KELLY'S FOOD CONCEPTS OF ALABAMA, LLP 141 FELIX ROAD SELMA, AL 36701-6492,	§	STATE OF ALABAMA DEPARTMENT OF REVENUE ADMINISTRATIVE LAW DIVISION
Taxpayer,	§	DOCKET NO. S. 10-1131
v.	§	
STATE OF ALABAMA DEPARTMENT OF REVENUE.	§	

FINAL ORDER

The Revenue Department assessed Kelly's Food Concepts of Alabama, LLP ("Taxpayer") for State and local sales tax for August 2005 through July 2008. 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 April 28, 2011. Jim Sizemore represented the Taxpayer. Assistant Counsel Wade Hope represented the Department.

The Taxpayer is in the restaurant supply business and is based in Selma, Alabama. It sold napkins, plastic utensils, straws, stirrers, disposable trays, kitchen supplies, and other items to Kentucky Fried Chicken, Popeye's Chicken, Church's Chicken, and other restaurants in Alabama during the period in issue. All of the Taxpayer's customers were licensed retail merchants that sold food at retail to the public.

The Taxpayer did not charge and collect State or local sales tax on its sales during the subject period. The Department audited the Taxpayer for sales tax and determined that some of the Taxpayer's sales during the period had been taxable retail sales. Specifically, the Department examiner assessed the Taxpayer on its sale of bathroom tissue, cleaning supplies, paper towels, and various other items that were used and consumed by its restaurant customers; and also on its sale of napkins, plastic utensils, salt and pepper

packets, straws, moist towelettes, and various other items that are commonly provided to or taken by fast food restaurant customers with their food purchases.

The Department examiner also included as taxable a "fuel surcharge" that the Taxpayer had included on its customer invoices. The examiner explained at the April 28 hearing that the surcharge was in the nature of a taxable delivery charge, and thus constituted a part of the Taxpayer's gross proceeds subject to sales tax. The examiner included the fuel surcharge in full if the majority of items on an invoice were taxable. She excluded the surcharge in full if the majority of the invoice items were not taxable.

The Taxpayer concedes that it owes sales tax on the cleaning supplies, paper towels, etc., that it sold to its restaurant customers that were used and consumed by the restaurants and not resold. It argues, however, that it does not owe sales tax on the napkins, plastic utensils, straws, and the various other items that the restaurants provided to their customers. It contends that the restaurants resold those items to their customers at retail as a part of the customers' food purchases. The Taxpayer thus asserts that its sales of the items to the restaurants were nontaxable wholesale sales for resale.

The Taxpayer cites the Alabama Court of Civil Appeals' decision in *Alabama Department of Revenue v. Logan's Roadhouse, Inc.*, ___ So.3d ___, 2011 WL 1820107 (Ala. Civ. App. May 31, 2011) in support of its position. Logan's operates full service restaurants in Alabama and surrounding states. It sells menu items for a specific price. It also offers peanuts to its customers without extra charge. The issue in the case was whether Logan's was reselling the peanuts at retail to its customers.

Logan's presented evidence, i.e., a "menu mix" document, in circuit court showing that it factored nine cents into the price of each menu entrée to offset the cost of the

peanuts provided to its customers. Based on that evidence, the Court of Civil Appeals affirmed the circuit court's holding that Logan's was selling the peanuts to its customers at retail.

Relying on *Logan's*, the Taxpayer argues that its restaurant customers were reselling the plastic utensils, napkins, and the other disputed items in issue to their customers at retail, and consequently, that its sales of the disputed items to the restaurants were nontaxable wholesale sales.

The Department counters that the Taxpayer's restaurant customers did not resell the items at retail to their customers, and consequently, that the sales by the Taxpayer to the restaurants were taxable retail sales. It cites two New York cases in support of that position.

In *In Matter of Burger King v. State Tax Comm.*, 416 N.E.2d 1024 (1980), the New York Court of Appeals held that Burger King was reselling hamburger wrappers, cups for beverages, and french fry "sleeves" because those items were "a critical element of the final product sold to customers. So regarded, the packing material is as much a part of the final price as is the food or drink item itself." *Burger King*, 416 N.E.2d at 1028.

Four years after its *Burger King* decision, the same New York Court decided *Celestial Food of Massapequa Corp. v. New York State Tax Comm.*, 473 N.E.2d 737 (1984), which addressed the issue in this case – is a fast food restaurant selling at retail the napkins, straws, stirrers, plastic utensils, etc., that it offers or provides to its customers without extra charge. The Court held that the items were not being resold by the restaurants.

Unlike the packaging in *Burger King*, the items respondent here seeks to

> exclude from sales tax are not a critical element of the product sold and thus are not purchased "for resale as such." Whereas a cup of coffee cannot be purchased without a container, the same cannot be said of napkins, stirrers and utensils, which are more akin to items of overhead, enhancing the comfort of restaurant patrons consuming the food products. The Appellate Division's reasoning in this case, that because "the fast food customer expects to be provided with a stirrer for coffee, a straw for soft drinks, plastic utensils for food, and napkins for cleanliness" such items are purchased "for resale as such" (cite omitted), has potentially limitless application. Although the cost of such items may well be taken into account by the restauranteur when setting the price of food, so are other amenities a restaurant patron expects, such as service, utilities and fixtures, which do not become a part of the product being sold merely because their cost is a factor in determining the price a customer pays. Only when, as in *Burger King*, such items are necessary to contain the product for delivery can they be considered a critical element of the product sold, and excluded from sales tax. Accordingly, the items referred to in (cite omitted) were not purchased "for resale as such" by respondent and the challenged regulation requiring payment of sales tax on its purchases of such items is not at odds with the Tax Law.

Celestial Food, 473 N.E.2d 738.

I agree with the New York Court's rationale in *Celestial Food*. A fast food restaurant is not reselling to its customers the straws, plastic utensils, and the other disputed items in issue in this case; rather, it is providing the items free as an amenity or courtesy to its customers. For the reasoning supporting that position, see endnote 1.

Nonetheless, the Court of Civil Appeals' holding in *Logan's Roadhouse* must control. That case holds that if a retailer includes or factors its cost of an item into the retail sales price of separate goods that the retailer is selling at retail, and the item is subsequently transferred to the customer, then the item is also being sold at retail with the separate goods.[1]

A critical fact in *Logan's Roadhouse*, however, was that Logan's presented evidence via the menu mix document that the cost of the peanuts had been factored into the prices charged for the menu items. "The trial court's determination in this case that the taxpayer

included the cost of peanuts . . . in the prices of the meals sold in its restaurants is supported by substantial evidence, and its legal conclusion that the peanuts were sold at retail to those customers is, therefore, not in error." *Logan's Roadhouse*, ___ So.3d at ___.

Unlike the facts in *Logan's Roadhouse*, there is no evidence in this case that the Taxpayer's restaurant customers considered or factored their cost of the napkins, plastic utensils, etc., into the prices they charged their customers for the food. That is, there is no evidence that the restaurants resold the napkins, plastic utensils, etc., "for a price," as required for a sale to occur. See, Code of Ala. 1975, §7-2-106, which defines "sale" as "the passing of title from the seller to the buyer for a price."

As discussed in endnote 1, all retailers generally must charge an amount sufficient to cover all operating costs, plus a profit margin. But I cannot presume as a fact that the Taxpayer's restaurant customers factored into their food prices their cost of the disputed items purchased from the Taxpayer. Because such evidence was crucial in *Logan's Roadhouse*, and is absent in this case, I must conclude that the Taxpayer's restaurant customers were not reselling the disputed items to their customers. Consequently, the Taxpayer's sales of the disputed items to the restaurants were taxable retail sales not for resale.

Concerning the fuel surcharges included on the Taxpayer's customer invoices, the Taxpayer argues that the charges are not taxable because the items being delivered were sold at wholesale, and thus not taxable. As discussed above, however, the Taxpayer did make taxable retail sales during the audit period. I agree with the Department that such charges are in substance transportation or delivery charges relating to goods sold at retail, and thus are a part of the Taxpayer's taxable gross proceeds subject to sales tax.

Department Reg. 810-6-1-.178(1) is directly on point. That regulation provides that "[w]here a seller delivers tangible personal property in his own equipment. . ., the transportation charges shall be considered a part of the selling price subject to sales or use tax. Said transportation charges are taxable even if billed separately."

The above regulation is consistent with Alabama law, which specifies that a sales transaction is closed when and where title to the goods is transferred from the seller to the purchaser. Code of Ala. 1975, §40-23-1(a)(5). Title is transferred when and where the seller completes the physical delivery of the goods to the buyer. See, Code of Ala. 1975, §7-2-401(2); *Oxmoor Press v. State of Alabama*, 500 So.2d 1098 (Ala. Civ. App. 1986).

In this case, the Taxpayer's sales were closed after it delivered the goods to its customers. The Taxpayer's cost of transporting the goods, including the fuel surcharges, constituted a part of the gross proceeds derived from the sales, and were thus taxable. See also, *East Brewton Materials, Inc. v. State, Dept. of Revenue*, 233 So.2d 751, 756 (Ala. Civ. App. 1971). ("When it is provided in Section 786(2)(f) (now Code of Ala. 1975, §40-23-1(a)(6)) that the value proceeding or accruing from the sale of tangible personal property shall include 'any other expense whatsoever,' we are of the opinion that the legislature intended thereby that sales tax be charged upon the total invoice price, including transportation charges incident to delivery of the material sold to a customer. . .")

The final assessments are affirmed. Judgment is entered against the Taxpayer for State sales tax of $60,773.96 and local sales tax of $7,834.27. Additional interest is also due from the date the final assessments were entered, November 19, 2010.

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

Entered January 5, 2012.

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BILL THOMPSON
Chief Administrative Law Judge

bt:dr
cc: Keith Maddox, Esq.
James M. Sizemore, Jr., Esq.
Joe Walls
Mike Emfinger

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[1] I respectfully disagree with the *Logan's Roadhouse* rationale. Specifically, I disagree that if a retailer factors the cost of an item or items into the price it is charging for the separate goods it is selling at retail, then the retailer is also selling the item or items to the customer at retail.

All successful retailers must factor into the price they charge for their product their cost of goods sold, labor expenses, utilities, taxes, supplies, and all other costs of doing business, plus a profit margin. But only the specific product offered for sale by the retailer, and all necessary and essential items transferred in conjunction with the product, are being sold at retail, not the various other items the cost of which may be factored into the price for the product. As stated by the New York Court in *Celestial Food*, to hold otherwise would have "potentially limitless application. Although the cost of such items may well be taken into account by the restauranteur when setting the price of food, so are other amenities a restaurant patron expects, such as service, utilities and fixtures, which do not become a part of the product being sold merely because their cost is a factor in determining the price a customer pays." *Celestial Food*, 473 N.E.2d at 738.

The *Logan's Roadhouse* decision may have been swayed by the fact that Logan's sells food items, and peanuts are a food item. But I can find no logical reason why the Court's rationale would not also apply if the item given away free to the customer is a different type product than the goods being sold at retail. For example, if Logan's provided or offered its customers free plastic peanut-shaped key chains with "I'm nuts about Logan's" printed on them, and Logan's presented evidence that it factored its cost of the key chains into the price it charged for its menu items, which it surely would, then per the *Logan's Roadhouse* rationale, Logan's would be selling the key chains as a part of the meals, even though they would obviously be a marketing or advertising tool being used by Logan's. Logan's also purchases toilet tissue, soap, and other bathroom supplies that it provides to its customers free-of-charge in its bathrooms. Logan's certainly considers its cost of those supplies, either directly or indirectly, in deciding the selling price it charges for its menu items. Consequently, if the rationale of *Logan's Roadhouse* is logically extended, Logan's must also be selling the bathroom supplies to its customers, the ultimate consumers, at retail. Clearly, that is not the case. Logan's is supplying those bathroom supplies free as an

amenity or courtesy to its customers, just as a fast food restaurant provides plastic utensils, napkins, etc., free as an amenity to its customers.

The circuit court in *Logan's Roadhouse* opined that it "sees no legal difference in the roasted peanuts served by Logan's from any item which a customer receives when he buys a meal at a restaurant: chips and salsa, bread and butter, olive oil, salt and pepper, ketchup, mustard, ice, etc." *Logan's Roadhouse v. State of Alabama*, Jefferson County Circuit Court Case 01-CV-2009-001930 (decided 4/2/2010) at 3. That statement at first blush seems reasonable, but I believe there is a subtle but important distinction. Ketchup, mustard, bread, and the other incidental food items provided to customers in restaurants are being sold at retail along with the ordered menu items because those items are customarily and regularly provided to restaurant customers as a part of the meal. I do not believe, however, that peanuts are an integral part of the menu items being sold by Logan's. A customer that orders a hamburger expects ketchup, mustard, etc., as a part of the meal, but not peanuts. Rather, as stated by the Administrative Law Division in *Logan's Roadhouse*, "The Taxpayer is using the peanuts as a marketing or advertising tool to entice customers into its restaurants." *Logan's Roadhouse*, Docket S. 08-700 (Admin. Law Div. 5/28/2009) at 8.

If the circuit court had held in *Logan's Roadhouse* that Logan's was selling the peanuts to its customer as an integral part of the meal, the same as bread, condiments, etc. are an integral part of the meal, I would disagree with that finding of fact, but I would otherwise have no problem with the rationale. My concern is that the holding in *Logan's Roadhouse* announces as a principle of law that if a retailer includes or factors in the cost of various items in the price it charges for its products being sold at retail, then the various items are also being sold to the customer at retail. As discussed, that rule of law would have "potentially limitless application," and perhaps open a Pandora's Box of potential problems.

One practical problem is illustrated by this case. The Taxpayer, or any similarly situated business, cannot know when it sells the disputed items in issue to a restaurant whether the restaurant will factor its cost of the items into the prices it charges for the food it sells to its customers. Some may, some may not. If the restaurant does factor in the cost in the food price, then the Taxpayer is selling the items to the restaurant tax-free at wholesale for resale per the *Logan's Roadhouse* rationale, but if not, the sales by the Taxpayer to the restaurant would be taxable retail sales.

It is problematic to treat a sale of an item as either a tax-free wholesale sale for resale or a taxable retail sale, depending solely on whether the purchaser/retailer factors its cost of the item into the price the purchaser/retailer charges for the goods it is selling at retail. If Logan's had not presented the menu mix document into evidence in circuit court, then presumably that court (and the Court of Civil Appeals) would not have found that Logan's was reselling the peanuts for a price. The menu mix document was not offered into evidence at the hearing before the Administrative Law Division, and it is not known when the document was prepared or what other costs were included. (Logically, all costs should

be included.) In any case, the point is that any retailer can create a document (or testify in court) showing all of the costs that are considered or factored into the prices it charges for its goods. The classification of a sale as either a tax-free wholesale sale or a taxable retail sale should not depend on such evidence.

Another problem is that a less sophisticated retailer may not do a detailed pricing analysis when it determines the prices to charge for its retail goods. For example, a rural mom-and-pop restaurant may simply charge the competitive and customary price in the area for the type of food being sold, knowing that it will make a sufficient overall profit from the amounts charged. If the restaurant also gave away to their customers peanuts, or key chains, or Frisbees, or any other item as an advertising or marketing tool, they would not be selling those items at retail with the food per the *Logan's Roadhouse* rationale because they did not specifically factor the cost of those items into the prices they charged for the food. In short, similarly situated retailers would be taxed differently, depending on whether they could produce evidence that they specifically factored various costs into the prices they charged for their goods.

In summary, when a retailer gives items free-of-charge to a customer along with the specific goods being sold at retail, the retailer is also selling those items at retail only if the items are a necessary and expected part of the goods being sold, i.e., the items are "a critical element of the final product sold to customers." *Burger King*, 416 N.E.2d at 1028. Whether an item is an integral and necessary part of the goods being sold is a sometimes difficult question of fact that must be decided on a case-by-case basis. I do not believe, however, that whether a retailer factors its cost of various items into the price it charges for its products being sold at retail is relevant in deciding if the various items are also being sold at retail. A fast food restaurant is not selling the plastic utensils, straws, paper napkins, etc. that it offers its customers free-of-charge, any more than a formal "eat-in" restaurant is renting the silverware and cloth napkins that it provides to its customers free-of-charge. The formal restaurant certainly considers its cost of the silverware and napkins in pricing its meals, but, as discussed, that should be irrelevant. In both type restaurants, the cutlery and napkins are being provided as a convenience or courtesy to the customer, and are not being sold (or rented) to the customer.