WALKER CO. ENTERTAINMENT, LLC d/b/a HIGHWAY 13 CHARITY BINGO AND ITS MEMBERS, CHRISTOPHER SHAWN FELLOWS, AND JIMMY RAY WILLIAMS 55864 HIGHWAY 13 ELDRIDGE, AL 35554-3608,	§	STATE OF ALABAMA DEPARTMENT OF REVENUE ADMINISTRATIVE LAW DIVISION
Taxpayers,	§	DOCKET NO. S. 10-379
v.	§	
STATE OF ALABAMA DEPARTMENT OF REVENUE.	§	

OPINION AND PRELIMINARY ORDER

This case involves a disputed final assessment of State sales tax entered against the above Taxpayers for October 2008 through August 2009.[1] The final assessment is based on the estimated "gross receipts" derived by the Taxpayer from the operation of electronic "bingo" machines in Walker County, Alabama during the subject period. A pre-hearing conference was conducted on February 24, 2011. Josh Watkins and Sam McCord represented the Taxpayers. Assistant Counsel Wade Hope represented the Department.

The parties agreed at the conference that the Administrative Law Division should decide two legal issues before conducting an evidentiary hearing in the case. This Order addresses those issues.

The first issue involves the sales tax bingo exemption at Code of Ala. 1975, §40-23-4(a)(43). That statute exempts from sales tax the gross receipts from bingo games conducted by certain charitable organizations that comply with legislation authorizing such games, and that properly distribute the game proceeds in accordance with applicable local

[1] The LLC and its members are hereafter referred to collectively as "Taxpayers." The LLC, individually, is hereafter referred to as "Taxpayer."

laws. The specific issue is whether the §40-23-4(a)(43) exemption could ever apply to the Taxpayer's gross receipts during the assessment period, given that the Walker County Circuit Court subsequently ruled on October 26, 2009 that the electronic bingo machines operated by the Taxpayer and others in Walker County constituted an illegal lottery, and not bingo. That issue turns on whether the Circuit Court's ruling should be applied retroactively to the assessment period in issue, or prospectively only.

The second issue concerns how the term "gross receipts," as used in Code of Ala. 1975, §40-23-2(2) for purposes of the gross receipts sales tax, should be defined. The Department contends that the term includes the total proceeds paid by the players to operate the electronic machines, without subtracting or netting out the winnings returned to the players. The Taxpayers argue that only the net amount or "hold" received and retained by the Taxpayer should be taxed.

The parties filed briefs and reply briefs concerning the above issues, with the final brief, the Taxpayers' Response to the ADOR's Supplemental Brief, submitted on November 14, 2011.

A brief overview is needed to understand the case.

Section 40-23-2(2) levies a sales tax on the gross receipts derived from the operation of public places of amusement. In *State v. Crayton*, 344 So.2d 771 (Ala. Civ. App. 1977), cert. denied 344 So.23d 775 (Ala. 1977), the Court of Civil Appeals held that a taxpayer that operated bingo games open to the public was liable for the gross receipts sales tax on its bingo receipts, even though at the time all bingo, paper or otherwise, constituted an illegal lottery. See also, Dept. Reg. 810-6-1-.24; *Fraternal Order of Eagles v. White*, 447 So.2d 783 (Ala. Civ. App. 1984).

Beginning in 1980, the Alabama Constitution was amended several times to allow legal bingo in various counties in Alabama.[2]

The Alabama Legislature enacted the §40-23-4(a)(43) bingo exemption by Act 90-671, effective June 1, 1990. That statute exempts from sales tax the gross receipts derived from bingo games "conducted in compliance with validly enacted legislation authorizing the conduct of such games and operations, and which comply with the distributional requirements of the applicable local laws, . . . [t]he exemption provided for in this section shall be limited to those games and operations by organizations," exempt under various subsections of 26 U.S.C. §501(c), or as defined in 26 U.S.C. §501(d).

In 1992, the Legislature enacted Act 92-526, which proposed a constitutional amendment that would legalize bingo in Walker County, Alabama outside the City of Jasper. The Legislature subsequently passed Act 92-574, which provided for the implementation and regulation of bingo in Walker County outside of the City of Jasper. The proposed amendment was ratified in November 1992, and became Amendment 549 to the Alabama Constitution. The Amendment provides that the operation of bingo games by certain nonprofit organizations for charitable, educational, or other lawful purposes shall be legal in Walker County outside of the City of Jasper, subject to any resolution by the County governing body.

The Walker County Commission adopted a resolution in February 1993 authorizing and regulating the operation of bingo games in Walker County outside the City of Jasper.

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[2] See, Amendment 356 (1980 Jefferson County), Amendment 387 (1980 Madison County), Amendment 413 (1982 Montgomery County), Amendment 440 (1984 Mobile County), Amendment 506 (1990 Etowah County), and Amendment 508 (1990 Calhoun County).

The resolution included various requirements, limitations, and restrictions relating to the operation of legal bingo in Walker County. For example, it specified that the Sheriff of Walker County would issue bingo permits for a fee to those charitable organizations that met the various requirements for operating legal bingo games in the County.

Several entities apparently began operating electronic bingo halls in Walker County in March 2007. At least 18 such businesses opened in the next few months.

In November 2007, the Walker County District Attorney and the Walker County Sheriff filed a declaratory judgment action in Walker County Circuit Court. See, *Baker, et al. v. Walker County Bingo, et al.,* CV2007-0400. Various entities that operated electronic bingo halls in the County were named as defendants. The complaint sought a declaratory ruling as to whether electronic "bingo" machines constituted the type of bingo authorized by Amendment 549, and also "whether the operation of the (bingo halls) concerning the electronic bingo and/or loosely grouped or combined organizations operating the games meets the legal definitions of (Act 92-526) and (Act 92-574)."

The original circuit judge assigned to the case issued a temporary restraining order ("TRO") on November 16, 2007 barring new bingo permits, then recused himself. The next circuit judge, Braxton Kittrell, amended the TRO on March 14, 2008 to allow for the annual renewal of existing permits. The Taxpayer in this case apparently had been issued a bingo permit by the Sheriff before the initial TRO was entered. Consequently, according to the Taxpayers' representatives, the Taxpayer renewed its bingo permit after Judge Kittrell amended the TRO to allow renewal of existing permits. Judge Kittrell subsequently recused himself, and Circuit Judge Robert Vance took over the case.

In mid-2009, Judge Vance ordered all existing electronic bingo operators in Walker County to restructure their operations to comply with existing law. The County Commission also doubled the bingo permit fee. The Taxpayer reorganized as directed by Judge Vance, and also paid the higher permit fee. It consequently continued operating electronic bingo in Walker County in compliance with Judge Vance's guidelines until Judge Vance ruled on October 26, 2009 that electronic bingo constituted an illegal lottery, and not bingo within the purview of Amendment 549. The Taxpayer ceased operating at that time.

The Department subsequently estimated the Taxpayer's bingo gross receipts for the period in issue. It then entered the final assessment in issue for the sales tax due. This appeal followed.

Issue (1). Should Judge Vance's Order be applied retroactively to the assessment period in issue?

The Taxpayers argue that Judge Vance's October 26, 2009 Order should be applied prospectively only, and that they should be allowed to prove at an evidentiary hearing that the Taxpayer is entitled to the §40-23-4(a)(43) exemption, i.e., that the Taxpayer complied with the requirements of Amendment 549, the applicable laws, and the Walker County resolution, during the period in issue. The Taxpayers cite *McCullar v. Universal Life Insurance Co., et al*, 6878 So.2d 156 (Ala. 1996), in support of their position.

In *McCullar*, the Alabama Supreme Court recognized that retroactive application of a judicial holding was the norm. It also explained, however, that prospective only application was appropriate under certain circumstances, citing U.S. Supreme Court precedent.

> The United States Supreme Court has suggested consideration of the following factors in choosing whether to apply a judicial decision prospectively.

> First, the decision to be applied nonretroactively must establish a new principle of law, either by overruling clear past precedent on which litigants may have relied, (cite omitted) . . . or by deciding an issue of first impression whose resolution was not clearly foreshadowed, (cite omitted). Second, it has been stressed that "we must . . . weight the merits and demerits in each case by looking to the prior history of the rule in question, its purpose and effect, and whether retrospective operation will further or retard its operation." (cite omitted). Finally, we have weighed the inequity imposed by retroactive application, for "where a decision of this Court could produce substantial inequitable results if applied retroactivity, there is ample basis in our cases for avoiding the 'injustice or hardship' by a holding of nonretroactivity."

McCullar, 687 So.2d at 165, quoting *Chevron Oil Co. v. Huson*, 404 U.S. 97, 106-07, 30 L. Ed. 2d 296, 92 S. Ct. 349 (1971).

The Taxpayers argue that the three requirements specified in *McCullar* for prospective only application of Judge Vance's ruling are present in this case. The Department does not dispute that a judicial ruling may be applied prospectively only. It contends, however, that the three factors in *McCullar* are not present in this case. I agree with the Taxpayers.

The first *McCullar* factor is that the ruling must have overruled past precedent or decided an issue of first impression whose resolution was not clearly foreshadowed. No court before Judge Vance's October 2009 ruling had ever decided the issue of whether electronic bingo machines constituted bingo within the purview of Amendment 549. Judge Vance's ruling thus clearly decided an issue of first impression.[3]

[3] It could also be argued that Judge Kittrell's Order altering the TRO and allowing existing bingo operators to renew their permits and continue operating, and Judge Vance's Order allowing bingo operators to restructure and continue operating, constituted past judicial precedent allowing electronic bingo that was overturned by Judge Vance's October 26,

(continued)

The ruling also could not be reasonably foreseen and was not clearly foreshadowed. There certainly was a disputed issue of public interest before Judge Vance's October 2009 ruling as to whether electronic bingo machines constituted legal bingo in Walker County (and elsewhere). But there was no consensus that electronic bingo was an illegal lottery and not legal bingo. To the contrary, the Walker County Sheriff issued a bingo permit only after his office investigated and determined that the applicant was engaging in legal bingo in accordance with Amendment 549 and the applicable Walker County resolution. The Sheriff thus clearly must have believed and recognized that the electronic bingo machines operated by the Taxpayer, and others, constituted legal bingo. Given those facts, Judge Vance's ruling that electronic bingo was an illegal lottery was not "clearly foreshadowed."

The second *McCullar* factor requires a review of the purpose and effect of the ruling, and "whether retroactive application will further or retard its operation." *McCullar*, 87 So.2d at 165. The case decided by Judge Vance was a declaratory judgment action seeking a ruling as to whether electronic bingo machines constituted bingo in accordance with Amendment 549. Judge Vance ruled that electronic bingo was not bingo as envisioned by the Amendment, and enjoined the bingo operators from using the electronic machines in the future. Applying Judge Vance's ruling retroactively would not further or aid that purpose, or the intended prospective injunctive relief provided by the Order. The ruling was not intended to punish or to hold the bingo operators liable for their actions before the

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2009 Order. The better view, however, is that Judge Vance's Order declaring electronic bingo to be an illegal lottery decided an issue of first impression.

ruling was issued.[4] That would result if the ruling is applied retroactively.

The third *McCullar* factor involves the "inequity imposed by retroaction application" of the Order. *McCullar*, 87 So.2d at 165. That is, a ruling should not be applied retroactively if doing so would produce inequitable results and hardship. Given the facts in this case, this factor is the strongest in favor of prospective only application of Judge Vance's ruling.

As discussed, the Walker County Sheriff permitted and re-permitted the Taxpayer during the subject period as a legal bingo operator in accordance with Amendment 549 and the applicable Walker County resolution. The Taxpayer reasonably relied on the Sheriff's actions, and thus had good reason to believe that its activities constituted legal bingo. It would be inequitable to now treat the Taxpayer's operations before Judge Vance's Order as an illegal lottery, in which case the §40-23-4(a)(43) sales tax exemption could never apply, even if the Taxpayer otherwise qualified for the exemption.

The Department argues that the Taxpayers should have known that legitimate "'charitable organizations' were not operating the bingo halls," and also that it would not be inequitable to apply Judge Vance's ruling retroactively because "[i]t is well-settled law that the State can tax an illegal activity." Department's Supplemental Brief at 4, 6.

The Taxpayer may not have been operated by legitimate charities or otherwise complied with the requirements to operate legal bingo in Walker County, but that is not the current issue in dispute. The present issue is whether Judge Vance's Order should be

[4] Retroactive application of the ruling would also bring into question the legality of the actions of the Sheriff and perhaps others that sanctioned and allowed the Taxpayer and others to operate electronic bingo machines during the period in question.

applied prospectively only, thereby giving the Taxpayer the opportunity to prove that it complied with all laws and resolutions concerning legal bingo. If the Taxpayer is unable to do so, as argued by the Department, then the §40-23-4(a)(43) exemption will not apply.

There is also no question that the Department can tax an illegal activity, or even legal bingo. But again, the present issue is whether the Taxpayers should be allowed the opportunity to prove that they operated according to the law, and consequently qualified for the bingo exemption at §40-23-4(a)(43). In fairness they should, given that they operated with the approval of the Walker County Sheriff and two Circuit Judges during the assessment period.

The Taxpayers also argue that the Department should be estopped from arguing that Judge Vance's ruling should be applied retroactively to the assessment period in issue.

The Alabama Supreme Court has held as a general rule that the Department cannot be estopped from assessing and collecting a tax that is legally due based on erroneous advice given by the Department or its employees. *Community Action Agency of Huntsville, Madison County, Inc. v. State*, 406 So.2d 890 (Ala. 1981). The Court has also held, however, "that the State may be estopped from asserting that a taxpayer failed to timely appeal 'where the untimeliness of the filing of their appeal was caused by misinformation furnished by the State's offices and relied on by the (taxpayer) to their detriment.'" *Home Depot USA, Inc. v. State*, Docket S. 06-1079 (Admin. Law Div. P.O. 5/2/2007), quoting *Ex parte Four Seasons, Ltd.*, 450 So.2d 110, 112 (Ala. 1984).

In *Ex parte Four Seasons*, the county tax assessor erroneously notified the petitioners that the county board of equalization had ruled on their appeal on October 20, 1982. The board had actually ruled on October 4, 1982. The petitioners appealed within

the 30 day appeal deadline from October 20, but after 30 days from October 4. The trial court and the Court of Civil Appeals dismissed the petitioners' appeal as untimely. The Supreme Court reversed.

> In the case before us, the secretary's active misrepresentation of the date of the board's decision is being used in an attempt to deny the taxpayers, who relied on it, their right to an appeal to a court of law. Such a result would obviously work a serious injustice. Furthermore, the public's interest would not be unduly damaged by the imposition of estoppel in this case.

Ex parte Four Seasons, 450 So.2d at 112.

The equities reflected in *Ex parte Four Seasons* apply equally in this case. The Taxpayer openly operated the electronic bingo machines during the period in issue under the legal auspice of the Sheriff, and with the approval of two Circuit Judges. For the government, through the Department, to now argue that the Taxpayer had operated illegally during the period, and thereby deny the Taxpayer the opportunity to prove that it complied with the requirements of the §40-23-4(a)(43) exemption, "would obviously work a serious injustice." *Ex parte Four Seasons*, 450 So.2d 110, 112.

Issue (2) The "gross receipts" issue.

This issue, which primarily involves a question of law, need not be addressed at this time. The parties should present evidence at the later evidentiary hearing concerning how the electronic machines operated during the period in issue. That is, did the players put money directly into the machines and directly receive money back from the machines if they won, or did the players pay money to an employee of the Taxpayer, who in turn gave the players tokens or credits which the players used to operate the machines.

A pre-hearing conference is scheduled in the case for **10:00 a.m., March 15, 2012**

at the Business Center of Alabama Building, 2 North Jackson Street, Suite 301, Montgomery, Alabama. The purpose for the conference is to identify the "validly enacted legislation" and the "applicable local laws" that the Taxpayer was required to comply with to be exempt under §40-23-4(a)(43). The Taxpayers should also identify the qualified §501(c) and/or 501(d) organization or organizations that they claim operated the bingo games during the assessment period. The intent of the conference is to ensure that both parties are aware of the other parties' positions/arguments before an evidentiary hearing is conducted in the case.

After the pre-hearing conference but before the evidentiary hearing, the Administrative Law Division may also require the parties to submit a list of their expected witnesses, with a general summary of the expected testimony of each witness. Again, the intended purpose would be to ensure that both parties are fully aware of the evidence to be submitted by the opposing party at the evidentiary hearing.

This Opinion and Preliminary Order is not an appealable Order. 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 February 1, 2012.

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BILL THOMPSON
Chief Administrative Law Judge

bt:dr
cc: Margaret Johnson McNeill, Esq.
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