STATE OF ALABAMA DEPARTMENT OF REVENUE,	§	STATE OF ALABAMA DEPARTMENT OF REVENUE ADMINISTRATIVE LAW DIVISION
v.	§	DOCKET NOS. S. 85-189 S. 85-190
ABBEY AMUSEMENTS, INC. P. O. Box 3539 Oxford, AL 36203,	§	
JACK GRIZZARD, d/b/a Grizzard Feed & Seed Center P.O. Box 3539 Oxford, AL 36203,	§	
Taxpayers.	§	

ORDER

This case involves preliminary assessments of State and City of Oxford sales tax entered against Jack Grizzard, d/b/a Grizzard Brothers Feed & Seed Center, for the period June 1, 1981 - June 30, 1982, and State, City of Oxford and various local sales taxes entered against Abbey Amusements, Inc. for all or part of the period March 1, 1982 - May 31, 1984. The above parties are hereinafter referred to either jointly or separately as "Taxpayer".

The assessments were consolidated and a hearing was conducted in the matter on March 26, 1987. The Taxpayer was represented at said hearing by CPA Mitchell Williams and attorney Fred Ray Lybrand. Assistant counsel J. Wade Hope was present and represented the Department. Based on the evidence adduced at the hearing, and in consideration of post-hearing briefs submitted by both parties, the following findings of fact and conclusions of law are hereby made and entered.

FINDINGS OF FACT

The Department audited the Taxpayer and assessed additional sales tax based on four general categories of sales or gross receipts, as follows:

(I) Sales of video games to various Alabama customers.

(II) Gross receipts derived from video games owned by the Taxpayer and located at various arcades, video rooms, etc. operated by others.

(III) Sales of video games claimed by the Taxpayer to have been made to out-of-state customers.

(IV) Video games either withdrawn from inventory or purchased by the Taxpayer for use in its own locations.

ISSUE (I)

The Taxpayer reported as wholesale sales for resale numerous sales of video games to Alabama customers. In each instance, the purchaser had provided the Taxpayer with an Alabama sales tax number, which was sufficiently reflected on the Taxpayer's records.

Nonetheless, the Department examiner included those sales in the audit as taxable. Specifically, the examiner determined, from personal observation and knowledge, that the purchasers, various game room and arcade operators, were not in the business of selling video games, and consequently, that the sales to them by the Taxpayer were for use only, and not for resale. Upon transmittal of the audit to the Sales Tax Division in Montgomery for review, sales to two businesses, totaling$47,500.00, were determined to be at wholesale and were thus deleted from the audit.

In rebuttal, the Taxpayer argues that the sales were to

licensed dealers, that the general nature of the purchasers' businesses included the sale of video games, and that it had obtained each dealers' sales tax number, as required by Department regulations. The evidence further indicates that the Taxpayer was told that the sales were for resale, and that in some instances the customers advertised for the subsequent sale of said games. While some of the games may have been used by the purchasers, and not resold, the Taxpayer contends that in those instances the purchaser would be liable under the withdrawal provisions of Code of Alabama 1975, §40-23-1(a)(10).

Further, the Taxpayer argues that it was customary in the video game business to advertise or offer a game for resale by displaying or using it in a game room.

ISSUE (II)

The Taxpayer owned a number of games that were located in game rooms, arcades, etc. operated by others. The gross receipts from those games were customarily split 50/50 or 60/40 between the Taxpayer and the location owner, respectively. The Taxpayer also operated games at its own locations from which it received 100 percent of the gross receipts. The Taxpayer paid tax only on the percentage of gross receipts that it actually received from the above machines.

The Department examiner, assuming that the Taxpayer had reported and paid tax on only 50 percent of gross receipts at each location,

doubled the Taxpayer's gross receipts and assessed liability accordingly. After transmittal of the audit to Montgomery for review, the Taxpayer's accountant produced records indicating that in some instances the Taxpayer had reported and paid tax on a 60 percent take, and that for locations owned by the Taxpayer, the full amount had been reported. The Department accepted the Taxpayer's calculations and adjusted the audit accordingly.

However, while the Taxpayer admits that it should have paid on the entire gross receipts derived from each of its machines, it argues that a credit should be allowed for any tax that was reported and paid by the location owner. The Taxpayer submitted affidavits from various location owners indicating payment on their portion of the receipts. Those affidavits were offered at the administrative hearing but were rejected as improper evidence. No other competent evidence on the issue was offered by either party. In any case, the Department argues that any payments that might have been made by a location owner were improperly made, and should not go to reduce the Taxpayer's liability.

ISSUE (III)

A number of sales reported by the Taxpayer as tax-exempt out-of-state sales were included in the audit as taxable. The Taxpayer produced affidavits from various purchasers attesting that the sales had been made outside of the State. However, the unsubstantiated and unverified affidavits were rejected as

improper. No contemporaneous records or other competent evidence was introduced at the administrative hearing showing that the sales were consummated outside the State. The Department did exclude sales to two vendors located in Louisiana and Texas as a result of records showing that said vendors were in the business of selling video games and that the subject games had been delivered outside of Alabama.

ISSUE (IV)

The depreciation schedules contained in the Taxpayer's personal income tax returns for the subject period indicated that machines worth $95,000.00 had been placed in service by the Taxpayer during the audit period. The business's sales records indicated that $56,000.00 worth of machines had been individually purchased by the Taxpayer. Consequently, the Department examiner set up the difference of $39,000.00 as taxable withdrawals from inventory.

The Taxpayer concedes that he had personally purchased $95,000.00 in games from the business, but argues that the $39,000.00 in missing sales were already included on the business's sales records, as sales on which no purchaser was listed.

CONCLUSIONS OF LAW

ISSUE (I)

Code of Alabama 1975, §40-23-1(a)(9) defines "wholesale sales" in part as follows:

> a. A sale of tangible personal property by wholesalers to licensed retail merchants, jobbers, dealers, or other

> wholesalers for resale and does not include a sale by wholesalers to users or consumers, not for resale;

In recognition of the fact that some businesses make both wholesale and retail sales, as well as withdrawals for personal use, the Revenue Department has promulgated regulations allowing for such dual operators, when properly licensed, to purchase all property at wholesale, with the burden then on said purchasers to report to the Department whether the subsequent disposition of the property is at wholesale, retail, or a withdrawal for use. The relevant regulations are as follows:

> 810-6-1-.56. Dual Business
>
> (1) Operators of businesses who are both making retail sales and withdrawing for use from the same stock of goods are to purchase at wholesale all of the goods so sold or used and report both retail sales and withdrawals for use under the sales tax law.
>
> (2) This ruling applies only to those who actually carry on a retail business having a substantial number of retail sales and does not apply to contractors, plumbers, repairmen, and others who make isolated or accommodation sales and who have not set themselves up as being engaged in selling. Where only isolated sales are made, tax should be paid on all of the taxable property purchased with no sales tax return being required of the seller making such isolated or 'accommodation" sales.
>
> 810-6-1-.89.02. Licensed Dealers, Sales to
>
> (1) Sales to dealers at wholesale. Sales of tangible personal property are sales at wholesale, not subject to tax when made to a licensed dealer to be put into the stock of goods he offers for sale, not withstanding the fact that he may occasionally or habitually withdraw from stock some part of his goods for his own use or consumption. Such withdrawals are to be treated by the dealer as retail sales and are to be reported as such in the sale tax returns he files with the Department of

Revenue.

(2) Sales to dealers at retail. Sales of tangible personal property to a licensed dealer for his own use or consumption rather than for resale purposes are sales at retail and are subject to tax.

810-6-1.144.03. Resale, Sales for. All buyers of property for resale purposes are entitled to purchase at wholesale, tax free, the property they resell as regular course of business when they have secured the sales tax license required by law. This rule also applies to retailers located outside Alabama when they have secured the sales tax license required by law in the state in which they are located. 40-23-6

810-6-1-.184. Vendor Sells Tax Free at his Risk. It is the vendor's duty under the Sales Tax Law to know the general and customary business of his customer and to collect the amount of tax due. The vendor is not, however, expected to follow each article of goods he sells to its final use, therefore, he is not to be held accountable for an isolated transaction made by his customer or for an isolated use of property by him. Where a vendor sells to a customer who both uses and sells from the same stock of goods such vendor may sell tax free at wholesale all of the goods so used or resold. 40-23-26

810-6-2-.107. Wholesale Sales.

(1)Record of sales at wholesale to be kept. In the court case State of Alabama v. Levey, 29 So.2d 129, the Alabama Supreme Court held that suitable records of wholesale sales must be kept in accordance with the provisions of the Sales and Use Tax Laws in order to claim nontaxability for such sales.

810-6-4-.10. Keeping Records of Sales for Resale, (Formerly Regulation L). Any seller within or without this state engaged in making sales at both retail and wholesale who claims as exempt from the Sales or Use Tax Act a sale to a licensed retail merchant, licensed dealer, licensed jobber, or other licensed person as a sale for resale must show on the invoice of such sales and the copy thereof (which copy must be retained in the seller's office) the name and address and the sales tax account number of such licensed retailer, dealer, jobber,

or other person; . . .

In summary, the above regulations allow that businesses making both retail sales (other than isolated) and withdrawals for use are allowed to purchase all goods at wholesale, and are required to subsequently report both withdrawals for use and retail sales on its tax return (Regs. 810-6-1-.56 and 810-6-1-.89.02(l)). Further, such sales are at wholesale "notwithstanding the fact that he may occasionally or habitually withdraw from stock some part of his goods for his use or consumption." (Reg. 810-6-1.89.02).

The seller is expected to know the general and customary business of the purchaser, but is not expected to follow each article of property to its final use. Whenever the purchaser both uses and sells from the same inventory, the seller may sell tax free all property so used or sold (Reg. 810-6-1-.184), and he seller's only requirement is that he obtain the purchaser's sales tax license and keep a proper record of same (Regs. 810-6-1-.144.03, 810-6-2-.107, and 810-6-4-.10).

Concerning the sales in issue, the Taxpayer obtained the purchasers' sales tax numbers and otherwise complied with the Department's recordkeeping requirements. The only dispute is whether the sales were properly "for resale." The Department contends that the machines were purchased for use, and not for resale. That determination was based on the examiner's personal

observation that some of the purchasers operated businesses in which the machines were used, and did not appear to be in the business of reselling the machines.

There is a legitimate dispute, which is left unsettled by the evidence, as to whether some or all of the machines in issue were purchased for use and/or resale. However, such circumstances, where the purchaser's intended purpose in buying the property is not readily discernible to the seller, are exactly the type situations in which the above-cited regulations are intended to apply. If there is a question at the time of sale as to whether the buyer intends to use or resell the goods, then the sales should be at wholesale and the purchaser, not the seller, should be liable for reporting and paying tax on any subsequent taxable withdrawal or sale.

The Taxpayer made the sales in issue tax free after obtaining the purchasers' sales tax numbers, as required by Department regulations, and based on the purchasers' assertions that the sales were for resale. In some instances, the purchasers also advertised for the sale of the machines. Finally, the Taxpayer was aware, from personal experience, that the nature of the video game business was such that a dealer would ordinarily both use and resell its inventory of machines, and would customarily use and display for sale its stock in a game room or arcade.

The question is whether a sale should qualify as a tax-free

wholesale sale must be decided on a case-by-case basis. Under the present facts, especially in consideration of the fact that the Taxpayer did obtain the purchasers' sales tax numbers and kept proper records relating thereto, the Taxpayer should not be held liable for tax on its sale to licensed purchasers.

If the purchasers did subsequently withdraw the machines for personal use, then the withdrawal provisions of the sales tax law, at Code of Alabama 1975, §40-23-1(a)(10), along with the above-cited and other pertinent Department regulations, would require that the purchaser/withdrawer must report and pay the tax thereon. The question, which is not in issue here, would then be whether the withdrawal of a machine for "temporary" use by the purchaser would qualify as a taxable withdrawal, See State v. Kershaw Manufacturing Company, 137 So.2d 740; Montgomery Aviation Corporation v. State, 154 So.2d 24.

ISSUE (II)

The Taxpayer admits liability for tax on the entire gross receipts received through its video games, but argues that a credit should be allowed for any tax paid by the location owners on their split of the proceeds. The Department rejects the Taxpayer's credit argument and contends that any tax paid by a location owner was erroneously paid, should be refunded, and should not go to reduce the Taxpayer's liability.

A similar situation arose in State v. Mack, 411 So.2d 799. In Mack, the Court of Civil Appeals, citing State v. Woods, 5 So.2d 732, found that the owner of an amusement machine business was liable for tax on its entire gross receipts regardless of commissions or splits paid to location owners. However, the taxpayer in Mack, as in the present case, argued that he should be allowed credit for taxes paid by the various location owners. The Court rejected the taxpayer's argument, not on the basis that a credit should not be allowed as a matter of law, but rather on the basis that there was insufficient evidence to establish payment by the location owners. Testimony was presented as to payment by one location owner, which was uncontested by the Department, and from which a credit was presumably allowed.

As in Mack, the Taxpayer's argument in the present case must be rejected for lack of substantiating evidence. No competent evidence was presented at the administrative hearing from which it could be determined that tax was remitted by any of the location owners. Accordingly, the Department's computation of liability on this issue must be upheld.

ISSUES (III & IV)

Both of these questions must be decided for the Department due to the Taxpayer's failure to maintain and produce adequate records in support of its position.

Code of Alabama 1975, §40-23-9 requires all persons subject to

sales tax to keep accurate and complete records from which their liability can be properly determined, State v. T. R. Miller Mill Company, 130 So.2d 185; State v. Levy, 29 So.2d 129, and in the absence of such records the Department is not required to rely on the verbal assertions of the taxpayer, but rather, can utilize the best information available in determining the correct liability. State v. Ludlum, 384 So.2d 1089.

Relating to Issue III, the Taxpayer provided no records indicating that the subject sales were made outside of Alabama. Without records to properly verify the non-taxability of the sales, the Department auditor properly included the sales as taxable.

Relating to Issue IV, it is undisputed that the Taxpayer, individually, placed in operation during the audit period machines valued at approximately $95,000.00. Yet the Taxpayer's business records reflect only $56,000.00 in sales to the Taxpayer. The examiner accordingly included the balance as taxable withdrawals from inventory under §40-23-1(a)(10).

The Taxpayer argues that all of the sales were properly recorded (and tax paid thereon) in its sales records, but that a portion could not be traced to the Taxpayer simply because no purchaser was listed. However, if it is agreed that the Taxpayer, individually, purchased or withdrew $95,000.00 worth of machines from the business, and the business records reflect only $56,000.00 having been sold to the Taxpayer, then the Taxpayer must suffer the

consequences for its insufficient recordkeeping. Without substantiating records, the Department is not required to rely on the Taxpayer's testimony that the missing $39,000.00 in sales were included as part of those sales for which no purchaser was set out. Accordingly, the $39,000.00 worth of machines in issue were properly included as taxable withdrawals by the Taxpayer.

The Department is hereby directed to adjust the audit and assessments as set out herein, and to thereafter make said assessments, as adjusted, final, with applicable interest as required by statute.

Done this 22nd day of May, 1987.

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BILL THOMPSON
Chief Administrative Law Judge