

STATE OF CALIFORNIA
BOARD OF EQUALIZATION

295.0775

BUSINESS TAXES APPEALS REVIEW SECTION

In the Matters of the Petition)
for Redetermination and Claim) DECISION AND RECOMMENDATION
For Refund Under the Sales and)
Use Tax Law of:)
C--- W--- CORPORATION) No. SY -- XX-XXXXXX-010
) No. SY -- XX-XXXXXX-001
)
Petitioner/Claimant)

The Appeals conference in the above-referenced matters was held by Senior Staff Counsel Stephen A. Ryan on May 6, 1994 in Sacramento, California.

Appearing for Petitioner/Claimant
(hereinafter "petitioner"):

Mr. J--- V--- B---
Director of Excise Taxes

Mr. J--- V---
Attorney

Appearing for the
Sales and Use Tax Department:

Mr. Chris Drews
Tax Auditor

Mr. Jack Warner
District Principal Auditor

Protested Item

The protested tax liability for the period September 1, 1987 through June 9, 1991 is measured by:

<u>Item</u>	<u>State, Local and County</u>
C. Unreported taxable gross receipts consisting of membership fees	\$2,656,588

Petitioner's Contentions

1. The membership fees are nontaxable. There was only one type of membership; the "90-day free pass" was not a membership. The regular members could not purchase property at a lower

price than any other members. The "surcharge" required to be paid by passholders on property purchased was merely to recoup for promotional expenses. Neither the language nor the spirit of Annotation 295.1540 renders these fees to be taxable.

2. The 90-day free pass program is "de minimus" since only about one percent of petitioner's total sales were made to passholders.

Summary

Petitioner operated in the U.S. and Canada as a discount membership retailer, with stores in California since 1985. It has since merged with --- --- ---, and has become P--- C---. This is the first Board audit under this permit.

Petitioner's somewhat unique operations were based upon the concepts of: (1) offering low prices on a limited number of products, with rapid inventory turnover and a high sales volume; and (2) selling to a restricted clientele who constituted a better credit risk than the general public.

In September 1987, petitioner offered two types of memberships, business (\$25 per year) and individual (\$30 per year). Each member paid the posted price for each product with no discount or surcharge. Non-members could not make purchases.

In October 1987, petitioner began a very successful "90-day free pass" promotional program to obtain more members. At various times at certain stores, petitioner offered a "90-day free pass" to many selected individuals which allowed them 90 days to shop and purchase goods at a price which was five percent above the posted price. Petitioner decided when to offer this program and at which of its stores on a store-by-store basis, apparently based upon local competition. The use of this program was described by petitioner as occasional, periodic, and sporadic. Petitioner chose the potential members from various information which led it to believe those persons were better credit risks than the general public. This program did not operate all the time, but only on selected occasions, and was never offered at nine stores. The program was initiated by petitioner's mailing of a promotional brochure to the targeted people. Respondents who then came to a store had the choice of immediately becoming a regular member (which some did), or obtaining a free pass which was good for only 90 days. Once the 90-day time limit expired, the passholder had the choice of becoming a regular member or being excluded from the stores.

The Sales and Use Tax Department ("Department") imposed sales tax on petitioner measured by a taxable percentage of each regular membership fee which was paid at each particular California store during the time a "90-day free pass" promotional program was being offered at the particular store. The taxable percentage was the same as petitioner's reported taxable portion of its total gross receipts listed on its tax returns for each particular quarter. The

Department did not include in this deficiency any membership fees paid at a store during times when that store was not offering the "90-day free pass" program. The Department's position is that a portion of the membership fees paid to such stores was related to the anticipated retail sale of property during times when that store offered the "90-day free pass" because there was a two-tier membership with the regular members entitled to purchase goods at a lower price than the passholder.

Mr. V--- B--- indicated that the five percent "surcharge" above the posted price was a "penalty" in order to induce passholders to become regular members.

Analysis and Conclusions

For the privilege of selling tangible personal property at retail, sales tax is imposed upon a retailer measured by the gross receipts it generated from California retail sales of such property (see Revenue and Taxation Code sections 6051 and 6003). The phrase "gross receipts" is defined in section 6012(a) to mean "the total amount of the sale...price...of the retail sales of retailers, valued in money, whether received in money or otherwise...." A "sale" is defined to mean and include "[a]ny transfer of title or possession, exchange, or barter, conditional or otherwise, in any manner or by any means whatsoever, of tangible personal property for a consideration." (Rev. & Tax. C. § 6006(a).) As used in the Sales and Use Tax Law, "consideration" has been defined as an act or return promise, bargained for and given in exchange for a promise giving a benefit to the promisor or imposing a detriment on the promisee." (Peterson Tractor Co. v. State Board of Equalization (1962) 199 Cal.App.2d 662, 670). However, in order to constitute "gross receipts", the consideration provided to petitioner must have been received in exchange for the sale of the property and not for another reason (see Szabo Food Service, Inc. v. State Board of Equalization (1975) 46 Cal.App.3d 268, 272, 273).

No statute specifically mentions membership fees. The Board has not adopted any formal regulation on the subject of membership fees. The Board issued Annotation 295.1540 [10/3/86]:

"Membership fees related to anticipated retail sales are includible in the gross receipts of the seller when a person who pays the fee is entitled to purchase merchandise for a lower price than a person who does not pay the fee, or when the fee exceeds a nominal amount (more than \$30 per year).

A nominal membership fee (\$30 or less per year) which does not entitle a person who pays the fee to purchase merchandise for a lower price than others is to be regarded as a charge for processing the membership application or membership renewal and is not includible in the gross receipts of the seller."

It is our conclusion that the \$2,656,588 relevant portion of petitioner's total membership fees is subject to sales tax as consideration derived from the retail sale of tangible personal property. The Department has voluntarily limited the deficiency measure to exclude the remaining substantial membership fees at each store when petitioner merely offered only the regular annual membership which was good for sales at the posted price of each product. But when the \$2,656,588 was received, petitioner then had in place at each particular store where and when such amounts were derived, two programs under which two classes of people made purchases of the same products at two different prices. When a potential customer approached petitioner at a store which was then offering the 90-day free pass program, that person had a choice: (1) to pay an annual membership fee allowing him or her to purchase products at the posted price; or (2) to obtain for free a pass which allowed him or her for 90 days to purchase products at five percent above the posted prices. This difference in price paid by the members was legitimate in order to induce passholders or potential members to pay a membership fee to become a member, and forms the basis for the taxability of the \$2,656,588 portion of the fees.

Whether or not the "90-day free pass" is a "membership" is irrelevant. The relevance of the pass is that the passholders paid a higher price for the same products than the price paid by the regular members. As a result of the pass program, regular members paid a lower price for the same products. Whatever the five percent difference is unilaterally labelled by petitioner is irrelevant. The fact is that it was required to be paid by passholders to purchase property, but not by regular members.

Petitioner's "de minimus" argument is misplaced. A comparison of petitioner's total gross receipts derived from passholders to its total gross receipts derived from members is irrelevant. The Department did not include in the \$2,656,588 deficiency measure all membership fees paid by all members at all stores. The Department merely included in the \$2,656,588 a taxable portion of membership fees paid to petitioner at a store only during the time the 90-day free pass program was being offered at such store. Only during that time was there a two-tiered pricing structure which made the fees part of gross receipts derived from members for petitioner's retail sales of tangible personal property (Rev. & Tax. Code § 6012(a)). The relevant percentage of petitioner's income from passholders to its income from regular members at the participating stores during the pass program, would show a non-de minimus nature of the program.

We note that the Department needs to delete the \$44,853 measure for the MPRI (Monterey County Public Repair and Improvement Authority transit tax) since that tax is unconstitutional.

C--- W--- CORPORATION
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June 6, 1994
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Recommendation

Deny the petition and claim, but delete the MPRI.

Stephen A. Ryan, Senior Staff Counsel

Date