Two recent decisions from the Administrative Law Division of the Alabama Department of Revenue highlight issues of unique concern to certain businesses operating in Alabama. The first decision concerns equipment leasing companies, and the second concerns retailers that deliver goods in their own vehicles throughout the State of Alabama.

Equipment Leasing Companies – Transactions With Exempt Organizations

Unlike most states, Alabama has a lease tax separate from its sales tax. Moreover, the Alabama lease tax is imposed on the lessor, not the lessee. Therefore, leases of equipment to organizations which may be exempt for sales tax purposes (like schools and certain charitable organizations) give rise to lease tax liability at the lessor level, even though a sale of the same equipment to such an organization could be exempt from the sales tax.

Equipment leasing companies often use a form lease document to evidence a transaction that is in substance a sale transaction. Such "leases" are oftentimes financing transactions that have either a mandatory purchase or bargain purchase option at the end of the term. If correctly characterized as a sale rather than a lease for Alabama tax purposes, the sales tax laws will govern to the exclusion of the lease tax – which generally means, in the case of an exempt buyer, that no sales tax will be due.

In Lease Equipment Company of Maryland, Inc. v. State, (Administrative Law Division, Docket No. S06-558, February 21, 2007), a leasing company used a form lease to finance the sale of certain equipment to an organization exempt from sales tax. The leasing company contended that this transaction was governed by the sales tax laws, not the lease tax laws; and, thus no sales tax was due because of the exempt status of the equipment user. On audit, the Alabama Department of Revenue characterized the lease as a true lease and assessed the lease tax against the leasing company.

The Administrative Law Judge held in favor of the leasing company, primarily because under the terms of an addendum to the lease the exempt organization was given its choice of two purchase options at the end of the lease or a trade-in for new equipment, but under no circumstance could the exempt organization have opted to simply return the equipment at the end of the lease term.

Although this particular case represents a taxpayer victory, the decision indicates that equipment leasing companies should make certain that any "lease" documents which are intended to be financed sales for Alabama tax purposes have terms which clearly place the ownership in the lessee, such as a bargain purchase option or a mandatory purchase agreement. In addition, and certainly in any lease document in which there may be some ambiguity, the lease should contain a statement that the lease is intended to be a security instrument and that the parties intend that ownership for federal, state and local tax purposes be with the lessee.
Retailers Making In-State Deliveries – Local Sales Tax

In Alabama, a retail business which delivers its goods in its own vehicles to customers outside the county or municipality in which it operates need not collect the sales tax for the county or municipality of delivery unless the retailer has some operations in that county or municipality, such as an office or sales personnel operating in that county or municipality. The forgoing tax principle is based upon the 1997 decision by the Alabama Court of Civil Appeals in the case of Yelverton’s, Inc. v. Jefferson County, Alabama.

In a recent Opinion and Preliminary Order in the case of Crown Housing Group, Inc. v. State (Administrative Law Division, Docket No. S06-399, July 26, 2007), the Administrative Law Judge criticized the holding in Yelverton’s as being incorrectly decided, reasoning that because the act of delivery consummates the sale, a retailer making such a delivery in its own vehicles is doing sufficient business in the jurisdiction of delivery to justify collection of the sales tax.

Although no change in the law has occurred (and the Judge in this administrative decision acknowledged that Yelverton’s remains the law), this case may signal increased scrutiny of such sales during audits and may eventually lead to a challenge to the Yelverton’s holding. In order to minimize any audit exposure, Alabama retailers should make certain they have no connections other than the delivery of goods in those local jurisdictions where they do not collect sales tax. Those retailers should also watch for further developments in the Legislature, in the courts and from the Department on this issue.