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May 4, 2011

PRELIMINARY HEARING OPINION

TO:	Angela J. Seekins, Esq. Scott Easterwood Rhinehart Equipment Company, Inc.	)
FROM:	Jonathan V. Gerth, Esq. Hearing Officer	)
RE:	Rhinehart Equipment Company, Inc.	)

BACKGROUND

The taxpayer, Rhinehart Equipment Company, a Georgia corporation headquartered in Rome, Georgia, is a retail heavy equipment dealer in the business of leasing and selling construction equipment. The taxpayer's market segment consists primarily of customers within Georgia and Alabama, primarily in areas contiguous to the Georgia-Alabama state line. Upon receiving orders for sales or rental activities, the taxpayer offers customers the option of picking up the equipment themselves from the facility in Rome, or having the equipment delivered directly to their location for an additional charge. The taxpayer delivers the equipment using its own vehicles and employees to locations in both Georgia and Alabama.

The taxpayer was audited by Revenue Discovery Systems (RDS) on behalf of self-administered county and municipal taxing authorities throughout the state of Alabama. The audit revealed that the taxpayer was selling, leasing, and delivering equipment into counties and municipalities within the state of Alabama. The auditor determined that the taxpayer had failed to comply with local jurisdictional delivery license taxes levied by counties and municipalities throughout the

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state, and had failed to collect sales tax on sales to Alabama residents occurring in a jurisdiction in which they had active leasing contracts. The examiner assessed the taxpayer for delivery license fees in all jurisdictions in which the taxpayer had made deliveries using their own vehicles, and assessed sales tax on those transactions where the taxpayer had simultaneous sales and rental activities within the same Alabama county/municipality. However, the auditor determined that the taxpayer did not have sufficient nexus to impose sales or use tax collection in those jurisdictions in which they had no active rental inventory.

The taxpayer timely filed a petition for review of the Preliminary Assessments in accordance with ALA. CODE § 40-2A-7(b)(4)a (1975) and a hearing was conducted on March 10, 2011.

ANALYSIS

The issues for analysis are: (1) whether the local taxing authorities are prohibited from assessing the taxpayer for delivery license fee by the Due Process Clause within the Fourteenth Amendment and the Commerce Clause under Article 1, §8, cl. 3 of the United States Constitution, and; (2) whether the taxpayer had sufficient nexus with Alabama to impose rental tax and collection of sales tax in those jurisdictions in which they purportedly had active rental inventory at the time of the sale.

The taxpayer does not dispute the amounts of the tax assessed under the delivery license and sales tax ordinances. Rather, they argue that they are not liable for the delivery licenses because their activities within Alabama are not sufficient to establish nexus within the state, that the levying of such license taxes are prohibited in Alabama under *Roanoke v. Stewart Grocery Co.* 176 So. 820 (Ala. 1937), and that to impose such a tax is an undue burden on interstate commerce in violation of the Commerce Clause. The taxpayer has also raised the contention that the auditor did not have sufficient evidence to show that the taxpayer had active rental inventory within the state of Alabama at the time sales tax was assessed. The examiner determined that the taxpayer established nexus for delivery licenses in Alabama under ALA. CODE §11-51-194 (1975), and that the physical presence of rental property within an Alabama county was sufficient to establish nexus for sales tax while the property was active within the jurisdiction.

In addressing the taxpayer's arguments, it is necessary to review the language of the statute granting the taxing jurisdictions the authority to levy the delivery licenses. Section 11-51-194 states in pertinent part:

> **Delivery license.**
>
> "(a) Each municipality shall allow the purchase of a delivery license by *any business that has no other physical presence within*

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> *the municipality or its police jurisdiction for the privilege of delivering its merchandise therein.* The amount of the delivery license shall not exceed one hundred dollars ($100).
>
> (b) As used in this section, a delivery license shall mean a fixed rate business license issued by a municipality for the limited privilege of delivering and requisite set-up and installation, *by the taxpayer's employees or agents, of the taxpayer's own merchandise in that municipality, by means of delivery vehicles owned, leased, or contracted by the taxpayer*; provided that the gross receipts derived from the sale and any requisite set-up or installation of all merchandise so delivered into the municipality shall not exceed seventy-five thousand dollars ($75,000) during the license year, and any set-up or installation shall relate only to (1) that required by the contract between the taxpayer and the customer or as may be required by state or local law, and (2) the merchandise so delivered. *Mere delivery of the taxpayer's merchandise by common carrier shall not allow the taxing jurisdiction to assess a business license tax against the taxpayer, . . .*"
>
> ALA. CODE §11-51-194 (1975) (emphasis added)

In 2006, the Alabama legislature enacted the above statute through the passage of Act 2006-586, p. 1548. §3. Through this enactment and subsequent codification, the legislature clearly expressed intent to overrule the Alabama Supreme Court decision in *Roanoke v. Stewart Grocery, supra,* (affirmed by *Rabren v, The Pullman Co.*, 254 So.2d 324 (Ala. 1971)) which previously precluded a city from imposing a license or tax on a foreign corporation engaging in interstate commerce and delivering merchandise within Alabama, even if the company did so using its own trucks and employees. The statute itself provides an alternative to the general business license provisions permitted under ALA. CODE §11-51-90, and allows for the purchase of a special, and less burdensome, license for those taxpayers whose only physical presence within a jurisdiction is the delivery and requisite set-up of their own merchandise by means of vehicles owned, leased or contracted by the taxpayer. It has long been the policy of this state that where the language of a statute is clear and unambiguous, it must be construed and applied as written. *State v. Foster*, 30 So. 477 (Ala. 1901); *Rush v. Department of Revenue of Alabama*, 416 So.2d 1023 (Ala. Civ. App. 1982); *HLH Constructors, Inc. v. State Dept. of Revenue*, 902 So.2d 680 (Ala. Civ. App. 2004). Additionally, statutes are an act of the legislature, and every judicial presumption is in the favor of their constitutionality. *Rogers v. City of Mobile*, 169 So.2d 282 (Ala. 1964); *Miller v. Marshall County Bd. of Educ.*, 652 So.2d 759 (Ala. 1995).

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A prerequisite of the authority to tax is some nexus between the taxpayer and the taxing jurisdiction. As explained by the Supreme Court, minimum contacts with the taxing jurisdiction are sufficient to meet the requirements of the Due Process Clause; however, the Commerce Clause requires "substantial nexus" with the taxing jurisdiction to justify burdening interstate commerce. *Quill Corp. v. North Dakota*, 504 U.S. 298, 313 (1992). Consequently, the *Quill* Court reaffirmed its prior holding in *National Bellas Hess, Inc. v. Department of Revenue*, 386 U.S. 753 (1967) that mere contacts with the state through common carrier or the mail is insufficient to subject the business to the taxing jurisdictions of the state. *Quill*, 504 U.S. at 307. The *Quill* Court further noted that they rejected the *Bellas Hess* physical presence test for due process purposes, and held in the spirit if *International Shoe Co. v. Washington*, 326 U.S. 310, 66 S.Ct. 154 that a state could tax an out-of-state seller who "purposefully avails itself of the benefits of an economic market" in that state. *Quill, supra.* The Due process clause is satisfied if the taxpayer is given "notice" and "fair warning" that it may be subject to tax in the state. *Id.* at 1913. The taxpayer in this instance has clearly availed itself to the economic markets of the state of Alabama. Evidence from the audit confirmed that the taxpayer had made nearly 350 deliveries into the state throughout the audit period, and had leased equipment on many occasions to customers who reside in the forum. The magnitude of these contacts with Alabama is more than sufficient to establish nexus for the purposes of Due Process.

The *Quill* Court did, however, affirm the ruling in *Bellas Hess* that some physical presence, although not a permanent physical presence, in the state is necessary in order to sufficiently satisfy the Commerce Clause nexus. Unfortunately, the Court failed to specify how much physical presence or activity is necessary to constitute "substantial nexus" for Commerce Clause purposes. Previously, in *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977) the Court, in an effort to address the conflicting principles that had developed, rejected the *per se* analysis which provided foreign taxpayers with virtual immunity, and declared that an out-of-state business can be taxed without violating the Commerce Clause and could withstand challenge as long as it; (1) is applied to an activity with substantial nexus with the taxing state; (2) is fairly apportioned; (3) does not discriminate against interstate commerce; and (4) is fairly related to the services provided by the state. *Id.* at 279, 97 S.Ct. at 1079. By doing so, the Court adopted a course that requires a centering on the practical effect of the tax in issue, and requires taxpayers engaged in interstate commerce to pay their just share of the state tax burden, even if it increases the cost of doing business. *Goldberg v. Sweet*, 488 U.S. 252, 259 (1989). A quagmire of varying results have ensued in the many federal and state courts both pre and post the subsequent ruling in *Quill*.

In support of its position that its activities in Alabama are not sufficient to establish substantial nexus, the taxpayer relies heavily on *Miller Brothers Co. v. Maryland*, 347 U.S. 340 (1954). In *Miller Brothers*, the State of Maryland attempted to impose the obligation of collecting its use tax on a Delaware furniture store. The store's sales to customers were all made in Delaware, the business had no employees or salesperson in Maryland, but the store did make sales to Delaware

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customers and occasionally delivered merchandise into Delaware. In most cases, the sales were made over the counter in Delaware to Maryland residents who traveled to the store; other sales were delivered to Maryland residents sometimes via common carrier and *occasionally* using the stores own truck. *Id.* at 347. Although it is notable that the decision in *Miller* was issued long before the Court's more recent and standing jurisprudence from *Complete Auto* and *Quill*, it should also be distinguished in that Maryland was attempting to impose sales and use tax collection upon the taxpayer, which has not been required in the instant case in any taxing jurisdiction in which the taxpayer had mere deliveries. The Court since then has regularly concluded that activities from the interstate operations of a foreign corporation may be subjected to state taxation provided the levy is not discriminatory and is properly apportioned to the local activities within the taxing state forming sufficient nexus to support the same. *Northwestern State Portland Cement Co. v. State of Minn.*, 358 U.S. 450,452 (1959), *Complete Auto, supra.* Contemporary dormant commerce clause analysis does not prohibit all state taxation of interstate commerce, but rather only that which is unduly restrictive or facially discriminatory. This prevents a state from "jeopardizing the welfare of the Nation as a whole" by "placing burdens on the flow of commerce across its borders that commerce wholly within those burdens would not bear." *Oklahoma Tax Comm'n v. Jefferson Lines, Inc.*, 514 U.S. 175, 179-180 (1995).

The Court in *Quill* recognized that "[u]ndue burdens on interstate commerce may be avoided not only by a case-by-case evaluation of the actual burdens imposed by particular regulations or taxes, but also, in some situations, by the demarcation of a discrete realm of commercial activity that is free from interstate taxation." *Quill*, 504 U.S. at 315, 112 S.C. at 1914. *Bellas Hess* followed the latter approach which created a safe harbor for those interstate vendors whose only connection with the customers in the taxing jurisdiction is by common carrier or mail. *Id.* Like other bright-line tests, the *Bellas Hess* rule appears artificial at its edges: Whether or not a State may compel a vendor to collect sales or use tax, or subject it to a business or occupational tax, may turn on the presence in the taxing State of a small sales force, plant, or office. *Quill*, 504 U.S. at 315 (citing *National Geographic Society v. California Bd. of Equalization*, 430 U.S. 551, 97 S.Ct. 1386 (1977)).

The taxpayer here argues that their "occasional" delivery of goods to Alabama customers through the use of their own trucks did not create nexus for license taxes purpose, and that their employees did not "exploit the consumer market" of the state. On the contrary, they are clearly within the licensing provisions of the tax as stated within the statute. As referenced above, the taxpayer was found to have performed nearly 350 deliveries of merchandise into Alabama, performed by their own employees, by means of their own delivery vehicles. The statute clearly states that this is the only physical presence required to subject them to the delivery license fee. Also notable is the fact that upon a large portion of these deliveries, the taxpayer's employee is required to complete an extensive twenty-item Delivery Report Checklist at the time of delivery within Alabama. (Exhibit 1) This checklist requires the employee to explain the operations, maintenance, safety, and warranty manuals, advise that the dealer is the source for operator

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training, review recommended loader and attachment usage, explain the capabilities and restrictions of the equipment, review safety decals, demonstrate use and maintenance of safety attachments, demonstrate how to operate and park the equipment, explain the availability of special application kits, advise the availability of other attachments and accessories, and many other functions that would typically be the required duties of a salesperson. Although the fact that the taxpayer already has the necessary nexus required under the statute for the delivery license tax, whether or not a State may compel a vendor to collect sales or use tax, or subject it to a business or occupational tax, may turn on the presence in the taxing state of property or the conduct of economic activities in the taxing state performed by the vendor's personnel on its behalf. *Quill, supra*; *Oklahoma Tax Comm'n, supra*. The extent of the deliveries into the state accompanied by the sales and consumer education duties performed by the taxpayer's employees leave little doubt that the taxpayer has "exploited the consumer market" of Alabama, and raises credible indications that they have established substantial nexus throughout the state that would require the collection of use taxes on all sales. *see Miller Bros.*, 347 U.S. at 347; *General Trading Co. v. State Tax Comm'n of Iowa*, 322 U.S. 335 (1944) (a Minnesota corporation engaged in retail sales which sent an unidentified number of traveling salesmen to solicit sales in Iowa, absent any other physical presence, established sufficient nexus to satisfy constitutional scrutiny); *Standard Pressed Steele Co. v. Washington Dept. of Revenue*, 419 U.S. 560 (1975) (through the presence of one resident employee in Washington which made possible the realization and continuance of valuable contractual relations with a customer, a sufficient nexus was established within the state to subject the foreign taxpayer to occupational taxes); *Tyler Pipe Industries, Inc. v. Washington State Dept. of Revenue*, 483 U.S. 232 (1987) (presence of independent contractors alone was sufficient to establish substantial nexus within the state); *Orvis Company v. Tax Appeals Tribunal*, 654 N.E.2d 954 (1995), *cert. denied,* 516 U.S. 989 (1995) (physical presence need not be "substantial" but must be more than a "slightest presence); *Brown's Furniture, Inc. v. Wagner*, 654 N.E.2d 795 (1996), *cert. denied*, 519 U.S. 866 (1996).

The primary purpose of the fair apportionment prong of the *Complete* Auto test is to prevent multiple taxation by ensuring that each state taxes only its fair share of an interstate transaction. *Goldberg*, 488 U.S. at 260. Determining whether a tax is fairly apportioned thus requires internal and external consistency. To be internally consistent, a tax must be structured so that if every state imposed an identical tax, no multiple taxation would occur. The external consistency test asks whether the State has taxed only that portion of the revenues from the interstate activity which reasonably reflects the in-state component of the activity being taxed. *Id.* at 260 – 262; *see also* *Townsend v. City of Mobile*, 793 So.2d 828 (Ala. Crim. App. 1999)(reversed on other grounds by 793 So.2d. 835) The predominantly flat-fee delivery license under §11-51-194 imposes a tax (not to exceed $100 annually) only upon that portion of an activity that takes place exclusively within each taxing jurisdiction, and is purely limited to that jurisdiction in which an actual delivery takes place. The license tax does not tax an interstate truck's entry into the state, nor does it tax transactions spanning multiple states. As a result, if every state replicated Alabama jurisdiction's delivery license tax, under the same terms, no hypothetical scenario

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would subject a single delivery to multiple taxation, therefore negating any need or basis for apportioning the tax. *American Trucking Assoc., Inc. v. Michigan Public Service Comm'n*, 545 U.S. 429, 438 (2005); *American Trucking Assoc., Inc. v. State Dept. of Transportation*, 124 P.3d 1210, 1218-1220 (Or. 2005), *cert. denied*, 548 U.S. 903 (2006).

The Alabama jurisdictions' delivery license tax structures do not discriminate against interstate commerce. The predominantly flat-fee license is imposed only on those transactions delivered directly into Alabama municipalities. It does not facially discriminate against interstate or out-of-state enterprises. It applies even-handedly to all carriers making domestic deliveries, and does not attempt to tax activity taking place outside the state. Nothing within the historical or current dormant Commerce Clause jurisprudence case law suggests that such a neutral, locally focused fee or tax is impermissibly offensive. *American Trucking*, 545 U.S. at 429. The only revenues subject to the license taxes are those derived solely from gross sales within each jurisdiction, which is mindful of the central purpose that each jurisdiction may tax only its fair share of an interstate or intrastate transaction. *See e.g., Container Corp. of America v. Franchise Tax Board*, 463 U.S. 159 (1983); *Gwin, White & Prince v. Henneford*, 305 U.S. 434, (1939); *M & Assoc., Inc. v. City of Irondale*, 723 So.2d 592 (Ala. 1998).

Finally, the tax is fairly related to benefits provided by the jurisdictions in which the taxpayers are conducting business. The fair relation prong of *Complete Auto* requires no detailed accounting of the services provided to the taxpayer on account of the activity being taxed. *Jefferson Lines,* 514 U.S. at 199. By making the deliveries in its own vehicles, the taxpayer enjoyed the benefits of the local roads, judicial system, and police protection.
If the event is taxable, the proceeds from the tax may ordinarily be used for purposes unrelated to the event itself. Interstate commerce may thus be made to pay its fair share of the state expenses and contribute to the cost of government services (i.e. Fire, Police, Highways) "along with the usual and usually forgotten advantages conferred by the State's maintenance of a civilized society, are justifications enough for the imposition of a tax." *Id.* at 1346.

The remaining issue under protest is whether the taxpayer had sufficient nexus to impose rental tax and collection of sales tax in those jurisdictions in which they purportedly had active rental inventory at the time of the sale and subsequent delivery.

While it is recognized that a state cannot tax the privilege of carrying on interstate business, it's also known that a state has the power to place a levy on an activity either before or after movement in interstate commerce. *Boswell v. Paramount Television Sales, Inc.*, 282 So.2d 892, 896 (Ala. 1973). An article which has been transported in interstate commerce having arrived at its destination and there held for use or disposal becomes subject to the state's taxing and police power. *Id.* at 895. Renting items for use by citizens within a neighboring state constitutes a local act which is the taxable event occurring wholly within that state after completion of its interstate journey and before its return. This theory is unquestionably reflected within the legislature's

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regulation on leasing of tangible personal property which states that when a lessor located outside Alabama leases property to a lessee within the state of Alabama, the total gross proceeds are subject to the State's rental tax. ALA. ADMIN. CODE r. 810-6-5-.09(8).

There was a valid question of fact within the audit as to the specific locations of where the taxpayer's leased equipment was used. The taxpayer did not keep adequate records from which it could be determined where an individual lease was actually carried out. Although the taxpayer indicated that he was at all times liable for damages to the property, even during the course of an active lease, they had no method in place by which they accounted for the specific location of where a lease would be carried out. Therefore, the auditor resorted to use the lessee's address in determining where lessees presumably used the leased equipment. Many of the leases involved Alabama residents in cities and counties contiguous to the Alabama-Georgia state line which logically could have rented property from Georgia for use within Alabama, and rental tax was assessed on these leases. The taxpayer contended throughout the audit that although the lessees were Alabama residents, the rental of the equipment was for jobs performed within the state of Georgia, and at no time did the leased property ever enter the state of Alabama. In Alabama, taxpayers are required to maintain adequate records to evidence properly the actual business transacted, and if the taxpayer's records are insufficient, taxing authorities are permitted to consider other evidence, and the taxpayer will suffer the penalty for noncompliance. *State v. Levey*, 29 So.2d 129 (Ala. 1946); *State v. Ludlum*, 384 So.2d 1089 (Ala. Civ. App. 1980).

On appeal, the taxpayer was able to provide sworn affidavits, signed under penalty of perjury, from lessees attesting to the fact that all equipment leased by Alabama residents was used on projects performed within the State of Georgia. In establishing this premise, the taxpayer has defeated the required constitutional-based nexus established during the audit which the examiner used to impose Alabama rental tax and sales and use tax collection duties. Therefore, the assessments against the taxpayer for sales (seller's use tax) and rental tax under the audit will be voided.

The taxpayer is liable for the license taxes assessed by the jurisdictions in Alabama in which they deliver merchandise by means of their own vehicles and employees under the clear and unambiguous provisions of ALA. CODE §11-51-194 (1975), and the jurisdictions are not prohibited from assessing such taxes under the Due Process Clause or the dormant Commerce Clause. The preliminary assessments entered against the taxpayer for delivery licenses are affirmed, and it is recommended they be made final following the issuance of this opinion.

In accordance with Alabama taxing statutes within Title 40 of the Code, no penalty shall be assessed, or if assessed, shall be abated if attributable to erroneous written advice by city or county employees acting in good faith while in the capacity of their official duties, or upon a determination of reasonable cause. ALA. CODE §§ 40-2A-4(d); 40-2A-11(h). However, the municipal license tax statutes under Title 11 are more restrictive, and provide for abatement only

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if the deficiencies are attributable to erroneous written advice furnished by employees or agents of the municipality's revenue department or its designee. ALA. CODE §11-51-186(d). No evidence exists that any portion of the taxpayer's delivery license deficiencies were the result of reasonable reliance upon written advice from any city or from RDS as its designee. Therefore, penalties attributable to the license taxes should be upheld.

The final assessments may be appealed to the administrative hearings officer or the circuit court within thirty (30) days in accordance with the provisions set for in ALA. CODE §40-2A-7(b)(5) (1975).

Entered May 4, 2011

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