

C. MARSHALL BENNETT
CMB COMPANY
9220 Roebuck Pkwy., Suite 181 #A-1
Birmingham, AL 35206,

Taxpayer,

v.

STATE OF ALABAMA
DEPARTMENT OF REVENUE.

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STATE OF ALABAMA
DEPARTMENT OF REVENUE
ADMINISTRATIVE LAW DIVISION

DOCKET NO. S. 04-590

FINAL ORDER

The Revenue Department assessed C. Marshall Bennett, d/b/a CMB Company ("Taxpayer"), for State sales tax for November 1998 through October 2001. The Taxpayer appealed to the Administrative Law Division pursuant to Code of Ala. 1975, §40-2A-7(b)(5)a. A hearing was conducted on December 6, 2004 in Birmingham, Alabama. Patrick Smith represented the Taxpayer. Assistant Counsel Keith Maddox represented the Department.

The Taxpayer owns video and other coin-operated amusement games or devices that it leases to various arcades, bars, and other businesses in Alabama. The Taxpayer executes a standard lease agreement with the business owners. The lease requires that the businesses pay the Taxpayer a rental of 50 percent of the gross receipts derived from the machines.

The business owners periodically remove the money from the machines. The owners are not required to count the machine proceeds, and the money taken from the machines may be commingled with the other funds of the business.

Each machine electronically records or tabulates the amount of money put into the machine. An employee of the Taxpayer visits each business location every two weeks and

determines the amount of money taken in by each machine since the last visit. The employee then notifies the business owner of the amount due under the lease. The business owner usually pays the Taxpayer in cash or by check, although in some instances the Taxpayer is unable to collect the amount due.

The Taxpayer paid the gross receipts sales tax levied at Code of Ala. 1975, 40-23-2(2) on the amounts it received under the lease agreements during the audit period. The Department determined that the Taxpayer was liable for sales tax on 100 percent of the machine receipts. It assessed the Taxpayer accordingly.

The Department cites *State v. Mack*, 411 So.2d 799 (Ala. Civ. App. 1982), in support of its case. Mack owned amusement machines that he placed in various businesses in Alabama. He split the machine proceeds with the location owners. He claimed that he paid sales tax on his half of the gross proceeds, and that the location owners were supposed to pay tax on their half of the proceeds.

The Department argued that Mack was liable for tax on the total gross receipts from the machines. The Court of Civil Appeals agreed – “The Department contends, and we agree, that Mack is required by §40-23-2(2), Code 1975, to report the total gross receipts from his machines regardless of any commissions paid to location owners.” *Mack*, 411 So.2d at 803. The Court also held that Mack would be relieved of liability for any tax that the location owners may have remitted on the machine receipts.

The Taxpayer argues that *Mack* can be distinguished from this case. Mack controlled the machines, removed the money from the machines, and then paid the location owners a commission for allowing him to put the machines at the locations. Under those facts, Mack was “in the business of conducting or operating . . . amusement devices . . .”

and was thus directly liable for tax on the gross receipts derived from the machines.

In this case, however, the Taxpayer leased the machines to the location owners.¹ The location owners, not the Taxpayer, controlled the machines, removed the money from the machines, and then paid the Taxpayer for the leasing of the machines. Consequently, the location owners, not the Taxpayer, were in the business of operating the amusement devices, and were thus liable for sales tax on the gross receipts from the machines.

The Taxpayer paid sales tax on the gross receipts it received from the business owners. However, the Taxpayer is in the business of leasing the amusement machines. Consequently, it owed Alabama lease tax, not sales tax, on its gross receipts from the leases. The location owners, as the operators of the machines, were liable for the gross receipts sales tax on 100 percent of the gross receipts from the machines.

The final assessment of sales tax in issue is voided. Technically, the Taxpayer is also entitled to a refund of the sales tax it erroneously paid on the lease receipts. However, the Taxpayer is also liable for an equal amount of lease tax. The Department is not time-barred from assessing the Taxpayer for the lease tax because the Taxpayer failed to file lease tax returns for the subject period. See, Code of Ala. 1975, §40-2A-7(b)(2)a. The

¹ The Taxpayer submitted a number of the lease agreements into evidence. The Department contends that the leases are not true leases because the lease language provides that 50 percent of the proceeds will be “retained” by the Taxpayer. The Department contends that to retain part of the proceeds, “the Taxpayer must have received 100 percent of the proceeds and is therefore subject to the tax on the total amount.” Department’s Answer at 2. I disagree.

The lease agreements are clearly valid leases between the Taxpayer and the location owners. The evidence shows that the location owners received 100 percent of the machine receipts. They then paid the Taxpayer 50 percent of the proceeds as a rental. Thus, despite the use of the word “retain” in the lease agreements, the Taxpayer was paid 50
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Department is also authorized to apply the overpaid sales tax to any final tax liability due the Department. Code of Ala. 1975, §40-2A-7(c)(4).²

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

Entered January 12, 2005.

BILL THOMPSON
Chief Administrative Law Judge

percent of the machine receipts. It did not retain 50 percent.

² Instead of requiring the Taxpayer to formally apply for a sales tax refund and then begin lease tax assessment proceedings, the parties may, of course, agree that the sales tax paid by the Taxpayer will serve to satisfy the lease tax due for the period. The Taxpayer should begin filing lease tax returns and paying the lease tax due on its gross proceeds. The Department may also assess the location owners for the gross receipts sales tax due on the game receipts.