WALKER CO. ENTERTAINMENT, LLC d/b/a HIGHWAY 13 CHARITY BINGO AND ITS MEMBERS, CHRISTOPHER SHAWN FELLOWS, AND JIMMY RAY WILLIAMS 55864 HIGHWAY 13 ELDRIDGE, AL 35554-3608, Taxpayers, v. STATE OF ALABAMA DEPARTMENT OF REVENUE.	§ § § § § § §	STATE OF ALABAMA DEPARTMENT OF REVENUE ADMINISTRATIVE LAW DIVISION DOCKET NO. S. 10-379

SECOND OPINION AND PRELIMINARY ORDER

This case involves a disputed final assessment of the "public amusement" gross receipts sales tax entered against the above Taxpayers for October 2008 through August 2009. Walker County Entertainment, LLC ("Taxpayer") operated electronic "bingo" machines in Walker County, Alabama during the period in issue. The final assessment in issue is based on the estimated gross receipts derived from the machines during the period.

The parties agreed at a February 24, 2011 conference that the Administrative Law Division should decide two legal issues before conducting an evidentiary hearing in the case. The issues were (1) whether an October 26, 2009 Walker County Circuit Court Order in *Baker, et al. v. Walker County Bingo, et al.*, CV2007-0400, holding that electronic bingo in Walker County constituted an illegal lottery should be applied prospectively only; and (2) should the term "gross receipts" be construed to include the gross amounts wagered on the Taxpayer's machines, without subtracting the payouts or winnings returned to the customers, or only the net amount or "hold" retained by the Taxpayer.

The Administrative Law Division issued an Opinion and Preliminary Order on February 1, 2012 holding that the October 26, 2009 Circuit Court decision should be applied prospectively only. As a consequence of that holding, the Taxpayers will, if necessary, be allowed to present evidence at a subsequent hearing showing that the bingo receipts in issue were exempt pursuant to the sales tax bingo exemption at Code of Ala. 1975, §40-23-4(a)(43). The February 1 Order did not, however, address the "gross receipts" issue.

The parties agreed at a March 15, 2012 conference that if the Division also addressed the "gross receipts" issue, the parties might be able to resolve or settle the case, depending on how the Division ruled. This Preliminary Order addresses that issue.

Code of Ala. 1975, §40-23-2(2) levies a four percent sales tax on any person conducting or operating a public place of amusement or entertainment in Alabama. The tax is measured by "the gross receipts of any such business."

Code of Ala. 1975, §40-23-1(a)(8) defines "gross receipts" for sales tax purposes in pertinent part as follows:

> The value proceeding or accruing from the sale of tangible personal property, including merchandise and commodities of any kind and character, all receipts actual and accrued, by reason of any business engaged in, . . . and without any deduction on account of the cost of the property sold, the cost of the materials used, labor or service cost, interest paid, any consumer excise taxes that may be included in the sales price of the property sold, or any other expenses whatsoever and without any deductions on account of losses.

The Department argues that the total amount wagered on the Taxpayer's machines constituted the taxable gross receipts for purposes of the §40-23-2(2) sales tax. It contends that the winnings paid by the Taxpayer to the players were an expense, i.e., a cost of doing business, that cannot be deducted in determining the taxable gross receipts.

It asserts that the plain language of the definition of "gross receipts" at §40-23-1(a)(8) must control, and that the definition specifies that there can be no deduction for any expenses incurred, and "without any deductions on account of losses."

The Taxpayer contends that if the Department's position is accepted, the State's taxing scheme would be unreasonable and confiscatory. It argues, rather, that its gross receipts should be computed on a cumulative basis, and that the tax should apply only to its net receipts after payouts. The Taxpayer explained its position in its April 7, 2010 appeal letter to the Administrative Law Division, at pages 3, 4.

> Assuming that the electronic bingo game is one dollar per turn, to play the electronic bingo game a customer puts money into the machine and receives a "spin" for each dollar put in the machine. A lever is pulled or a button is pushed, and the spin occurs. The customer either "wins" and receives a ticket for the amount of money won or "loses" and receives nothing but can take another pull of the lever or push of the button commensurate to the amount of money remaining from the amount he put in the machine to start with. Although it is not clear, the State's position seems to be that when each dollar is put into the electronic game, or perhaps as the lever is pulled or button pushed for each turn, a transaction occurs, and the dollar becomes a dollar of gross receipts and is subject to the tax.
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> It is taxpayer's position that the transaction is not complete when money is placed in the machine or when the lever is pulled or button pushed because the taxpayer does not have an unfettered right to the funds at that time. The funds are still subject to further restrictions, requirements, liability or further steps that may have to be taken, and it is taxpayer's position that the transaction cannot be considered complete until the customer has taken his ticket to the cashier and been paid or the customer has taken all of his turns and has received no tickets to cash.

To summarize, the Department contends that every time a customer pulled a lever or pushed a button on one of the Taxpayer's machines, the $1 or other amount wagered became a taxable gross receipt received by the Taxpayer. Consequently, if a customer had put $20 into a $1 machine and lost all 20 pulls, the Taxpayer would, according to the

Department, have received $20 in taxable gross receipts. The Taxpayer agrees that it would have had $20 in taxable gross receipts in the above example. If the customer won $20 on the twentieth pull, received $20 in credits on the machine, and then cashed out, the Department would still argue that the Taxpayer had $20 in receipts. The Taxpayer would assert, however, that it had $0 receipts because it netted nothing after the payout. If the customer had won $1,000 on the twentieth pull, received $1,000 in credits, and continued playing and lost the next 1,000 pulls, the Department would argue that each pull constituted a taxable transaction, and that the Taxpayer had received $1,020 in taxable receipts, even though it had netted only $20, the original amount bet by the customer. Conversely, the Taxpayer would argue that only the net $20 would have been taxable.

Alabama's courts have never specifically addressed the issue of whether bingo "gross receipts," for purposes of the gross receipts sales tax, constituted the total amount paid to play, or the total amount paid to play less payouts to the players.

In 1977, the Court of Civil Appeals addressed the issue of whether an illegal bingo business was subject to the public amusement sales tax.[1] In *State v. Crayton*, 344 So.2d 771 (Ala. Civ. App. 1977), the Court had no trouble finding that an illegal bingo establishment was a place of entertainment, and thus subject to the §40-23-2(2) tax. "As suggested by the State, we believe that Crayton's patrons were there because they wanted to be entertained and that the majority of them received exhilaration, pleasure and

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[1] Before 1980, all bingo in Alabama constituted an illegal lottery pursuant to Art. IV, §65, Ala. Const. 1901. That began changing in 1980. "Since 1980, Alabama has adopted various constitutional amendments creating *exceptions* to §65, specifically allowing the game of bingo under certain circumstances. See Ala. Const., Amendments 368, 387, 413, 440, 506, 508, 542, 549, 550, 565, 569, 599, and 612." *Barber v. Cornerstone Community Outreach, Inc.*, 42 So.3d 65, 78 (Ala. 2009).

enjoyment from the prospect of winning a prize or a jackpot." *Crayton*, 344 So.2d at 775.

The Court in *Crayton* did not directly address what constituted the taxable gross receipts subject to the §40-23-2(2) tax because the parties agreed that if the bingo proceeds were taxable, the Department had correctly assessed Crayton for $13,178.72. *Crayton*, 344 So.2d at 773. The Court also indicated that the bingo operation had "grossed approximately $330,000" during the assessment period. *Crayton*, 344 So.2d at 774. At the four percent State rate, sales tax on $330,000 would be $13,200, or the approximate amount assessed by the Department, which suggests that the tax is measured by the gross amounts paid by the customers to play bingo, without deducting or netting the payouts.

The only other bingo tax case decided by the appellate courts in Alabama is *Fraternal Order of Eagles v. White*, 447 So.2d 783 (Ala. Civ. App. 1984). The Court held in that case that the bingo receipts were taxable in full, even though the net proceeds were donated to exempt charities. But as in *Crayton*, the Court did not specifically address the issue in this case. The Court did state that "[t]he tax in question is levied upon gross receipts. Included in the definition of 'gross receipts' is 'all receipts actual and accrued, by reason of any business engaged in, . . .' §40-23-1(a)(8), Code 1975. Here, each of the plaintiffs had gross receipts as so defined, for they actually received funds by reason of their bingo business." *Fraternal Order of Eagles*, 447 So.2d at 784. The Court's statement that "the plaintiffs had gross receipts as so defined, for they actually received funds" indicates that the total amount "received" by the bingo operators constituted the taxable gross receipts, not the net amount after payouts.

The Taxpayer argues that *Crayton* and *Fraternal Order of Eagles* are inapplicable because they involved traditional bingo, and that electronic bingo can be distinguished

because with electronic bingo, the operator owes the player a "payout." The Taxpayer explained its position on page 5 of its Response to the ADOR Brief:

> Because of the nature of electronic bingo, the cases that the State cites are inapplicable and Taxpayer should not be taxed on the total amount wagered. Electronic bingo differs from paper bingo because Taxpayer owes the patron a "payout." Gross receipts are only realized by Taxpayer after the "payout" that is owed to the patron has been paid. In other words, the gross receipts are equal to the "hold." Assessing the tax based on the total amount of bets is illogical because Taxpayer directly pays out a significant portion of the amount bet.

I agree that traditional paper bingo and so-called electronic bingo are different. See generally, *Barber v. Cornerstone Community, infra*. But the Taxpayer's argument is flawed because there is also a payout in traditional bingo. That is, the first player to "bingo" at traditional bingo also receives a cash payout or other thing of value from the bingo operator. The fact that electronic bingo can be played in a few seconds and that traditional bingo takes much longer is of no legal consequence.

The definition of "gross receipts" at §40-23-1(a)(8) specifies that a taxpayer operating a public place of amusement cannot deduct any expenses or losses in computing the gross receipts subject to the §40-23-2(2) tax. The Taxpayer's payouts to its customers constituted expenses or losses incurred by the Taxpayer. The Taxpayer's position that its taxable gross receipts was the net amount it retained after deducting the payouts thus cannot be correct.

If the payouts cannot be deducted, the question becomes what constituted the Taxpayer's gross receipts to begin with. As discussed, the Department contends that every button push or lever pull on one of the Taxpayer's machines constituted a taxable transaction, and that the cumulative amount "bet" on the machines constituted the taxable

gross receipts received by the Taxpayer. I disagree.

The Taxpayer's gross receipts included only the actual dollar amounts the customers put into the machines to play. If a customer won and received credits on a machine, and then used the credits to continue playing, those plays or bets using the credits would not result in additional gross receipts to the Taxpayer because the Taxpayer received nothing as a result. In the above example, the Taxpayer did not receive any additional money, i.e., gross receipts, when the customer won $1,000 on the twentieth pull and then lost the "winnings" back on the next 1,000 pulls. Rather, the Taxpayer's actual gross receipts was the $20 the customer put into the machine to begin with. After the customer paid the $20 to take 20 spins, it was irrelevant for purposes of the gross receipts tax whether the customer lost some or all of the amount, got his $20 back, or eventually won $1,000 or any other amount. The amount actually received by the Taxpayer was the $20. And the number of spins or lever pulls the customer made after investing the $20 was also irrelevant.

To summarize, the Taxpayer's gross receipts for purposes of the §40-23-2(2) public amusement sales tax was the total amount the Taxpayer's customers put into the electronic machines, and, if the Taxpayer also sold tokens that were used to operate the machines, the amounts received by the Taxpayer from the sale of the tokens. That amount constituted "all receipts actual and accrued by reason of" the business engaged in by the Taxpayer, without deducting or excluding the winnings paid out by the Taxpayer or any other expenses whatsoever. See, §40-23-1(a)(8). The amount would not, however, include any credits won that the players used to continue playing the machines.[2]

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[2] The above holding is also consistent with how electronic game machines in traditional video arcades are taxed. Assume an expert player puts $1 into an arcade machine to play

The above holding is also consistent with how courts in other states have ruled on the issue. In *Fraternal Order of Police, et al. v. South Carolina Dept. of Revenue*, 506 S.E.2d 495 (1998), the South Carolina Supreme Court addressed the issue of what constituted "gross proceeds" derived by bingo operators in the State. "Gross proceeds" was defined by South Carolina law as "[t]he total amount received from the sale of bingo cards and entry fees. . . ." S.C. Code Ann. §12-21-3320(8) (Supp. 1997)." The Court held that the total amount received, without deduction for payouts, was taxable.

> The next issue is whether gross proceeds includes the monies bingo operators are statutorily required to pay out as prize money under § 2-21-3420(1) (Supp. 1997). The circuit court held these funds are part of the taxable gross proceeds, and that to adopt the operators' argument that these funds are excluded would be to rewrite "gross proceeds" as "net proceeds." We agree. The statute defines gross proceeds as "the total amount received from the sale of bingo cards and entrance fees. . .", and provides no deduction for prize money or any other expenses. The statutory language is clear and unambiguous.

Fraternal Order of Police at 497.

The Minnesota Tax Court also addressed the issue in *South Robert Street Business Men's Town Social Club v. Comm. of Taxation*, 1972 WL111, Minn. Tax, 1972. The applicable Minnesota statute levied a sales tax on the gross receipts received for the privilege of participating in bingo games. The Court held that payouts could not be deducted in computing the tax.

> The second argument made by appellant is that if such gross receipts are taxable, the amount of the prizes or awards made to the participants should be deducted from gross receipts in computing the sales tax due. We reject that contention. The statute makes no provision nor does it contemplate the

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one game. The player wins numerous "free" games on the machine because of his expert ability. Regardless of how many free games the player wins and plays, the arcade owner would still have only $1 in taxable gross receipts.

> deduction of expenses of operation or other deductions from gross receipts. The deduction of the payments made for prizes and awards would be akin to deducting salaries of actors and players and other expenses of operation incurred by places of amusement. We find nothing in the Sales Tax Act which permits for such a deduction from gross receipts.

South Robert Street at 2.

The Taxpayer argues that the above cases do not apply because they involved paper bingo, not electronic bingo. But as discussed, there is no difference between traditional paper bingo and electronic bingo for purposes of computing the gross receipts sales tax. Both involve payouts to the players that cannot be deducted in computing taxable gross receipts.

It is unclear how the above holding will impact the Taxpayer's liability in this case, assuming that the sales tax bingo exemption at §40-23-4(a)(43) does not apply. A conference is scheduled for **12:30 p.m., June 28, 2012 at the Department's Jefferson/Shelby Taxpayer Service Center, 2020 Valleydale Road, Suite 208, Hoover, Alabama.** The purpose for the conference is to discuss and determine how to proceed in the case.

Entered May 29, 2011.

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BILL THOMPSON
Chief Administrative Law Judge

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