STATE OF ALABAMA, DEPARTMENT OF REVENUE, vs. RUSH HOSPITAL/BUTLER, INC. P. O. Box 518 Butler, AL 36904, Taxpayer.	§ § § § § §	STATE OF ALABAMA DEPARTMENT OF REVENUE ADMINISTRATIVE LAW DIVISION DOCKET NO. U. 88-193

FINAL ORDER

The Revenue Department assessed State and Choctaw County use tax against Rush Hospital/Butler, Inc. (Taxpayer) for the period April 1985 through March 1988. The Taxpayer timely appealed to the Administrative Law Division. D'Wayne May represented the Taxpayer. Assistant counsel Wade Hope represented the Department.

The issue in this case is whether the Taxpayer is liable for Alabama use tax on tangible personal property delivered into Alabama by the Taxpayer's parent corporation in Mississippi (or by a third party supplier on behalf of the parent) and subsequently used by the Taxpayer in Alabama.

The Taxpayer is a wholly-owned subsidiary corporation of Rush Hospital Foundation in Meridian, Mississippi (Rush/Meridian), and was incorporated as a Mississippi nonprofit corporation in 1981. Both Rush/Meridian and the Taxpayer are qualified charitable organizations under §501(c)(3) of the Internal Revenue Code (I.R.C.). The Taxpayer qualified with the Alabama Secretary of State to do business in Alabama in 1981.

The Taxpayer purchased the Choctaw County Hospital in Butler, Alabama in 1981 or 1982 and owned and operated the hospital during the years in issue.

The Taxpayer requisitioned supplies, equipment and other materials from Rush/Meridian in Mississippi during the period in issue. Rush/Meridian subsequently withdrew the materials from inventory and delivered them to the Taxpayer's facility in Alabama. If the materials were not in inventory, Rush/Meridian purchased the materials from a third-party supplier who then delivered the materials to the Taxpayer in Alabama. Rush/Meridian is exempt from Mississippi sales tax as a §501(c) entity, and thus purchased all of the materials in issue tax free.

Rush/Meridian billed the Taxpayer for the materials at cost at the end of each month. The Taxpayer paid Rush/Meridian for some but not all of the materials. The unpaid items were treated as an account payable by the Taxpayer and an account receivable by Rush/Meridian. Rush/Meridian's Board of Directors met at the end of each year and decided what portion of the Taxpayer's account receivables would be forgiven or written off as uncollectible.

The Department audited the Taxpayer and assessed use tax on the materials provided by Rush/Meridian to the Taxpayer as follows: Schedule A includes those materials that were paid for by the Taxpayer; Schedule B includes those materials not paid for by the Taxpayer; and Schedule C includes the materials purchased by

Rush/Meridian from third party suppliers and then delivered to the Taxpayer in Alabama.

The Taxpayer first argues that it is exempt from all Alabama use tax either as a §501(c)(3) organization or under §40-23-5(m) (all statute cites herein are to the Alabama Code of 1975, except I.R.C. §501). The Taxpayer also contends that even if it is not exempt, use tax is still not owed on the Schedule B property because those items were gifts from Rush/Meridian and not retail sales subject to the use tax.

I find that the Taxpayer is not exempt under either I.R.C. §501(c)(3) or §40-23-5(m). I also find that the Schedule B transactions involved retail sales by Rush/Meridian to the Taxpayer and not gifts. However, use tax cannot be assessed on any of the property because the sales were closed in Alabama and under applicable case law sales tax is due, not use tax. State v. Dees, 333 So.2d 818.

The Claimed §501(c)(3) Exemption.

Use tax is due on tangible personal property purchased at retail and subsequently used, stored or consumed in Alabama. §40-23-61. However, no tax can be assessed if the entity using the property is exempt, the use of the property is exempt, or the Department is prohibited by either the Alabama or U.S. Constitution from taxing the entity or the property. None of the above is applicable in this case. A §501(c)(3) organization is not

specifically exempted from Alabama sales or use tax and the Department is not constitutionally prohibited from taxing a §501(c)(3) organization. Consequently, the Taxpayer is not exempt from Alabama sales or use tax because it is a §501(c)(3) charitable organization.

The Claimed §40-23-5(m) Exemption.

Likewise, the Taxpayer is not exempt under §40-23-5(m). That section exempts from sales and use tax all public hospital associations organized under §10-3A-1 et seq., the Alabama Nonprofit Corporation Act. The Taxpayer, although a nonprofit corporation, was organized in Mississippi in 1981 and not under the above Alabama statute. The Alabama Nonprofit Corporation Act was not even enacted until 1984. Consequently, §40-23-5(m) does not apply.

The Applicability of Alabama Use Tax.

This issue is more complicated.

Alabama's use tax applies to tangible personal property used, stored or consumed in Alabama, but only if the property is previously purchased at retail. §40-23-61. The Taxpayer claims that the Schedule B materials were not sold at retail but rather were gifts from Rush/Meridian and thus not subject to use tax. I disagree.

"Sale" is defined as "the passing of title from the seller to the buyer for a price". §7-2-106(1). Rush/Meridian transferred

title to the property in issue to the Taxpayer for a price -- Rush/Meridian's cost. The materials were thus sold by Rush/Meridian to the Taxpayer. The fact that the Schedule B sales were on credit and Rush/Meridian subsequently forgave all or part of the debt does not change the nature of the initial transaction as a sale.

"Retail sale" is defined for use tax purposes as "all sales of tangible personal property except those above defined as wholesale sales". §40-23-60(5). The sales in issue were not wholesale sales for resale and thus were retail sales for purposes of the use tax.

However, even though the materials were sold at retail by Rush/Meridian to the Taxpayer, use tax is not applicable because the retail sales occurred within Alabama.

The Department assessed use tax in this case because Rush/Meridian is located outside of Alabama and the goods were delivered into and used in Alabama. However, those facts are not controlling. Rather, the issue turns on where the sale is closed. Alabama's courts follow the general rule that sales tax is due on retail sales closed in Alabama and use tax is due on retail sales closed outside of Alabama where the property is subsequently used, stored or consumed in Alabama. (hereinafter "the general rule"). State v. Marmon Indus., Inc., 456 So.2d 798; Boswell v. General Oils, Inc., 368 So.2d 27; Paramount-Richards Theaters v. State, 55 So.2d 812; State v. Dees, supra.

Under both §7-2-106(1) and §40-23-1(a)(5), a sale occurs when and where title passes from the seller to the buyer. Under both §7-2-401(2) and §40-23-1(a)(5), title passes and thus a sale is closed at the time and place the seller completes physical delivery of the goods. Oxmoor Press, Inc. v. State, 500 So.2d 1098; Department of Revenue v. Dixie Tool and Die Company, 537 So.2d 921.[1]

In this case, Rush/Meridian (and the third-party suppliers) delivered the materials in issue to the Taxpayer in Alabama. The retail sales thus were closed upon delivery within Alabama and sales tax is applicable, not use tax. Consequently, the use tax assessments in issue were erroneously entered and must be dismissed.[2]

The above holding is dispositive in this case. However, while I am required to follow the general rule discussed above, I disagree with that general rule that all sales in Alabama are

[1]Section 40-23-1(a)(5) is a sales tax section. However, the same rules concerning passage of title and when a sale is closed apply for use tax purposes through the UCC, specifically §§7-2-106(1) and 7-2-401(2).

[2]I reached a similar result in a 1985 case, Docket No. U. 84-194. In that case, an Alabama contractor ordered structural steel from a Texas supplier. The supplier subsequently delivered the steel to the Alabama jobsite. The Department assessed the Alabama contractor for use tax. I dismissed the use tax assessments because the sales were closed in Alabama and thus under the general rule sales tax was due, not use tax. The Department appealed to Montgomery County Circuit Court and Judge Phelps affirmed. See, CV-86-175-Ph. The Department elected not to appeal further.

subject to Alabama sales tax and thus cannot be subject to use tax. The general rule is correct to the extent that most retail sales in Alabama are subject to Alabama sales tax, but there is an important exception, and to apply the general rule in all situations causes an unintended loophole in the sales and use tax structure.

The loophole occurs when the retail sale in Alabama is by an out-of-state seller with no nexus with Alabama. If the general rule is followed in that situation, then the out-of-state seller cannot be taxed because of lack of nexus[3], use tax cannot be assessed against the Alabama purchaser because the retail sale was closed in Alabama (the general rule), nor can sales tax be assessed

[3]See, Miller Brothers Co. v. Maryland, 74 S. Ct. 535; National Bellas Hess Inc. v. Department of Revenue, 87 S. Ct. 1389; and Quill Corporation v. North Dakota, 112 S.Ct. 1904.

against the Alabama purchaser because only the retail seller is liable for Alabama sales tax. Thus, Alabama tax cannot be assessed on the transaction even though the retail sale occurred in Alabama and the property was subsequently used in Alabama. Clearly that was not intended by the Legislature.[4]

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[4]The loophole was widened by Act 86-536 in 1986. Act 86-536 amended §40-23-1(a)(5) and designated the U. S. Postal Service and all common carriers as agents of the seller. Thus, if an Alabama resident orders goods from an out-of-state seller with no nexus with Alabama, and the goods are delivered into Alabama by common carrier or by mail, no Alabama tax can be collected. The seller is protected because of lack of nexus and the Alabama purchaser is not

liable for use (or sales) tax because the retail sale is closed within Alabama.

Likewise, if an Alabama seller sells goods to an out-of-state purchaser and the goods are delivered by common carrier or by mail outside of Alabama, the sales are technically closed outside of Alabama, and again, no Alabama tax is due.

I would close the loophole by holding the purchaser/user liable for Alabama use tax where the retail sale occurs in Alabama but the seller lacks nexus with Alabama and thus is not liable for Alabama sales tax. If the out-of-state seller isn't required to collect and remit Alabama sales tax on the retail sale of the property, then use tax should be paid by the purchaser/user on the subsequent taxable use of the property in Alabama. The rule would of course not apply to "casual" sales which, except for cars and boats, are not subject to either sales tax or use tax. State v. Bay Towing and Dredge Co., 90 So.2d 743; Department Reg. 810-6-1-.33.

The above rule fits both the intent and the wording of the sales and use tax laws.

Alabama's sales tax applies to all retail sales closed in Alabama by sellers "engaged or continuing within this state, in the business of selling at retail". §40-23-2. The use tax is complementary to the sales tax and was intended to apply to all property purchased at retail and used in Alabama on which Alabama sales tax is not paid.

Use tax is not by statute levied only on property purchased at retail outside of Alabama. Rather, §40-23-61 levies a use tax on all property purchased (anywhere) at retail and subsequently used in Alabama, and §40-23-62(1) then exempts from the use tax all sales subject to Alabama sales tax. In that way, the two taxes

together were intended as a cohesive system of taxation applying to all tangible personal property either purchased at retail or used in Alabama. State v. Marmon Indus Inc., supra; Paramount-Richards Theatres v. State, supra; State v. Bay Towing and Dredge Co., supra; Holloway v. State, 79 So.2nd 40.

However, contrary to the general rule, not all retail sales in Alabama are subject to Alabama sales tax and thereby exempt from use tax. A seller without nexus with Alabama cannot be engaged in the business of selling at retail in Alabama as required to be subject to Alabama sales tax under §40-23-2. If the seller isn't liable for Alabama sales tax, then a retail sale by the seller, although closed in Alabama, is not subject to Alabama sales tax, the §40-23-62(1) use tax exemption thus would not apply, and use tax would be due on the subsequent taxable use, storage or consumption of the property in Alabama.

I should emphasize the difference between an out-of-state seller with no nexus with Alabama and an out-of-state seller that by physical presence or otherwise does have sufficient nexus with Alabama. If the seller does not have nexus, Alabama sales tax cannot be assessed and use tax should be paid by the purchaser/user in Alabama. If the seller has nexus, the seller is liable for sales tax and use tax cannot be assessed, even if the Department is unable to collect the sales tax from the out-of-state seller.

The tax consequences in the present case should turn on whether Rush/Meridian established nexus with Alabama by delivering the materials into Alabama on a regular basis. If Rush/Meridian established nexus with Alabama, then sales tax should have been assessed against Rush/Meridian as a retail seller engaged in business in Alabama, not use tax against the Taxpayer. The situation in that case would be similar to Dees, supra, where the Mississippi seller had a physical presence in Alabama and perhaps had sufficient nexus to be subject to Alabama tax. If so, then clearly the Department should have assessed sales tax against the Mississippi seller, not use tax against the Alabama purchaser. The Court of Civil Appeals stated as much in its opinion. Dees, supra, at page 820.

However, if Rush/Meridian lacked nexus with Alabama, then instead of dismissing the use tax assessments in issue, as required by the general rule, I would hold the Taxpayer liable.

What constitutes sufficient nexus by an out-of-state seller is unclear and must be decided on a case-by-case basis. Physical presence by the seller is probably necessary, but to what degree is not clear.[5] However, an out-of-state seller that only delivers

[5]The Supreme Court in Quill affirmed the "bright line" physical presence requirement established in National Bellas Hess. Quill, supra, at page 1916. However, I agree with Justice White's dissent that the physical presence test is not clear and will lead to numerous court cases. Quill, supra, at page 1921. The one-time delivery of goods into Alabama probably isn't sufficient in light of Miller Bros. Co. However, it is not clear at what point or even

goods into Alabama by common carrier or by mail does not by that fact alone have sufficient contact to be liable for Alabama tax. See, National Bellas Hess, supra. Thus, as discussed in footnote 3, if the general rule is followed, an Alabama purchaser can avoid any Alabama transactional tax by ordering goods from an out-of-state seller without nexus with Alabama and having the goods delivered into Alabama by common carrier or by mail. The purchaser will then have accomplished what the use tax was intended to prevent - an Alabama resident buying from an out-of-state seller to avoid Alabama tax.

In deciding this case, I considered recognizing the exception to the general rule myself, and thus holding the Taxpayer liable for Alabama use tax even though the sales in issue occurred in Alabama. I decided not to first because Rush/Meridian may have established nexus with Alabama by delivering the materials into Alabama on a regular basis, in which case sales tax should have been assessed against Rush/Meridian, not use tax against the Taxpayer. Second, the general rule that only sales tax can be

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if repeated deliveries into Alabama by the seller's own vehicles creates sufficient nexus to subject an out-of-state seller to Alabama taxation.

assessed on sales closed in Alabama appears to be so ingrained in appellate court decisions that any exception should first be recognized by the appellate courts. Alabama's courts have never directly addressed the issue, but hopefully they will recognize the problem and close the loophole. Otherwise, if the general rule is followed in all cases, the State will be technically prohibited from taxing numerous transactions in Alabama that the use tax was intended to cover.

Unfortunately, by having to follow the general rule in this case, the end result is that the Taxpayer, a non-exempt entity, is through a loophole being allowed to purchase and use property in Alabama without paying any Alabama (or Mississippi) sales or use tax .[6] The use tax assessments in issue

[6] An alternative method of closing the loophole would be to hold the Alabama purchaser secondarily liable for sales tax. Alabama's sales tax is a direct tax on the consumer, precollected

by the seller for convenience only. State v. Hertz Sky Center, Inc., 317 So.2d 319; §40-23-26. Thus, if a retailer fails to collect and remit tax on a taxable retail sale, the Department should logically be allowed to go directly against the purchaser. The above approach was adopted by Louisiana in McNamara v. Oilfield Const. Co., Inc., 417 So.2d 1311.

I concede that Alabama law does not specify that sales tax can be assessed and collected directly from the consumer. But the tax is a direct tax on the consumer, and if the Department can prove that a retail consumer failed to pay sales tax to a retailer on a taxable retail sale, logically and equitable the consumer should be held liable. Assessment and collection against individual consumers would create an administrative burden for the Department,

must be and hereby are dismissed.

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

Entered on November 12, 1993.

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BILL THOMPSON
Chief Administrative Law Judge

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but for years the Department has collected the "consumers" use tax against individual users in the State.