STATE OF ALABAMA, DEPARTMENT OF REVENUE, vs. BOEING COMPUTER SUPPORT SERVICES, INC. P. O. Box 5968 Huntsville, AL 35814-5968, Taxpayer.	§ § § § § § §	STATE OF ALABAMA DEPARTMENT OF REVENUE ADMINISTRATIVE LAW DIVISION DOCKET NO. S. 89-117

FINAL ORDER

The Revenue Department assessed lease tax against Boeing Computer Support Services, Inc. ("Taxpayer") for the period April 1, 1986 through May 5, 1987. The Taxpayer appealed to the Administrative Law Division and a hearing was conducted on November 16, 1993. William J. Ward represented the Taxpayer. Assistant counsel Beth Acker represented the Department.

The primary issue in this case is whether a contract between the Taxpayer and the National Aeronautics and Space Administration ("NASA") constituted a lease agreement or a conditional sales agreement during the period in question. If the transaction is deemed to be a lease, then the assessment in issue should be affirmed, and vice versa. A secondary issue is that if lease tax is owed, should transmission charges paid by the Taxpayer to various communications companies pursuant to the contract be excluded from taxable gross proceeds. The relevant facts are undisputed.

On May 16, 1985, the Taxpayer and NASA entered into a contract consisting of two parts, Division I and Division II. This case involves Division II only.

Division II of the contract required the Taxpayer to provide NASA with telecommunications equipment and also to procure transmission arrangements with various communications companies to achieve interconnection of the equipment.[1] Specifically, the Taxpayer was required to provide and place in service, or "cut-over", equipment to NASA by April 1, 1986. The contract as written was a "lease with option to purchase", with NASA having an option to purchase at cut-over or at the end of the five year lease term.

Lease payments under the contract were to begin on the proposed cut-over date of April 1, 1986. However, the cut-over date was pushed back to July, 1986 due to government delays.

In March and early April, 1986, the Taxpayer proposed various changes in the contract that would result in mutual savings for both parties. NASA agreed to the changes, which included converting the contract from a lease with option to purchase to "lease to ownership". The agreement is evidenced by a memorandum dated April 22, 1986 from Henry Hopkins, the Taxpayer's principal representative in its dealings with NASA, which verifies that NASA

[1]The assessment in issue originally included all equipment and related telecommunications services involved in Division II. The assessment was adjusted, and presently the only tax in issue relates to some Division II equipment located in Alabama, plus intra-Alabama transmission charges.

and the Taxpayer agreed on that date to convert the agreement to lease to ownership. Hopkins also testified to that effect at the November 16, 1993 administrative hearing.

Hopkins followed up the April 22, 1986 memorandum with a letter to NASA's representative, Dan Adkins, dated May 7, 1986. That letter confirmed "NASA and Boeing's recent agreement to contract for all Division II equipment and software under a lease to ownership arrangement . . .". The May 7 letter also indicated that the net savings to NASA for converting to lease to ownership was $3,153,000.00. A contract pricing proposal dated May 14, 1986 also confirmed the conversion to lease to ownership and verified the expected savings to NASA of $3,153,000.00.

The Taxpayer issued its first invoice under Division II of the contract on April 30, 1986. The invoice amount was based on the new lease to ownership payment schedule previously agreed to by the parties.

NASA executed modification 54 to the contract on June 2, 1986. Modification 54 authorized immediate payment of the April 30 invoice even though the cut-over date had been delayed until July, 1986. The invoice was subsequently paid later on June 2, 1986. The Taxpayer thereafter completed the contract in accordance with the lease to ownership terms, and was paid by NASA in accordance with the lease to ownership payment schedule as agreed to by the parties in April, 1986.

NASA executed modification 84 to the contract on May 7, 1987. Modification 84 formally evidenced the change from lease with option to purchase to lease to ownership. Modification 84 further confirmed the net savings to NASA of $3,153,000.00 as previously indicated in both the May 7, 1986 letter from Hopkins to Adkins and in the May 14, 1986 pricing proposal.

Modification 84 indicated on its face that it was executed pursuant to the "Changes" clause of the contract. The "Changes" clause is a standard clause in the Federal Acquisitions Regulations ("FAR") that was incorporated by reference into the contract. The FAR "Changes" clause provides that "the contracting officer may at any time, by written order, . . ." make unilateral changes in the contract.

Charles Henke was the contracting officer on the contract in question. Mr. Henke testified that his reference to the "Changes" clause in modification 84 was unnecessary because modification 84 was not a unilateral change covered by the "Changes" clause, but rather only confirmed the prior bilateral oral agreement of the parties.

The Department does not dispute that NASA and the Taxpayer orally agreed in April, 1986 to convert the transaction to a conditional sales agreement. However, the Department argues that the change did not become effective until executed in writing by modification 84 on May 7, 1987. This case thus turns on whether

the oral agreement by the parties in April, 1986 converted the original lease agreement into a conditional sales agreement, effective in April, 1986. I believe that it did.

A written agreement may be effectively modified by a subsequent oral agreement, even if the written agreement requires that all modifications must be in writing. Duncan v. Rossuck, 621 So.2d 1313 (1993); Commercial Contractors, Inc. v. United States F. and G. Co., 524 F.2d 944 (1975). The parties in this case clearly agreed in April, 1986 that the contract would be converted to a lease to ownership or conditional sales contract, effective at that time. The Taxpayer thereafter completed the contract in accordance with the newly agreed lease to ownership terms, and NASA remitted the payments in issue pursuant to the lease to ownership payment schedule.

The Department argues that the verbal agreement of the parties in April, 1986 was not sufficient to convert the lease transaction into a conditional sales agreement because the FAR "Changes" clause required all changes to be in writing. However, I agree with the Taxpayer that the "Changes" clause concerns only unilateral changes made by a NASA contracting officer. The April, 1986 oral agreement was a bilateral agreement between the parties and thus was not covered by the "Changes" clause.

The above considered, the gross proceeds in issue were exempt sales proceeds, not lease proceeds.[2] Consequently, the lease tax assessment in issue is dismissed.

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

Entered on April 29, 1994.

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BILL THOMPSON
Chief Administrative Law Judge

[2] A sale to the federal government is exempt because sales tax is levied on the consumer, in this case the exempt government. However, lease tax is owed by the lessor involving property leased to the federal government because the lease tax is levied on the non-exempt lessor, not the exempt leasee/federal government.