**ALABAMA TAX TRIBUNAL**

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| PINNACLE AMUSEMENT, LLC, | § | |
| | § | |
| Taxpayer, | § | DOCKET NO. S. 19-1105-LP |
| v. | § | |
| STATE OF ALABAMA DEPARTMENT OF REVENUE. | § | |

**OPINION AND PRELIMINARY ORDER**

This appeal involves disputed final assessments of State and local sales tax for January 1, 2016, through June 30, 2018. A hearing was held on March 10, 2022. John Bolton and David Johnston represented the Taxpayer. David Avery represented the Alabama Department of Revenue. Sherry Johnson, a Revenue examiner, and Brian Powers, the account manager for the Taxpayer, were present and testified. The parties submitted post-hearing briefs.

Facts

The Taxpayer entered into agreements, each titled "Location Rental Agreement," (collectively, "the contracts") with several convenience stores (the "proprietors") concerning "bona fide coin-operated amusement machines" (hereinafter referred to as "machines").[1] The contracts all contained standard language. Specifically, the contracts reflected that the Taxpayer's business involves

[1] Mr. Powers testified that the Taxpayer also had verbal contracts with other Locations under the same terms as the written contracts.

"providing, leasing, renting, operating, servicing, maintaining and repairing machines" and that "it is mutually beneficial for each party … that they enter into an agreement for the placement, servicing and maintaining of certain machines in [the proprietor's location]". The contracts provided for the sharing of the net revenue from the machines. Some of the contracts stated that the proprietor's share of the net revenue is 70% and Taxpayer's share is 30%; the some of the contracts left the percentage amounts blank. Mr. Powers's testimony reflected that the 70/30 split was standard.

The contracts provided the Taxpayer with "the right to open the machines periodically to determine the gross and net revenue from the machines". Pursuant to the contract, the proprietor was responsible for paying to the Taxpayer its share on a weekly basis or as otherwise agreed by the parties.[2] Powers testified that, in practice, the Taxpayer's route-man visited the proprietor's locations only once a month for approximately fifteen minutes. The route-man would print two copies of a document showing the machine's revenue; he gave one copy to the proprietor or the proprietor's employee and kept the other copy for the Taxpayer's records. The route-man would collect 30% of the total revenue in cash from the proprietor or the proprietor's employee. If the proprietor was unable to pay in full at that time, the route-man would make a record of that fact.

Pursuant to the contracts, the Taxpayer agreed to provide at least two

[2] Mr. Powers advised the store owners to empty the machines of money daily and to leave the machine door open at night to prevent someone from breaking into the machine; however, not all owners followed that advice.

machines at each location and to "service, repair and maintain the machines in a timely manner". The proprietor, on the other hand, agreed to "lease" the machines from the Taxpayer for the "fee" set out in the paragraph concerning the "Sharing of Revenue" and to provide a "conspicuous place" for the installation and operation of the machines that is "readily accessible to the public patronizing [the p]roprietor's premises." The proprietor was prohibited from having any other agreements with a third party relating to machines.[3]

The proprietor was required by the contracts to "provide and pay for all necessary electrical power, lighting, computer and/or telecommunication support needed to operate the machines"; "contact [the Taxpayer] promptly if any of the machines need service or repair"; "provide [the Taxpayer] with access to [the] Location at all reasonable times so that [the Taxpayer may exercise its rights and perform its obligations under [the contract]; "keep the exterior surfaces of the machines clean and attractive"; "promptly notify [the Taxpayer] of any change in operating hours"; and "operate all machines in a lawful manner". The Taxpayer provided Location owners with an 8.5" by 11" poster of Rules for Operation of the machines. Under Alabama law, no cash could be paid out to winners; only credit for merchandise redemption was allowed. The Taxpayer and the proprietor each agreed to "pay its own income taxes on its share of the net revenue." There was no provision for the payment of sales tax.

[3] The Taxpayer filed a lawsuit against one of the proprietors for violating the exclusivity clause in the contract. The proprietor had unplugged the Taxpayer's machine and put it in a back room while offering other gaming machines in the front of his store.

According to Mr. Powers, if a person was a winner at the video game, a machine called the "Mother Goose," which was located behind the counter, would print a receipt with a credit voucher, either in dollars or credits equal to dollars, to be used to purchase merchandise from the Location. If the customer used only a portion of the credit voucher, he or she would be given a paper certificate for the balance. The Location owner or employee was responsible for fulfilling the credits and certificates for the winning customers.

Discussion

I.

On appeal, the Taxpayer argues that it is in the vending machine business but not in the vending machine operating business; thus, according to the Taxpayer, it is not liable for sales tax. Instead, the Taxpayer asserts that it owes only lease tax on the 30% portion of net revenue. The Revenue Department, on the other hand, argues that the Taxpayer's contracts with the proprietors constitute joint ventures rather than rental agreements. According to the Revenue Department, the Taxpayer is liable along with the proprietors for sales tax.

Section 40-23-2(2), Ala. Code 1975, provides for the levy of "a privilege or license tax …[u]pon every person, firm, or corporation engaged or continuing within this state in the business of … operating … amusement devices …[in] an amount equal to four percent of the gross receipts". Merrism-Webster Dictionary defines operating as "engaged in active business" and "arising out of or relating to the current daily operations of a concern (as in transportation or manufacturing) … as distinct

from its financial transactions and permanent improvements". Merriam-Webster.com Dictionary, Merriam-Webster, https://www.merriam-webster.com/dictionary/operating.

In State v. Mack, 411 So. 2d 799 (Ala. Civ. App. 1982), the Alabama Court of Civil Appeals considered an issue similar to the issue in the present case. In Mack, the Revenue Department appealed from a judgment entered by the Covington Circuit Court that held that Mack was not liable for certain additional sales tax. Mack, 411 So. 2d at 801. The Court of Civil Appeals explained that W.G. Mack owned an amusement machine business that placed amusement machines at various locations and that he normally split the proceeds from each machine equally with the owner of the store in which the machine was placed. Id. The Court of Civil Appeals held that Mack was "required by §40-23-2(2) … to report [to the Revenue Department] the total gross receipts from his machines regardless of any commissions paid to location owners." Mack, 411 So. 2d at 803. The Court further held that, in all but one instance, there was insufficient evidence indicating that the store owner had paid sales tax on the store owner's portion of the proceeds. Id. Therefore, the Court reversed the Circuit Court's judgment to the extent that it held that Mack did not owe additional sales tax. Id. The cause was remanded for the Circuit Court "to determine if Mack [was] able to rebut … the prima facie presumption of correctness of the final assessments in those instances where Mack claimed to have a fifty-fifty arrangement with the location owner." Id.

Subsequent to the issuance of the opinion in Mack, the Administrative Law

Division of the Revenue Department had occasions to consider similar situations. For example, in Gulf Coast Elks Lodge 2782 v. State of Ala. Dep't of Rev., Docket N. S. 13-137, July 9, 2013 (Ala. Dep't of Revenue Admin. Law Div. 2013), the Administrative Law Judge held that, because the owner of the machines in that case removed the money from and maintained control of the machines, the owner was "100 percent liable for the tax on the gross receipts derived from the machines." I note that, in that case, there was no contract available indicating the division of the proceeds or which party was responsible for taxes.

On the other hand, in C. Marshall Bennett CMB Company v. State of Alabama Department of Revenue, Docket No. S. 04-590, January 12, 2005 (Admin. Law Div. 2005), the Administrative Law Judge held that "the [t]axpayer leased the machines to the location owners…[ and that t]he location owners … controlled the machines, removed the money from the machines, and then paid the [t]axpayer for the leasing of the machines." Despite the Revenue Department's contention "that the leases are not true leases because the lease language provides that 50 percent of the proceeds will be 'retained' by the [t]axpayer", the Administrative Law Judge held that the lease agreements created valid leases. Thus, according to the Administrative Law Judge, "the location owners, not the [t]axpayer, were in the business of operating the amusement devices, and were thus liable for sales tax on the gross receipts from the machines."

In the present case, the dispute is whether the relationship between the Taxpayer and the respective proprietors is lessor/lessee or whether they are operators

in a "joint venture".

> "The elements of a joint venture have been held to be: a contribution by the parties of money, property, effort, knowledge, skill, or other assets to a common undertaking; a joint property interest in the subject matter of the venture and a right to mutual control or management of the enterprise; expectation of profits; a right to participate in the profits; and usually, a limitation of the objective to a single undertaking or ad hoc enterprise. While every element is not necessarily present in every case, it is generally agreed that in order to constitute a joint venture, there must be a community of interest and a right to joint control."

Moore v. Merchants & Planters Bank, 434 So.2d 751, 753 (Ala. 1983).

Our Supreme Court has held that a joint venture was present under facts similar to those in the present case. See Birmingham Vending Co. v. State, 251 Ala. 584, 38 So. 2d 876 (Ala. 1949). In Birmingham Vending, the issue was whether the owner of automatic record players who furnished those players to "'small cafes, lunchrooms, confectionaries, etc.'" was liable for " an excise tax" levied on the gross receipts of "'every person, firm or corporation engaged' in the business of operating musical devices within the State of Alabama." Birmingham Vending, 251 Ala. at 586, 38 So. 2d at 877, (quoting appellants' brief). The Alabama Supreme Court set forth the following pertinent facts as stated in the appellants' brief:

> "'The usual agreement between appellants and the proprietors, as to the amount which must be paid to appellants, was as follows: If the machine took in $10.00 or more per week, appellants received 50% of the intake; if it took in less than $10.00, but more than $6.00, appellants received 66 2/3% of the intake; and, if less than $6.00, the appellants received 75% of the intake. If the appellants' share did not amount to $2.00, the proprietor would have to pay that amount, or the machine would be taken out of his place of business. Appellants always had written contracts of some kind with virtually every proprietor who had one of appellants' machines in his place of business.

> "'Appellants collected from proprietors by sending to each location an agent who would open the cash box in the machine in the presence of the proprietor. In most cases, the keys to the machine and cash box were kept by appellants. The money was always counted either by the agent in the presence of the proprietor, by the proprietor himself, or by the agent and proprietor jointly. In every case, settlement was made between the appellants' agent and the proprietor at the time the music machine was opened in the proprietor's place of business, so that there were never debits and credits subsisting between them thereafter.
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> 'The appellants' agent, prior to taking the appellants' agreed percentage from the proceeds of the cash box, with the proprietor's consent, would withdraw 2% of the total proceeds. These funds were to be set aside by appellants as a reserve for sales tax liability pending the outcome of this suit, which was then proposed by appellants' counsel.
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> "….
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> "'The proprietors of the places of business in which the machines were placed supplied the electricity for the operation of the machines; the proprietors could permit the playing of the machines during whatever time of the day or night that they considered proper; the proprietors could control the volume, loudness or softness, by the use of a device on the machines; and the proprietors could, of course, allow or refuse to allow whomever they wished to play the machines."

Birmingham Vending, 251 Ala. at 587, 38 So. 2d 877.

Based on the specific facts in Birmingham Vending, the Supreme Court held that the Taxpayer and the respective proprietors were "joint adventurers".[4] Id. The Supreme Court noted that, while the better practice would be for the Revenue Department to include all parties to the joint venture on the sales tax assessment, it was permissible to make the assessment against only one of the parties to the joint venture. Birmingham Vending, 25 Ala. at 589, 38 So. 2d at 880.

Turning back to the facts of the present case, we must determine if the entity

[4] The terms "joint adventure" and "joint venture" may be used interchangeably. See, e.g., Underwood v. Holy Name of Jesus Hospital, 266 So. 2d 773, 289 Ala. 216 (Ala. 1972).

operating the machines is (1) the Taxpayer; (2) the respective proprietor; or (3) the Taxpayer and respective proprietor as joint venturers. As noted previously, the contracts specifically provided that the Taxpayer is in the business of "providing, leasing, renting, operating, servicing, maintaining and repairing machines." (emphasis added). The contracts further provided that "it is mutually beneficial for each party … that they enter into an agreement for the placement, servicing and maintaining of certain machines in [the proprietor's location]". The contracts provided for the sharing of the responsibilities for and control of the machines as well as for the "[s]haring of the [net] [r]evenue" from the machines. Like in Birmingham Vending, in the present case, the specific facts of this case indicate that the Taxpayer and the respective proprietors were joint venturers in the operation, i.e., active business, of the machines. Although the contracts purported to be "Rental Agreement[s]", "the substance of the [contracts] pierc[e] that illusion". Alabama Department of Revenue v. Greentrack, Inc., [Ms. 1200841, June 30, 2022] ___ So. 3d at ___ (Ala. 2022). Because the Taxpayer was a party to a joint venture, the Revenue Department was permitted to assess the Taxpayer for sales tax on 100% of the gross receipts (although, as noted in Birmingham Vending, the better practice would be to include both parties to the joint venture on the assessment).[5]

II.

The Revenue Department also asserts that, subsequent to the Alabama

[5] As the Administrative Law Judge indicated in footnote one of the opinion in Gulf Coast Elks Lodge 2782, parties to a contract may agree as to the division of the tax liability; however, that agreement does not affect each party's liability to the Revenue Department.

Supreme Court's release of the opinion in Greentrack, supra, it has determined that the tax liabilities set forth in the final assessments are understated. Specifically, the Revenue Department asserts that it calculated the tax liabilities using the "net take" from the machines" (in accordance with the holding of the Administrative Law Judge in Walker Cnty. Entm't, LLC v. State Department of Revenue, Docket No. S. 10-379, May 29, 2011 (Ala. Dep't of Revenue Admin. Law Div. 2011) (second opinion and preliminary order)). According to the Revenue Department, it determined the "net take" based on what it deemed to be 50% of the payout of the machines. It notes, however, that the Alabama Supreme Court in Greentrack overruled that decision and stated that the tax should be calculated on the "total wagers" placed using the machines.

The Revenue Department asserts that, based on its calculations, considering the "total wagers" placed using the machines (as opposed to the "net take", i.e. 50% of the payout of the machines), the final assessments are due to be increased to State tax in the total amount of $382,525.51 (consisting of tax in the amount of $292,541.65, interest calculated to June 30, 2022, in the amount of $60,729.70, and a penalty in the amount of $29,254.16); and Local tax in the total amount of $15,447.88 (consisting of tax in the amount of $11,771.58, interest calculated to June 30, 2022, in the amount of $2,499.18, and a penalty in the amount of $1,177.12). The Revenue Department notes that the Tax Tribunal has the authority to "increase or decrease the assessment to reflect the correct amount due" pursuant to Ala. Code 1975, § 40-2A-7(b)(5)d.1. The Taxpayer argues, however, that there is insufficient evidence that the "net take" was

based on 50% of the payout of the machines.

I conclude that the Revenue Department is correct that the final assessments are due to be recalculated in compliance with the decision in Greentrack. The parties are directed to submit to the Tax Tribunal, by **February 10, 2023**, documentation showing the total taxable wagers for the assessment period. The parties may not submit or refer to evidence excluded under the Tax Tribunal's March 9, 2022, order.

Conclusion

Based on the foregoing, I conclude that the Revenue Department was permitted to assess the Taxpayer for sales tax on 100% of the gross receipts based on the total wagers as will be determined after the parties' submission of evidence. Because of the complicated legal issues involved in this case, I conclude that the penalties assessed are not warranted. Therefore, the penalties are hereby waived.

Entered December 29, 2022.

/s/ Leslie H. Pitman
LESLIE H. PITMAN
Associate Tax Tribunal Judge

llp:ac
cc: John M. Bolton, Esq.
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