BROCK SERVICES, LLC 1670 E. CARDINAL DRIVE BEAUMONT, TX 77705-6623,	§	STATE OF ALABAMA ALABAMA TAX TRIBUNAL
	§	DOCKET NO. S. 14-1236
Taxpayer,	§	
v.	§	
STATE OF ALABAMA DEPARTMENT OF REVENUE.	§	

FINAL ORDER

The Revenue Department assessed Brock Services, LLC ("Taxpayer") for rental tax for June 2009 through May 2012. The Taxpayer appealed to the Tax Tribunal pursuant to Code of Ala. 1975, §40-2A-7(b)(5)a. A hearing was conducted on June 9, 2015. Bobby Bui, Patrick Loynes, and Shirley Sicilian represented the Taxpayer. Assistant Counsel Mary Martin Mitchell represented the Department.

ISSUE

The Taxpayer is in the business of renting scaffolding and also providing scaffolding erection, maintenance, dismantling, and other labor services for its customers. The Taxpayer (1) sometimes only rents scaffolding to a customer; (2) sometimes only provides scaffolding labor services for a customer; and (3) sometimes both rents scaffolding to and also provides scaffolding labor services for a customer.

The parties agree that rental tax is not due when the Taxpayer only provides the scaffolding labor services for a customer. The issue is whether the proceeds from the scaffolding services are subject to rental tax when the Taxpayer also rents the scaffolding to the customer.

FACTS

In October 2008, BE&K Construction Company requested that United Scaffolding, Inc. submit a bid to rent scaffolding to and also provide certain scaffolding labor services to BE&K for a construction project in Tuscaloosa County, Alabama.[1] The Taxpayer submitted at least two proposals to BE&K. The parties negotiated over the terms and conditions, and a final contract was executed in early December 2008. The contract required the Taxpayer to rent scaffolding to BE&K for a fixed rate, and also to provide scaffolding and other labor services relating to the construction project at fixed rates. Some of the specific labor services provided by the Taxpayer are discussed below.

The contract stated that the "[r]ental begins when the scaffold unit has been completed and released to BE&K and terminates when BE&K releases the scaffold unit to be dismantled." It further provided that the initial 30 days of the rental would be included with the labor charges. Exhibit G to the contract also specified the labor rates for a superintendent, foreman, lead carpenter, carpenter, helper 1 and helper 2, clerk, and a safety manager. The Taxpayer subsequently submitted separate monthly invoices to BE&K for the scaffolding rental and the labor services.

A Taxpayer witness explained that the labor provided by the Taxpayer included not only the erection, maintenance, and dismantling of the scaffolding, but also various other miscellaneous tasks.

> It's all inclusive labor, includes everything as far as the nails, the wire, the hard hats, the people, the hiring, the drug screens. And that way, they know for 30 – they're planning their business for 30 days – that they're going to get the scaffold built, they're going to get their work done, the scaffold's going to

[1] The Taxpayer subsequently purchased United Scaffolding, Inc. Both entities are hereafter referred to as Taxpayer.

> be tore down, they're going to move the labor elsewhere, because in between those first 30 days, the – we're not just erecting scaffolding. We could be erecting scaffolding, we could be building chutes, we could be building steps and ladders. We are carpenters by trade. There's a lot of different tangents involved in that with fire blankets, visqueen, building tents. I mean, they even ask us to build railway crossings and things that scaffolding is not always used.

(T. 37 – 38).

> The Witness: It could be for anything. It could be for –
>
> Judge Thompson: Related to the scaffolding?
>
> The Witness: It could be related to scaffolding, it could be related to fire blanket for the scaffolding that you hang on it, it could be visqueen for the scaffolding, any kind of woodwork that we may do, tents, shelters, any – anything that we provide as far as on the scaffolding trade, yes, sir.

(T. 53 – 54).

When asked if providing a fire blanket or visquene helped maintain the scaffolding, the witness responded – "not particularly to the scaffolding. It just keeps fire from falling when they're burning the welder, it keeps rain off of them when they're working on (the scaffolding). It has nothing to do with the scaffolding." (T. 57, 58).

When asked what the helper, the safety manager, and the clerk did relating to the scaffolding, the witness replied – "Some of them never have any dealings with the scaffolding. The clerk never – they just do the payroll and the time, the invoicing. The safety manager's the safety lead overseeing the project." (T. 62, 63).

The witness further explained that it is common in the industry for one company to rent scaffolding to a contractor for a project, and for another company to provide the scaffolding labor services on the project.

Other relevant facts are stated in the below analysis.

ANALYSIS

Alabama's rental tax is levied on "the gross proceeds derived by the lessor from the lease or rental of tangible personal property" in Alabama. Code of Ala. 1975, §40-12-222(a). "Gross proceeds" is defined as the "value proceeding or accruing from the leasing or rental of tangible personal property, . . . without any deduction on account of the cost of the property so leased or rented, the cost of materials used, labor or service cost, interest paid, or any other expense whatsoever, . . ." Code of Ala. 1975, §40-12-220(4).

The Department's Administrative Law Division, now the Tax Tribunal, decided three cases involving the issue of whether proceeds paid by a lessee to a lessor for labor services performed by the lessor in conjunction with the leasing of tangible personal property constituted gross proceeds subject to Alabama's rental tax.[2]

In *State v. Storage Technology Corp.*, Docket S. 89-241 (Admin. Law Div. 6/17/1991), the taxpayer leased computer equipment and also provided computer maintenance services. The taxpayer performed maintenance services on computers it also leased to customers, and also on computers sold or leased to customers by a third party.

The Department argued that the proceeds from the taxpayer's maintenance contracts on the computers the taxpayer also leased to its customers "were a direct consequence of the lease contracts between the Taxpayer and the customer, and therefore, the maintenance payments constitute taxable gross proceeds derived from the leasing of tangible personal property." *Storage Technology* at 2.

[2] The parties do not cite and I am not aware of any Alabama appellate court decision that addresses this specific issue.

The Division held that the maintenance contracts were not taxable because the taxpayer was not obligated by the lease agreements to perform the services.

> Independent services provided by a lessor are taxable only if the services are incidental to the lease and the lessor is required to provide the services by the lease agreement. If so, then the services are taxable even if they are scheduled as a separate item in the lease contract, and even if the lessor and the lessee enter into a separate contract for the services. That is not the case here.
>
> In this case, the Taxpayer was not required to perform the maintenance services by the prior lease agreements nor enter into the separate maintenance contracts with the lessees. The lessees could choose the Taxpayer or any other approved maintenance company. Consequently, the maintenance proceeds were not derived from the leasing of the equipment and are not subject to lease tax.

Storage Technology at 3.

In *Laser Vision Centers, Inc. v. State of Alabama*, Docket S. 03-1161 (Admin. Law Div. 10/7/2004), the taxpayer leased laser machines and related equipment that ophthalmologists used to perform eye surgeries. The taxpayer also provided trained laser technicians and other support personnel that assisted the ophthalmologists in performing the procedures.

The Division agreed with the Department that the taxpayer was leasing the machines and equipment to the ophthalmologists because the ophthalmologists took possession and control of the property. The Division disagreed, however, that the amounts the ophthalmologists paid to the taxpayer for the technical assistance personnel and support services were also subject to lease tax. Rather, it held that those services, although included in a lump-sum billing with the proceeds for the leasing of the machines, were separate from the leasing of the machines, and thus not subject to lease tax.

> The Department contends that because the machines were being leased, the entire proceeds received by the Taxpayer are subject to lease tax. I disagree. The various technical assistance and support services provided by the Taxpayer's employees are separate and apart from the leasing of the laser machines to the ophthalmologists. As explained by Professor Walter Hellerstein in his treatise on state taxation, if a seller or lessor of tangible property also provides services that are separate from and not embodied in the tangible property being sold or leased, the proceeds from the sale or lease of the tangible property are taxable, but the charges for the separate services are not. J. Hellerstein & W. Hellerstein, *State Taxation* (3d ed. 2001) at ¶12.07.
>
> * * *
>
> As discussed, in this case the services provided by the Taxpayer's employees, while necessary in assisting the ophthalmologists in performing the procedures, are separate and distinct from the leasing of the machines to the ophthalmologists. The separate nature of the laser rentals and the providing of services by the Taxpayer's employees is illustrated by the fact that the Taxpayer leases the fixed-site lasers without providing the separate services.

Laser Vision at 6, 8.

Finally, in *Thyssenkrupp Safeway Inc. v. State of Alabama*, Docket S. 08-401 (Admin. Law Div. 3/18/2009), the taxpayer leased scaffolding and also contracted to provide scaffolding-related labor services to some of its lease customers. The taxpayer separately stated the lease charges and the labor charges on the monthly invoices issued to its customers. And as in this case, the taxpayer also sometimes provided labor services for customers that owned their own scaffolding or leased it from a third party.

The Department argued that the labor services performed for a lessee that also leased scaffolding from the Taxpayer were incidental to the leasing of the scaffolding, and thus constituted labor charges that could not be deducted from taxable gross proceeds. The Division disagreed. "The proceeds from the separately contracted for setup were not derived from the Taxpayer's rental of scaffolding. Such services were optional, and thus

not a required service performed incidental to or as a part of the lease agreements." *Thyssenkrupp* at 3.

In *Thyssenkrupp*, the Department attempted to distinguish *Storage Technology* and *Laser Vision* because the types of labor performed in the cases were different. The Division held that the factual distinction was irrelevant.

> The Department argues that the facts in *Laser Vision* are different from the facts in this case. But as was the case concerning *Storage Technology*, while the types of services performed in *Laser Vision* and this case can be factually distinguished, the difference is without legal significance. The same legal principle applies – when a lessor performs services for a lessee that are separate, distinct, and not incidental to the leasing of the tangible personal property, the proceeds from those separate services are not subject to lease tax. The principle applies whether the separate service provided is maintenance on leased computers, helping an ophthalmologist operate a leased laser machine, or erecting leased scaffolding.

Thyssenkrupp at 5.

The Division also rejected the Department's claim that the labor fees constituted labor costs that could not be deducted from taxable gross proceeds.

> Finally, the setup fees were not labor costs that the Taxpayer is improperly attempting to deduct from otherwise taxable gross proceeds. Rather, the fees did not constitute gross proceeds subject to lease tax to begin with because they were not "value proceeding or accruing from the rental" of the scaffolding. Section 40-12-220(4). The broad definition of "gross proceeds" at §40-12-220(4) was intended to prevent a lessor from deducting from taxable receipts its various costs incurred in leasing tangible personal property. As discussed, however, if the lessor also performs a separate service that is apart from and not incidental to the leasing of the property, the fee for that service is not derived from the lease, and thus is not subject to lease tax.

Thyssenkrupp at 8.

The general rule to be taken from the above cases is that the proceeds for labor or services performed by a lessor for a lessee in conjunction with the leasing of tangible

personal property are subject to Alabama lease tax if (1) the labor or services were incidental to the leasing of the property, and (2) the lessor was required to perform the labor or services pursuant to the rental agreement.

In both *Storage Technology* and *Thyssenkrupp*, the Administrative Law Division cited the fact that the services were separately contracted for as a factor in determining that the proceeds from the labor services were not subject to rental tax.[3] Upon further analysis, I now believe that whether separate labor services provided by a lessor to a lessee are required by the lease agreement or by a separate agreement is irrelevant in determining if the proceeds from the labor are subject to rental tax. Rather, the sole issue is whether the labor proceeds constitute "value proceeding or accruing from the leasing or rental of tangible personal property, . . ." Section 40-12-222(a). That is, were the proceeds from the labor received as a direct result of and thus incidental to the leasing of the tangible property; or stated differently, did the lessee pay the amounts as a result of the leasing of the tangible property. If not, the proceeds are not subject to rental tax, whether the labor services were required by the rental contract or by a separate contract.

The Department's regulation on the leasing or rental of tangible personal property, Reg. 810-6-5-.09.01, provides in part:

> (3)(a) When a lessor engaged in leasing or renting tangible personal property requires maintenance of the item leased or rented as part of the leasing or rental contract, the gross proceeds derived therefrom, including charges for maintenance, will be subject to the tax. When there is a separate, optional contract for maintenance only, the rental or leasing tax will not apply to the gross proceeds derived therefrom.

[3]The Final Order in *Laser Vision* does not state whether the rental of the lasers and the providing of the service personnel were separately contracted for or included in a single contract. As explained below, whether there was one contract or two is of no legal significance.

> (b) When a lessor engaged in leasing or renting tangible personal property is required to deliver and pick-up the leased property as part of the leasing or rental contract, the gross proceeds derived therefrom, including the delivery and pick-up charges, will be subject to the tax. When there is a separate, optional agreement for delivery and pick-up of the leased property, the rental tax will not apply to the gross proceeds derived therefrom.
>
> (c) When a lessor engaged in leasing or renting tangible personal property is required to provide installation or setup services as part of the leasing or rental contract, the gross proceeds derived therefrom, including charges for the installation or setup, will be subject to the tax. When there is a separate, optional agreement for installation or setup of the leased property, the rental tax will not apply to the gross proceeds derived therefrom. (Thyssenkrupp Safeway, Inc. v. State of Alabama (Admin. Law Div. Docket No. S. 08-401, Final Order entered March 18, 2009)).

The above provisions make the same contract versus separate contract issue controlling because they provide that labor services are taxable if included in the rental contract, but not taxable if contracted for separately. But the substance of the transaction or transactions must control in tax matters, not the form. "Substance must govern over form. Otherwise, evasion of the taxing statutes would be permitted by merely affixing a non-taxable label to an otherwise taxable transaction." *State v. Rockaway Corporation*, 346 So.2d 444, 448 (Ala. Civ. App. 1977). If the labor is performed as a direct result of and thus incidental to the leasing of the property, the labor proceeds are in substance derived from the lease transaction, and thus subject to lease tax. In such cases, the taxable proceeds should not become nontaxable simply because the leasing of the property and the labor were required by separate contracts. Conversely, if the labor is not a direct result of and incidental to the leasing of the property, the proceeds are not subject to lease tax, even if the labor is required by the lease agreement.

In *State of Alabama v. Service Engraving Company, Inc.*, 495 So.2d 695 (Ala. Civ. App. 1986), the taxpayer printed and sold materials and also provided mailing preparation

services. It sometimes only printed the materials; sometimes both printed the materials and also prepared the materials for mailing; and sometimes only provided the mailing preparation services. The parties agreed that the mailing preparation charges were not taxable if the taxpayer did not also print and sell the materials to the customer. The issue was whether the mailing preparation services were taxable if the taxpayer also printed and sold the materials.

The Court of Civil Appeals held that the taxpayer was engaged in two distinct business activities – the printing of materials and the preparation of materials for mailing. It found that because the proceeds from the mailing preparation services were not by themselves subject to sales tax, those same services did not become taxable only because the taxpayer had also printed and sold the materials being mailed.[4]

> The parties are in agreement that in all cases the taxpayer is liable for the tax on the gross proceeds of sales derived as a result of its printing of material. The parties also agree that the mailing preparation charges are not taxable in those cases where the taxpayer did not also print the material. The only point of dispute is whether the mailing preparation charges are taxable as part of the gross proceeds of sale in those cases where the taxpayer also printed the materials.
>
> * * *
>
> The State does not tax the packaging and labeling services of the taxpayer as to those materials which are printed by a third party, but the taxpayer is taxed for the packaging and labeling services which it performs upon materials which are printed by the taxpayer. In either instance, its mailing preparation services are the same. We agree with the taxpayer that, under those circumstances, *Eagerton v. Dixie Color Corporation*, 421 So. 2d 1251 (Ala. 1982), is the case most nearly in point. To paraphrase *Eagerton*, we see no reason why the tax consequences of identical services should differ

[4] In *Service Engraving*, the Court did not mention whether the taxpayer and its customers agreed for the taxpayer to both print the materials and also provide the mailing services in a single contract or by separate contracts. I assume that the Court did not deem it relevant whether there was a single contract or separate contracts. As discussed, I agree.

> based entirely and solely upon who does the printing of the material. To hold otherwise would provide a seven percent advantage, which is the total of all sales taxes, to a competitor who only provides such a mailing preparation service. Stated differently, if the contentions of the State were accepted, the taxpayer would be penalized seven percent of its invoice for the preparation for mailing of any material which it also printed. We are not convinced that the legislature ever intended such an unequal treatment for identical services.

Service Engraving, 495 So.2d at 696, 697.

While *Service Engraving* involved sales tax and this case involves rental tax, the rationale of *Service Engraving* is still on point. The taxpayer in *Service Engraving* was not liable for sale tax when it only provided the mailing preparation services to its customers. Likewise, the Taxpayer in this case is not liable for rental tax when it only provides scaffolding labor services for its customers. The taxability of those intangible services should not change based on who provided or rented the scaffolding to the customers. I agree with the Court of Civil Appeals' rationale that there is "no reason why the tax consequences of identical services should differ based entirely and solely upon who" rents the scaffolding to the customer. *Service Engraving*, 495 So.2d at 697.

In *Thyssenkrupp*, the Division stated that the scaffolding services were "optional, and thus not a required service performed incidental" to the lease. *Thyssenkrupp* at 3. Presumably based on that statement, paragraphs (3)(a), (b), and (c) of Reg. 810-6-5-.09.01 provide that the various services are not taxable if there is "a separate, optional agreement" between the parties for the services. As discussed, I now believe that whether the rental of property and the providing of labor services are required by a single contract or by separate contracts is irrelevant. In any case, I agree with the Taxpayer that labor services performed by a lessor in conjunction with the leasing of tangible personal property

are optional if the lessee has the option, before entering into a contract, of selecting the lessor or a third party to perform the labor services. If the lessee selects the lessor to also perform the labor services and contracts for the lessor to do so, the labor services will not thereafter be optional, whether they are required by the rental contract or by a separate contract. That is, if the lessor is required by a contract to perform the labor services, the services cannot be optional. The Department's use of the phrase "separate, optional contract" in the regulation is thus misleading.

In this case, BE&K had the option of hiring another company to provide the scaffolding labor services. After almost two months of negotiations, however, the parties agreed that the Taxpayer would both rent the scaffolding and also provide the labor services. BE&K controlled the form of the transaction, and decided to include both the rental and labor in a single contract. As discussed, executing a single contract for both the rental and the labor services should have no bearing on whether the proceeds from the labor were derived or flowed from the rental of the scaffolding.

Nor is it relevant that the labor services were necessary for BE&K to use the scaffolding. The laser technicians and the other support personnel provided by the lessor/taxpayer in *Laser Vision* were also required and necessary for the ophthalmologists to use the laser machines. As stated in *Laser Vision*, at 8 – ". . . the services provided by (Laser Vision's) employees, while necessary in assisting the ophthalmologist in performing the procedures, are separate and distinct from the leasing of the machines to the ophthalmologists." And as in *Laser Vision*, the separate nature of the scaffolding rental and the providing of the scaffolding labor services by the Taxpayer in this case is illustrated by the fact that the Taxpayer sometimes only provides the labor services for a customer

without also renting the scaffolding to the customer.

Some of the labor services also did not involve the scaffolding, and the erection and dismantling of the scaffolding was performed before and after the lease period, respectively, which further illustrates that the labor was not performed incidental to the rental of the scaffolding. And 75 to 80 percent of the total proceeds from the contract were for the labor services. That amount of labor cannot be said to be incidental to the leasing of the scaffolding.[5]

Finally, the Taxpayer in this case is not attempting to improperly deduct the labor proceeds from its otherwise taxable gross proceeds. The broad definition of "gross proceeds" at §40-12-220(4) prevents a lessor from deducting its overhead, labor, and other operating expenses from its otherwise taxable gross proceeds. Like the gross proceeds for the scaffolding labor in *Thyssenkrupp*, the labor receipts in issue in this case were never gross proceeds subject to the rental tax to begin with.

In summary, the rule to be applied is that "if the lessor also performs a separate service that is apart from and not incidental to the leasing of the property, the fee for that service is not derived from the lease, and thus is not subject to lease tax." *Thyssenkrupp* at 8. The above applies regardless of whether the separate labor services are included in the rental agreement or in a separate contract. The labor services performed by the Taxpayer on the Tuscaloosa project in issue were, like the scaffolding services provided in

[5] The American Heritage Dictionary, Fourth Ed. at 700, defines "incidental" as "[o]f a minor, casual, or subordinate nature; incidental expenses." The large amounts paid by BE&K for the Taxpayer to perform the labor certainly did not constitute an incidental expense.

Thyssenkrupp, separate from the rental of the scaffolding, and thus not subject to rental tax.

The final assessment in issue is voided. Judgment is entered accordingly.

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

Entered September 28, 2015.

_____
BILL THOMPSON
Chief Tax Tribunal Judge

bt:dr
cc: Mary Martin Mitchell, Esq.
Bobby Bui