. Consequently, the maintenance proceeds were not derived from the leasing of the equipment, and are not subject to the lease tax.

Storage Technology at 3.

The above rationale applies in this case. The Taxpayer charged a fixed amount for the rental of the scaffolding. It correctly paid lease tax on those charges. The Taxpayer's lease customers could opt to erect the scaffolding themselves, hire a third party to erect the scaffolding, or separately contract for the Taxpayer to perform the work. The Taxpayer's fees for that optional service were independent of and not derived from the leasing of the scaffolding, and thus were not subject to lease tax.

The Department attempts to distinguish this case from *Storage Technology* by arguing that "[m]aintenance does not equal setup." Dept. Brief at 5. I agree with the Taxpayer, however, that while computer maintenance and scaffolding setup are factually distinct services, that factual distinction is without legal significance. The rule to be applied is that when a lessor also provides optional services to the lessee that are separate and distinct from and not embodied in the tangible personal property being leased, the proceeds from the separate services are not subject to lease tax.

In *Laser Vision Centers, Inc. v. State of Alabama*, S. 03-1161 (Admin. Law Div. O.P.O. 10/7/2004), the primary issue was whether the taxpayer was leasing laser machines to ophthalmologists. If so, a second issue was whether the proceeds derived from labor services performed by certain Laser Vision employees should be included in the measure of the lease tax. The Administrative Law Division held that Laser Vision was leasing the machines, but that the separate services provided by the Laser Vision employees were not

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.

Laser Vision at 6.

The Department argues that the facts in *Laser Vision* are different from the facts in this case. But as was the case concerning *Storage Technology*, while the types of services performed in *Laser Vision* and this case can be factually distinguished, the difference is without legal significance. The same legal principle applies – when a lessor performs services for a lessee that are separate, distinct, and not incidental to the leasing of the tangible personal property, the proceeds from those separate services are not subject to lease tax. The principle applies whether the separate service provided is maintenance on leased computers, helping an ophthalmologist operate a leased laser machine, or erecting leased scaffolding.

In *State of Alabama v. Service Engraving Co., Inc.*, 495 So.2d 695 (Ala. Civ. App. 1986), the taxpayer printed and sold materials and also packaged, labeled, and otherwise prepared printed materials for mailing. The taxpayer sometimes printed the materials but did not prepare the materials for mailing; sometimes both printed and prepared the materials for mailing; and sometimes did not print the materials and only performed the

mailing preparation services. The parties agreed that the taxpayer was liable for sales tax when it only printed and sold the materials, but not when it only performed the mail preparation services. At issue was whether the taxpayer owed sales tax on the mail preparation services when it also printed the materials, i.e., were the separately invoiced mail preparation charges a part of the gross proceeds derived from the sale of the printed materials by the taxpayer.

The Court of Civil Appeals first held that because a business that only provided mail preparation services would not be subject to sales tax, the taxpayer's mail preparation services also could not be taxed – ". . . we see no reason why the tax consequences of identical services should differ based entirely and solely upon who does the printing (and selling) of the materials . . we are not convinced that the legislature ever intended such an unequal treatment for identical services." *Service Engraving*, 495 So.2d at 697.

I respectfully disagree that the above rationale applies in all cases. If a retailer performs a service that is incidental to and occurs before a sale is closed, the charge for that service should be included in the taxable measure subject to sales tax, even if the service would not be taxable if performed by another party. For example, if a retailer delivers merchandise to a customer in its own truck, the delivery charge must be included in the taxable measure because the service was incidental to and performed before the sale was closed. If, however, the customer hires a common carrier to pick up the merchandise at the retailer's business, the delivery service would not be subject to sales tax. The same delivery service would thus be taxable in one instance, and not taxable in the other.

In any case, if the above rationale is applied in this case, the Taxpayer's setup fees cannot be taxed because setup services, like mailing preparation services, are not per se subject to sales tax. If one of the Taxpayer's lease customers hired a third party to erect the scaffolding, the third party's charge for the service would not be taxable. Applying the *Service Engraving* rationale, the Taxpayer's charge for performing the identical service also cannot be taxed.

The *Service Engraving* Court further held that the mail preparation services also could not be taxed because they were performed after the sale of the printed materials was closed. I agree with that finding. In this case, the leases were "closed" upon delivery when the Taxpayer's customers took possession and control of the scaffolding. The setup services thereafter performed by the Taxpayer were thus in addition to and independent from the prior leasing of the scaffolding.

The Department argues that "[i]f a taxpayer could separately list the labor charges for the delivery and setup of the scaffolding and exclude such charges from the rental tax, it would be very easy to shelter what would otherwise by taxable receipts by simply inflating the delivery and setup charges." Dept. Brief at 5. The Department's argument is misplaced. There is no evidence that the Taxpayer was attempting to reduce its lease tax liability by inflating its setup charges. The Taxpayer charged an arm's-length, fair market price when it leased scaffolding to a customer. It then offered its setup services to the lease customer, and to all other potential customers that needed the services, for a fair market price. When the Taxpayer both leased and set up scaffolding for a customer, there is no evidence that the Taxpayer reduced its standard lease charge and increased its setup

charge to avoid lease tax. In both substance and form, the Taxpayer was leasing scaffolding at a fair market price, and also separately providing its nontaxable setup services for a fair market price.

Finally, the setup fees were not labor costs that the Taxpayer is improperly attempting to deduct from otherwise taxable gross proceeds. Rather, the fees did not constitute gross proceeds subject to lease tax to begin with because they were not "value proceeding or accruing from the rental" of the scaffolding. Section 40-12-220(4). The broad definition of "gross proceeds" at §40-12-220(4) was intended to prevent a lessor from deducting from taxable receipts its various costs incurred in leasing tangible personal property. As discussed, however, if the lessor also performs a separate service that is apart from and not incidental to the leasing of the property, the fee for that service is not derived from the lease, and thus is not subject to lease tax.

The Department is directed to issue the Taxpayer a lease tax refund of $148,015.27, plus applicable interest. Judgment is entered accordingly.

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

Entered March 18, 2009.

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BILL THOMPSON
Chief Administrative Law Judge

bt:dr
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