WARRIOR TRACTOR & EQUIPMENT COMPANY, INC P.O. BOX 412 NORTHPORT, AL 35476-0412,	§	STATE OF ALABAMA DEPARTMENT OF REVENUE ADMINISTRATIVE LAW DIVISION
Taxpayer,	§	DOCKET NO. S. 12-821
v.	§	
STATE OF ALABAMA DEPARTMENT OF REVENUE.	§	

SECOND PRELIMINARY ORDER ON TAXPAYER'S APPLICATION FOR REHEARING

This appeal involves final assessments of State and local sales tax and State rental tax for January 2006 through December 2008. A Final Order was entered on October 16, 2013. The Taxpayer timely applied for a rehearing. A rehearing was conducted on May 1, 2014. Blake Madison represented the Taxpayer. Assistant Counsel Margaret McNeill represented the Department.

Three substantive issues are involved. The Taxpayer sells at retail heavy forestry equipment, i.e., log loaders, skidders, etc. The primary issue is whether 16 pieces of heavy equipment held for sale by the Taxpayer, but also used by the Taxpayer as demonstrators on land owned by a separate entity, Alawest, were subject to sales tax pursuant to the sales tax "withdrawal" provision at Code of Ala. 1975, §40-23-1(a)(10).

The second issue is whether the Department correctly assessed the Taxpayer on the Taxpayer's cost of filters that it used to maintain free-of-charge the equipment it sold to its customers.

The third issue is whether ether and degreaser used by the Taxpayer on the equipment was taxable at the lower one and one-half percent "machine" rate levied at Code of Ala. 1975, §40-23-2(3).

An Opinion and Preliminary Order was entered on July 8, 2013 holding that (1) the withdrawal provision applied to the machines used as demonstrators; (2) the filters were not subject to tax; and (3) the ether and degreaser were taxable at the general four percent rate, not the reduced machine rate. After the Division entered the October 16, 2013 Final Order, the Taxpayer timely applied for a rehearing concerning issue (1), the demonstrators.

The Administrative Law Division held in the July 8 Opinion and Preliminary Order that the demonstrators were taxable under the withdrawal provision based on the Division's understanding of the evidence that the Taxpayer also used the equipment for a profit-motivated purpose unrelated to the use of the machines as demonstrators.

> In summary, the Taxpayer's use of the equipment on the Alawest property served a dual purpose. It allowed the Taxpayer to demonstrate the equipment for potential buyers, which, by itself, was not a taxable use under the withdrawal provision. But using the equipment to harvest the Alawest timber free-of-charge also benefitted the Taxpayer's owner, who also owns 90 – 95 percent of Alawest. And importantly, the Taxpayer also used the equipment to harvest timber on property not owned by Alawest. The equipment was not demonstrated for potential customers on those occasions, and thus was used in a profit-motivated activity unrelated to the sale of the equipment. Sales tax is thus due under the withdrawal provision on that separate use of the equipment for profit.

Opinion and Preliminary Order at 10.

The Taxpayer argues on rehearing that the Division misconstrued the testimony of the Taxpayer's principal owner, Gene Taylor. Specifically, the Taxpayer contends that the demonstrator equipment was not otherwise used in a profit-motivated activity during the period in issue, but rather was at all times used by the Taxpayer only as demonstrators.

The Taxpayer's comptroller and principal owner both testified at the May 1, 2014 rehearing. The comptroller stated that the Taxpayer did not depreciate the equipment in

issue. He indicated that all of the equipment was eventually sold at retail for fair market value, and that sales tax was paid on the proceeds. Importantly, he confirmed that the machines were only used as demonstrators, either on property owned by Alawest, or on property owned by a potential customer, and that the machines were never used in a profit-motivated activity. The testimony of the Taxpayer's principal owner confirmed the testimony of the comptroller.

As discussed in the Opinion and Preliminary Order at 6, 7, the Alabama Supreme Court has held that the withdrawal provision does not apply when an automobile dealership removes a vehicle from inventory and uses it solely as a demonstrator. See, *Drennan Motors Co. v. State*, 185 So.2d 405 (Ala. 1966). The undisputed evidence submitted at the May 1 rehearing shows that the equipment in issue was used only as demonstrators, was available for sale at all times, and was eventually sold at retail, and sales tax paid thereon. The rationale of *Drennan Motors* applies. The Taxpayer's use of the equipment as demonstrators did not subject the equipment to sales tax under the withdrawal provision.

As also discussed in the Opinion and Preliminary Order, this case is complicated by the fact that the Taxpayer's use of the equipment to harvest the Alawest timber directly benefitted the Taxpayer's owner, who, together with his wife, owns 100 percent of Alawest.

> This case is difficult because the Taxpayer's use of the equipment on the Alawest property served two purposes. First, the equipment was used to demonstrate the equipment. But unlike the demonstrators in *Drennan Motors*, which were "used only to promote selling" the dealership's vehicles, *Drennan Motors*, 185 So.2d at 411, the use of the equipment to harvest the Alawest timber free-of-charge also personally benefitted the Taxpayer's owner because he also owns 90 – 95 percent of Alawest. It could be argued that when a retail business entity owned by an individual withdraws an item from inventory and uses the item in an activity that financially benefits the owner, as in this case, then the withdrawal provision should apply. The

> Alabama Supreme Court has held, however, that two commonly-owned but separate entities must be treated as separate entities for sale tax purposes. *Ex parte Capital City Asphalt*, 437 So.2d 1291 (Ala. 1983). Consequently, the fact that the Taxpayer's use of the equipment financially benefited another entity, Alawest, and not the Taxpayer, is not necessarily fatal to the Taxpayer's case.

Opinion and Preliminary Order at 8.

If the equipment in issue had been used to harvest timber on property owned by the Taxpayer, then clearly the withdrawal provision would apply because the Taxpayer would have otherwise profited from the use of the equipment. But while the Taxpayer and Alawest are majority owned by the same individual, they are separate legal entities. Consequently, because the evidence shows that the Taxpayer did not benefit from the use of the equipment other than as demonstrators, the withdrawal provision does not apply. The Taxpayer's cost of the equipment should accordingly be removed from the Department audit.

The Department should recompute the assessments in issue and notify the Administrative Law Division of the adjusted amounts due. A Final Order on Rehearing will then be entered.

This Order is not an appealable Order. The Final Order on Rehearing, when entered, may be appealed to circuit court within 30 days pursuant to Code of Ala. 1975, §40-2A-9(g).

Entered May 30, 2014.

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BILL THOMPSON
Chief Administrative Law Judge

bt:dr
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