

STATE OF ALABAMA §
DEPARTMENT OF REVENUE, §

STATE OF ALABAMA
DEPARTMENT OF REVENUE
ADMINISTRATIVE LAW DIVISION

vs. §

CELLULAR PRO CORPORATION
3439A McGehee Road §
P. O. Box 11462 §
Montgomery, AL 36111, §

DOCKET NO. S. 94-303

Taxpayer. §

OPINION AND PRELIMINARY ORDER

The Revenue Department assessed State sales tax against Cellular Pro Corporation ("Taxpayer") for the period July 1993 through December 1993. The Taxpayer appealed to the Administrative Law Division and a hearing was conducted on October 3, 1994. Gregory Davis and Jim Edwards represented the Taxpayer. Assistant counsel Margaret McNeill represented the Department. Bruce P. Ely and Blake Madison filed an amicus brief on behalf of Circuit City Stores, Inc.

The Taxpayer sells cellular telephones at retail. The Taxpayer also solicits cellular telephone service as an authorized agent on behalf of Alltel Mobile Communications of Montgomery ("Alltel"). The Taxpayer receives a commission from Alltel for each activation of cellular service. The commission is not related to or contingent on the sale of a telephone by the Taxpayer. The issue in dispute is whether the commissions received by the Taxpayer from Alltel constitute taxable gross proceeds subject to sales tax.

After the Taxpayer successfully solicits a customer for Alltel

service, the customer contracts directly with Alltel for the service. Activation fees and monthly service fees are paid by the customer directly to Alltel.

The Taxpayer receives a commission from Alltel for each service activation. The commission fluctuates based on the cost of the cellular service ordered by a customer. The commission is not contingent on or tied to the sale of a cellular telephone by the Taxpayer. If a customer cancels Alltel service for any reason within 180 days of activation, the Taxpayer is required to repay the entire commission amount to Alltel.

Alltel pays the Taxpayer based on net activations during the month. That is, the commission is based on all new activations less all pre-180 day cancellations that occur during the month.

The service contracts between the customer and Alltel require that if the customer cancels service with Alltel within one year, the customer is liable to Alltel for a \$200.00 cancellation penalty. The \$200.00 is paid directly by the customer to Alltel, and does not affect the Taxpayer's commission from Alltel.

The Taxpayer sells cellular telephones from a retail outlet in Montgomery. Alltel is not involved in the Taxpayer's retail business. The Taxpayer has sole discretion over the retail selling price it charges for its products.

During the period in issue, the Taxpayer offered a special promotional phone for \$.99, but only if the customer also purchased Alltel service through the Taxpayer. The Taxpayer also offered

other reduced price specials during the period in issue, although only the \$.99 phones were tied to the purchase of Alltel service by the customer.

The Taxpayer collected and remitted sales tax to the Department on the retail amount paid by its customers. The Department audited the Taxpayer and included as taxable gross proceeds the net commissions received by the Taxpayer from Alltel.

The Department's position is that the commissions constitute a part of the value accruing from the sale of the telephones, and thus must be included in taxable gross proceeds as defined at Code of Ala. §40-23-1(a)(6). I disagree.

Alabama sales tax is based on the gross proceeds derived from the retail sale of tangible personal property. "Gross proceeds" is defined as the "value proceeding or accruing from the sale of tangible personal property . . .". Code of Ala. 1975, §40-23-1(a)(6).

The commissions do not proceed or accrue from the sale of cellular telephones by the Taxpayer. Rather, the commissions are paid by Alltel solely for each activation of cellular telephone service solicited by the Taxpayer. The commissions are based on the cost of the Alltel service purchased by a customer, and are not contingent on or otherwise related to the sale of a cellular telephone by the Taxpayer. The Taxpayer receives the same commission from Alltel whether the customer purchases a telephone for \$.99, \$500.00, or not at all.

The Taxpayer is engaged in two distinct and separate businesses: (1) the sale of cellular telephone equipment, and (2) the solicitation of cellular service on behalf of and as agent for Alltel. The commissions received from Alltel are received for soliciting activations, not for selling tangible personal property. The commissions clearly should not be included in taxable gross proceeds subject to sales tax. This case is not analogous to the manufacturer's coupon example set out on page 2 of the Department's brief. In that example, the retail sales price of an item is \$2.50. However, the customer purchases the item for \$2.00 cash, plus a \$.50 manufacturer's coupon. The retailer later redeems the coupon and receives \$.50 from the manufacturer.

In the above example, the retailer is liable on the entire \$2.50 received from the sale of the product. The \$.50 received from the manufacturer constitutes taxable gross proceeds because it is directly derived from and related to the sale of the item.¹ This case clearly is different because the commissions in issue are

¹ If the coupon was a retailer's coupon, the \$.50 coupon would be a discount and tax would be owed only on the \$2.00, which would be the total amount received by the retailer.

not related to, contingent on or derived from the sale of the cellular telephones.

However, while the commissions paid by Alltel to the Taxpayer are not taxable, the Taxpayer is liable for sales tax on the wholesale cost of the promotional phones sold for \$.99 under the sales tax "withdrawal" provision found at Code of Ala. 1975, §40-23-1(a)(10). That section defines "retail sale" in part to include the withdrawal, use or consumption of tangible personal property previously purchased at wholesale for the personal and private use of the wholesale purchaser/withdrawer. Ex parte Sizemore, 605 So.2d 1221.

The Taxpayer in this case purchased the promotional phones at wholesale. In my opinion, selling the phones for \$.99 for promotional purposes constituted in substance a personal use or consumption of the phones by the Taxpayer. The sale of the phones for \$.99 was tied to and contingent on the customer agreeing to buy Alltel service, in which case the Taxpayer would receive a commission. The Taxpayer clearly "used" the promotional phones to acquire the commissions, and thus owes sales tax on its wholesale cost of the phones.

If the Taxpayer had given the promotional phones away free-of-charge in return for the customer buying Alltel service, then clearly the "withdrawal" provision would apply and tax would be due on the Taxpayer's wholesale cost. Certainly the Taxpayer should not be allowed to charge a nominal \$.99 and thereby escape tax on

the difference between \$.99 and the wholesale cost of the phone.

The "withdrawal" provision applies even though the phones were technically resold for \$.99. Substance over form must govern, and in substance the \$.99 phones were used by the Taxpayer to obtain the Alltel commissions.

In summary, the general rule to be applied is that if a retailer sells tangible personal property at below cost (or free), and the reduced selling price is linked to an obligation by the customer to purchase or subscribe to some form of service for which the retailer receives compensation, then the retailer owes sales tax on its wholesale cost of the property. The above is a practical rule and clearly in accord with the intent of the "withdrawal" provision.

The above holding is supported by Massachusetts DOR Directive 94-2, released February 4, 1994, which reads in pertinent part as follows:

Cellular telephone service carriers that use cellular telephones as promotional items are liable for a sales or use tax based upon the cost of those items. In the event that the carriers collect a sales or use tax from their customers based upon the amount of any nominal consideration charged for the telephones, they may claim an offsetting credit for those amounts.

This is a new issue, and admittedly other States handle the issue differently. (See exhibits attached to Circuit City's amicus brief). However, clearly under Alabama law the commissions received by the Taxpayer from Alltel based on service activations are not taxable. Rather, the Taxpayer owes tax on its wholesale

cost of the \$.99 promotional phones under the sales tax "withdrawal" provision.

The above holding leaves open the related issue of how to tax items sold at below cost for promotional or advertising purposes where the customer is not obligated to buy or subscribe to anything else. That question is not in issue here and is left for another time.

The Department is directed to reaudit the Taxpayer and recompute the Taxpayer's liability as set out above. The Department should notify the Administrative Law Division of the Taxpayer's adjusted liability, and a Final Order will be entered accordingly. The Final Order when entered may be appealed to circuit court within 30 days pursuant to Code of Ala. 1975, §40-2A-9(g).

Entered on January 30, 1995.

BILL THOMPSON
Chief Administrative Law Judge