ALABAMA TAX TRIBUNAL

LINE X, LLC,	§	
Taxpayer,	§	DOCKET NO. S. 18-369-LP
v.	§	
STATE OF ALABAMA DEPARTMENT OF REVENUE.	§	

OPINION AND PRELIMINARY ORDER

This appeal involves a final assessment of State sales tax for March 2014 through February 2017. A hearing was conducted on February 21, 2019. Marc Grossman and Dan Megathlin, both of Crowe, LLP, represented the Taxpayer. Deputy Counsel David Avery represented the Revenue Department.

The Revenue Department conducted an audit of the Taxpayer and found that it should have charged sales tax on sales to the Taxpayer's franchisees of chemical ingredients for its spray-on bedliners. The Department made adjustments to the Taxpayer's returns for the periods at issue, which resulted in the final assessment. The final assessment includes a credit for taxes paid on sales from the company store. The Taxpayer disagrees with the Department's determination, arguing that it is not required to charge sales tax on the sales to franchisees.

FACTS

The Taxpayer sells a product used as a spray-on bedliner for pick-up trucks (although it is also used on other surfaces). The Taxpayer operates a company store in which it sells the application of the bedliners directly to customers, who are car dealerships and individuals. The Taxpayer also licenses the product to franchisees and sells the chemical ingredients to those franchisees. The

Taxpayer also sells the equipment and supplies for mixing the chemicals and applying the spray-on bedliner as well as some auto accessories to the franchisees.

The Taxpayer collected sales tax at the machine rate on the equipment sold to the franchisees. The Taxpayer collected sales tax at the general sales tax rate on the accessories and supplies it sold to the franchisees. The Department agreed that the Taxpayer correctly collected tax on those sales.

The Taxpayer did not charge sales tax on the chemical sales to franchisees. The Department determined that the taxation of the chemical ingredients for the spray-on bedliner was governed by the Department regulation concerning auto painting (and building supplies if applying it to buildings). Under that regulation, 810-6-1-.06, paint and painting equipment is taxed when sold to the painters; the painters do not resell the paint to their customers but sell a service, which is not taxed.

The Taxpayer charged sales tax on sales of bedliner application from the company store to customers. The Department's position is that the tax should have been charged when the chemicals were removed from inventory.

The Taxpayer makes 22 percent of its chemical sales to its company store and 78 percent to independent franchisees. The company store sells the bedliner application to its customers, with 22 percent to individuals and 78 percent to car dealerships.

The company store charges the individuals sales tax on the sale of the spray-on bedliner. The company store does not charge sales tax on sales made to dealerships because the dealerships charge sales tax on the sales of the vehicles to their customers. The examiner testified that if a customer provides a seller with a resale license, the seller can accept the resale license on faith without an obligation to verify that the purchaser will resell the product and charge tax.

The Taxpayer argues that the franchisee customers are similar to its own, and thus the franchisees are not required to collect sales tax on the majority of its sales as they should be to dealers. If the Taxpayer was required to charge tax on the sale of the chemicals to the franchisees or the company store, the Taxpayer contends that double taxation would result for the majority of those sales as tax is charged by the dealerships to its customers.

For company store sales on which it did charge tax, the taxable measure was the price of the chemicals and the labor for mixing and spraying the liner. However, the company store did not charge sales tax on the labor for preparing the vehicles for the liner, which included cleaning and other work. The preparation was necessary for optimal application and it is unlikely that any customers did the preparation work prior to coming to the store.

The Taxpayer argues that the rule for auto manufacturers should apply. Auto manufacturers do not pay sales tax on chemicals made into a bedliner during the production of vehicles. Alternatively, the Taxpayer argues that the spray-on bedliner is essentially the same as a drop-in bedliner although how they are installed is different. Thus, the Taxpayer argues the taxation should be the same – it should be taxed at retail.

The application process is patented. The franchisees and company store employees are required to attend training for the application. Neither of the two chemicals can be used alone to create a bedliner. Once the bedliner is applied, it cannot be easily removed. Removal will ruin the bedliner.

The Taxpayer's representatives pointed out that the Taxpayer was acting in good faith to follow the tax laws: it charged sales tax on sales from the company store, it charged sales tax on equipment and supplies sold to franchisees, it required resale certificates from franchisees in order to

exempt chemical purchases from tax, and it employed compliance software to determine the correct rates for various tax jurisdictions.

LAW & ANALYSIS

810-6-1-.06. Automobile Painting.
(1) The painting of automobiles is a service by the painter. Receipts from such painting are not taxable. The paint, supplies, etc., used or consumed by the painter are taxable when sold to him.

(2) Refer to Rule entitled "Parts and Materials Used to Repair or Recondition Dealers' Automobiles" with reference to painting of automobiles of dealers, which automobiles are a part of the dealers' stock in trade for sale. (Adopted March 9, 1961, amended November 1, 1963, readopted through APA effective October 1, 1982)

810-6-1-.07. Automobile Parts Installed for Customer.
(1) The repairman sells at retail parts used in making repairs to the customer's automobile which are passed substantially intact (as purchased by him) to the customer. Illustrations of such parts are pistons, piston rings, fan belts, gears, batteries, and tires.

(2) On the other hand, the repairman does not sell at retail, but consumes such materials and supplies as paints or lubricants furnished by him as an incident to rendering a service. These materials and supplies are purchased at retail by the repairman. (Doby v. State, 174 So. 233, Merriwether v. State, 42 So. 2d, 465.)

(3) Refer to the rule entitled "Parts and Materials Used to Repair or Recondition Dealers' Automobiles, with reference to parts used by repairmen on automobiles of dealers, which automobiles are part of the dealers' stock in trade for sale. (Adopted March 9, 1961, amended November 1, 1963, readopted through APA effective October 1, 1982)

810-6-1-.08. Automobile Repair Shops.
(1) Automobile repairmen must report and pay tax on all sales of automobile parts, accessories, tires, tubes, and batteries which are passed to the automobile owner for his use. When the repairman does not itemize parts, in his billing, any amount charged for labor or service and included in the lump sum billing is to be included in the taxable amount.

(2) Supplies consumed by the repairman, such as paint, solder, upholstery tacks, also tools and machinery used, are taxable on their sale to or use by the repairman, with tax to be collected from the repairman by his supplier, or to be paid to this

> Department as use tax if the supplier is not licensed under the sales tax law or registered under the use tax law. Doby v. State, 174 So. 233, Cody v. State, 177 So. 146.
>
> (3) Refer to regulation 810-6-1-.116 entitled "Parts and Materials Used to Repair or Recondition Dealers' Automobiles" with reference to parts and materials used by repairmen on automobiles of dealers, which automobiles are a part of the dealer's stock in trade for sale. (Adopted March 9, 1961, amended November 1, 1963, readopted through APA effective October 1, 1982).

While the application of the bedliner is similar to that of painting an automobile, rule 810-6-1-.06 is not the most applicable rule here; paint is sold to painters as paint, but the bedliner is not sold to the franchisees in its final form but as ingredients. However, paragraphs (2) of rules -.07 and -.08 above do apply to the Taxpayer here. The franchisees did not sell the chemicals at retail but consumed them in installing the Line X bedliners. Testimony and post-hearing evidence provided clarifies that a Line X bedliner cannot be removed in such a way as to remain intact. Thus, the product is consumed upon installation and is not sold at retail.

Additionally, the Line X bedliner cannot be considered a custom sale under 810-6-1-.19. As shown in the Franchise Agreement and through testimony, the Line X bedliner is a patented product. The customer cannot specify how it should be made.

Thus, the sales of the chemicals from the Taxpayer to the franchisees are taxable sales. The transfers to the company store are taxable. But the sales from the company store to dealers are not taxable under 810-6-1-.116.

The Revenue Department is directed to notify the Tax Tribunal whether the final assessment includes tax assessed on sales from the company store to dealerships that provided resale certificates. If so, the Department is directed to remove such sales from the taxable measure and recompute the final assessment.

The parties have 15 days from this order to apply for a rehearing. Ala. Code § 40-2B-2(l)(5).

Entered October 1, 2019.

/s/ *Leslie H. Pitman*
LESLIE H. PITMAN
Associate Tax Tribunal Judge

lhp:dr
cc: Marc Grossman, Esq.
David E. Avery, III, Esq.