



STATE OF CALIFORNIA

STATE BOARD OF EQUALIZATION

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January 16, 2004

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Fourth District, Los Angeles

STEVE WESTLY
State Controller, Sacramento

TIMOTHY W. BOYER
Interim Executive Director

Dear Interested Party :

Enclosed are the Agenda, Issue Paper, and Revenue Estimate for the January 27, 2004 Business Taxes Committee meeting. This meeting will address the proposed amendments to Regulation 1584, *Membership Fees*.

Action 1 on the Agenda consists of items to which we believe there are no objections. If you wish to have any consent items (Action 1) discussed fully at the Committee meeting, you must contact a Board Member prior to Tuesday, January 27, 2004 to request removal of the item from the Consent Agenda. In addition, please notify Mr. Geoffrey E. Lyle, Supervisor, Business Taxes Committee and Training Section, after you contact a Board Member's Office. Mr. Lyle may be reached at (916) 322-0849.

If you are interested in other topics to be considered by the Business Taxes Committee, you may refer to the "Board Meetings and Committee Information" page on the Board's Internet web site (<http://www.boe.ca.gov/meetings/meetings.htm#two>) for copies of Committee discussion or issue papers, minutes, a procedures manual and calendars arranged according to subject matter and by month.

Thank you for your input on these issues and I look forward to seeing you at the Business Taxes Committee meeting at **9:30 a.m.** on **January 27, 2004** in Room 121 at the address shown above.

Sincerely,

Ramon J. Hirsig
Deputy Director
Sales and Use Tax Department

RJH: lk

Enclosures

cc: (all with enclosures)
Honorable Carole Migden, Chairwoman
Honorable Claude Parrish, Vice Chairman
Honorable Bill Leonard, Member, Second District (MIC 78)
Honorable John Chiang, Member, Fourth District
Honorable Steve Westly, State Controller, C/O Ms. Marcy Jo Mandel
Ms. Carole Ruwart, Board Member's Office, First District (MIC 71)
Ms. Sabina Crocette, Board Member's Office, First District
Mr. Neil Shah, Board Member's Office, Third District (via e-mail)
Mr. Romeo Vinzon, Board Member's Office, Third District (via e-mail)
Ms. Margaret Pennington, Board Member's Office, Second District (via e-mail)
Mr. Lee Williams, Board Member's Office, Second District (MIC 78 and via e-mail)
Mr. Tim Treichel, Board Member's Office, Second District (via e-mail)
Mr. Michael Thomas, Board Member's Office, Fourth District (MIC 72)
Ms. Sylvia Tang, Board Member's Office, Fourth District (MIC 72)
Mr. Timothy Boyer (MIC 73)
Acting Chief Counsel (MIC 83)
Ms. Janice Thurston (MIC 82)
Mr. Jeffrey Graybill (MIC 82)
Mr. Chris Schutz (MIC 82)
Ms. Jean Ogrod (via e-mail)
Mr. Jeff Vest (via e-mail)
Mr. David Levine (MIC 85)
Mr. Steve Ryan (via e-mail)
Mr. Rey Obligacion (via e-mail)
Mr. Todd Gilman (MIC 70)
Mr. Dan Tokutomi (via e-mail)
Mr. Dave Hayes (MIC 67)
Mr. Joseph Young (via e-mail)
Mr. Jerry Cornelius (via e-mail)
Mr. Jeffrey L. McGuire (MIC 92 and via e-mail)
Mr. Vic Anderson (MIC 40 and via e-mail)
Mr. Larry Bergkamp (via e-mail)
Mr. Geoffrey E. Lyle (MIC 50)
Ms. Lauren Simpson (MIC 50)
Ms. Leila Khabbaz (MIC 50)
Mr. Peter Horton (MIC 50)

AGENDA —January 27, 2004 Business Taxes Committee Meeting
Application of Tax to Membership Fees when the Entity Selling the Membership is not the Person Selling the Tangible Personal Property – Regulation 1584, Membership Fees

<p>Action 1 — Agreed Upon Items</p> <p>Regulation 1584(a)(2) Agenda, page 2.</p> <p>Regulation 1584(a)(3) and (a)(4) Agenda, page 2</p>	<p>Adopt proposed amendments to Regulation 1584 as recommended by staff to do the following:</p> <ul style="list-style-type: none"> ● Explain that when persons other than retailers make sales of memberships and the retailer’s sales meet the criteria established in subdivision (a)(1) of the regulation, the gross receipts from such membership sales should be included in the taxable measure of the retailer selling tangible personal property to members and not the person selling the membership. ● Make a minor correction and renumber subdivisions.
<p>Action 2 – Authorization to Publish</p>	<p>Recommend publication of amendments to Regulation 1584 as adopted in the above actions.</p> <p>Operative Date: None Implementation: 30 days following OAL approval</p>

AGENDA —January 27, 2004 Business Taxes Committee Meeting
Application of Tax to Membership Fees when the Entity Selling the Membership is not the Person Selling the Tangible Personal Property – Regulation 1584, Membership Fees

Action Item	Staff's Proposed Regulatory Language
<p>Action 1 — Agreed Upon Items</p>	<p>(a) APPLICATION OF TAX</p> <p>(1) IN GENERAL. Membership fees related to the anticipated retail sale of tangible personal property are includible in taxable gross receipts when either</p> <p style="padding-left: 40px;">(A) the retailer sells its products only to members and the membership fee exceeds a nominal amount,</p> <p style="padding-left: 80px;">or</p> <p style="padding-left: 40px;">(B) regardless of the amount of the membership fee, the retailer sells its products for a lower price to a person who has paid the membership fee than to a person who has not paid the fee.</p> <p><u>(2) The membership fees described in subdivision (a)(1)(A) or (a)(1)(B) are part of the gross receipts of the person selling tangible personal property to a member. It is immaterial that the person who sold the membership is not the person who sells the tangible personal property to a member. Any sale of a membership described in subdivision (a)(1)(A) or (a)(1)(B) is regarded as related to the retail sale by the retailer selling tangible personal property to a member, not by the person selling the membership, measured by the amounts received by the person selling the membership.</u></p> <p>(2)<u>(3)</u> INCIDENTAL SALES. Charges for memberships fees not related to anticipated retail transactions are not subject to tax. For example, when a country club or similar organization charges fees (dues) to members and provides substantial service benefits, e.g., the use of golfing, tennis and swimming facilities, the membership fees are not related to sales even though the organization may establish minimum meal and drink purchase requirements for its members.</p> <p>(3)<u>(4)</u> CONSUMER COOPERATIVES. Initial or periodic membership fees received by consumer cooperatives, as defined in sections 6011.1 and 6012.1 of the Revenue and Taxation Code, are not subject to tax.</p>

H:\acrobat\test\1584 ip Agenda.doc **AGENDA — January 27, 2004 Business Taxes Committee Meeting**

Application of Tax to Membership Fees when the Entity Selling the Membership is not the Person Selling the Tangible Personal Property – Regulation 1584, Membership Fees

Action Item	Staff's Proposed Regulatory Language
	<p>(b) NOMINAL AMOUNT.</p> <p>(1) For purposes of this regulation, beginning January 1, 2001, the term “nominal amount” means an amount totaling \$45 or less per year subject to increase as provided in subdivision (b)(2). For periods prior to January 1, 2001, the term “nominal amount” for purposes of this regulation meant an amount totaling \$40 or less per year. Amounts received for memberships which are in conjunction with a basic membership (add-ons) are not considered a part of the basic membership fee in determining the nominal amount of the basic membership. Additional cards issued under the same membership number are sales of separate memberships.</p> <p>(2) During September in the year 2000, and every five years thereafter, the threshold for the nominal amount will be adjusted effective the following January 1, rounded to the nearest \$5, to reflect changes in the California Consumer Price Index (CCPI) whenever that change is more than 5 percent higher than any previous adjustment. For purposes of computing the CCPI increase, the June 30 CCPI index of the computation year will be compared with the June 30 CCPI index of the computation year which resulted in an adjusted nominal amount. For example, for the January 1, 2006 adjustment computation, the CCPI index on June 30, 2005, will be compared with the CCPI index on June 30, 2000. If no adjustment is made at that time, the next comparison will be of the CCPI index on June 30, 2010 with the CCPI index on June 30, 2000.</p> <p>(c) OPERATIVE DATE.</p> <p>The provisions of this regulation are operative January 1, 1996.</p>

Issue Paper Number **03 - 018**



- Board Meeting
- Business Taxes Committee
- Customer Services and Administrative Efficiency Committee
- Legislative Committee
- Property Tax Committee
- Other

Application of Tax to Membership Fees when the Person Selling the Membership is not the Person Selling the Tangible Personal Property Regulation 1584, Membership Fees

I. Issue

Should Regulation 1584, *Membership Fees*, be amended to address the application of tax to sales of memberships, when the person who sells the membership is not the same person selling tangible personal property at the membership store?

II. Staff Recommendation

Staff recommends:

Adding new subdivision (a)(2) to explain that when persons other than retailers make sales of memberships and the retailer's sales meet the criteria established under subdivisions (a)(1)(A) or (a)(1)(B) of Regulation 1584, the gross receipts from such membership sales should be included in the taxable measure of the retailer selling tangible personal property to members and not the person selling the membership.

Renumbering former subdivisions (a)(2) and (a)(3) as (a)(3) and (a)(4) respectively and making a minor correction.

A copy of staff's recommended amendments to Regulation 1584 is illustrated in Exhibit 2. See Issue Paper (IP) pages 2-4, and agenda action item 1 for additional information. The proposed amendments are scheduled for discussion at the January 27, 2004 meeting of the Business Taxes Committee.

III. Other Alternative Considered

Do not amend Regulation 1584, *Membership Fees*. See IP page 5.

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IV. Background

At its July 9, 2003 meeting, the Board heard an appeal involving the application of tax to charges for memberships that entitled members to purchase tangible personal property at warehouse retail stores and on the Internet. Staff argued that since a membership allowed a person to purchase products from the Internet site for a lower price than a person who had not paid the membership fee, the fees were subject to tax under Regulation 1584. During the hearing, the taxpayer argued that the fees were not subject to tax under Regulation 1584, since the person selling the membership was a separate legal entity from the person selling the tangible personal property, and the entity selling the membership sold no tangible personal property. As a result of this hearing, the Board directed staff to review this issue and, to the extent a problem is identified, revise the regulation as needed.

Revenue and Taxation Code (RTC) section 6012 defines gross receipts as the total amount of the sale price of the retail sales of retailers, without any deduction on account of the cost of materials, labor cost, service cost, losses or any other expense. The Board adopted Regulation 1584 in 1996 to interpret gross receipts as they apply to membership fees. The regulation provides in part that membership fees related to the anticipated retail sale of tangible personal property are included in taxable gross receipts when either:

- (A) the retailer sells its products only to members and the membership fee exceeds a nominal amount, or
- (B) regardless of the amount of the membership fee, the retailer sells its products for a lower price to a person who has paid the membership fee than to a person who has not paid the fee.

The regulation further provides that charges for memberships not related to anticipated retail transactions are not subject to tax; for example, a country club fee entitling members to substantial service benefits.

Interested parties meetings were held on September 16 and November 20, 2003 to discuss the proposed amendments. No written submissions were received after the meetings. This topic is scheduled for discussion at the January 27, 2004 meeting of the Business Taxes Committee.

V. Staff Recommendation

A. Description of the Staff Recommendation

Staff recommends adding new subdivision (a)(2) to Regulation 1584 to explain that when sales of memberships are related to the anticipated sale of tangible personal property and taxable under subdivisions (a)(1)(A) or (a)(1)(B), it is immaterial that the person who sold the membership is not the person who sells the tangible personal property to a member. The gross receipts from such sales of memberships should be included in the taxable measure of the retailer selling tangible personal property to the member.

Staff's position has been that when charges for memberships are taxable under Regulation 1584, they remain subject to tax regardless of the party to whom the fees were paid. There is no express language in the regulation that makes the taxability of the membership fees contingent on the memberships being sold by the same entity that makes the related retail sales of tangible personal property. When persons

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must pay a membership fee exceeding a nominal amount in order to purchase tangible personal property from a retailer or must pay a membership fee to buy tangible personal property from a retailer for a lower price than that paid by nonmembers, that payment of the membership fee is related to the anticipated sale of tangible personal property and subject to tax, regardless of to whom it is paid. Generally, membership fees related to anticipated retail sales of tangible personal property at the retailer's outlet stores or on the Internet are charged by the retailer selling the products. Subsequent to the adoption of the regulation in 1996, at least one entity has restructured its businesses such that the memberships are sold by a separate entity that is affiliated with the retailer of the tangible personal property. The customer must pay the membership fee to obtain the tangible personal property and the membership fee paid to obtain the tangible personal property is subject to tax. This restructuring has raised questions regarding a purported interpretation of Regulation 1584, namely that the entity selling the membership is selling intangible rights of membership and that such sales are not subject to tax, even though tangible personal property is being sold at lower prices to members than to non-members. The taxpayer who was the subject of the hearing that triggered this issue no longer sells memberships the gross receipts from which are taxable, and staff is currently unaware of other businesses structured in a manner such that the retailer of tangible personal property sells its memberships through a separate entity. Nonetheless, to the extent there is potential ambiguity in interpreting the regulation, staff drafted proposed regulatory language to clarify the issue.

Furthermore, staff's proposed amendments explain that when sales of the memberships are taxable and the memberships are sold by an entity other than the retailer of the tangible personal property, the gross receipts from the sale of the memberships are part of the consideration for the retailer's sale of tangible personal property, and should be included in the taxable measure of the entity selling tangible personal property. This approach will ensure that the tax on sales of memberships is reported and paid in California when a retailer uses a separate entity to sell its memberships, whether or not such sales are made by an entity engaged in business in this state. A California retailer selling tangible personal property to members receives the benefit of the membership sales by having members buy tangible personal property at its facilities even if the membership is sold outside the state by an entity not engaged in business in California. By clarifying that the retailer selling tangible personal property to members is responsible to report and pay tax on the gross receipts from the sales of memberships and not the person selling the membership, the potential for retailers seeking to avoid tax on the sale of taxable memberships through the use of out-of-state entities is eliminated.

While staff received no written comments following the interested parties meetings in September and November, two interested parties made verbal comments regarding the proposed regulatory language. A taxpayer's representative, who did not object to the idea of amending the regulation for clarity and who did not believe his client will encounter the scenario described in the proposed amendments, disagreed with the wording used in the proposed amendments. He believes the proposed language is too broad and does not recognize the relationship between the separate legal entities when one sells the membership and the other sells the tangible personal property. The interested party believes it is more appropriate to use language with a reference to Internal Revenue Code sections to specify that sales of memberships are taxable when the entity selling the membership and the one selling the tangible personal property are affiliated and are required to file a consolidated return. In response, staff indicated that the concern expressed by the interested party assumes that the proposed amendments are limited to related entities. Staff's purpose is to preclude tax avoidance by addressing broader fact patterns that could develop as a result of the ever-increasing creativity and sophistication in cross-branding and marketing campaigns.

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Another interested party representing an accounting firm indicated she had no problems with the proposed language covering unrelated entities. However, she suggested that staff consider revising the proposed language to clarify how the amendments would affect fundraising programs involving sales of “discount” cards. She indicated that nonprofit fundraising clubs are moving away from selling coupon books to selling plastic cards with magnetic strips (some referred to as “membership cards”) entitling the bearer to receive discounts for products and services at a number of businesses. Her concern is that the proposed regulatory language could be interpreted to require a retailer who participates in the program to report the tax on the fee or a portion of the fee charged by the fundraising club for the discount card. Generally, staff views these types of fundraising transactions as sales of coupons entitling the bearer to discounts for various services and products and are generally not governed by Regulation 1584. They are addressed in a number of annotations¹ that cover discount and rebate programs.

B. Pros of the Staff Recommendation

- Avoids confusion regarding the application of tax when a membership is sold by a person other than the retailer selling tangible personal property to members.
- Satisfies the Board’s directive to staff to review the regulation and, to the extent a problem is identified, make a recommendation to amend the regulation to clarify and explain the application of tax to membership fees.

C. Cons of the Staff Recommendation

- Requires regulatory amendment.

D. Statutory or Regulatory Change

No statutory change is required. However, staff’s recommendation does require an amendment to Regulation 1584.

E. Administrative Impact

Staff will be required to notify taxpayers of the amendments to the regulation through an article in the Tax Information Bulletin (TIB), and to update and distribute the amended regulation.

F. Fiscal Impact

1. Cost Impact

There will be no additional costs. Staff will notify taxpayers of the new regulation through a Tax Information Bulletin (TIB) article and by updating and distributing the amended regulation to interested parties. The workload associated with publishing and distributing the TIB and the amended regulation is considered routine and any corresponding cost would be within the Board’s existing budget.

2. Revenue Impact

None. The proposed amendments clarify and explain existing policy. See Revenue Estimate (Exhibit 1).

¹ See Annotations 540.0175 and 540.0180.

Annotations published in the Business Taxes Law Guides are summaries of the conclusions reached in selected legal rulings of counsel. “Legal ruling of counsel” means a legal opinion written and signed by the Chief Counsel or an attorney who is the Chief Counsel’s designee, addressing a specific tax application inquiry from a taxpayer or taxpayer representative, a local government, or Board of Equalization staff.

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G. Taxpayer/Customer Impact

Clarifies the application of tax when a membership is sold by a person other than the retailer selling tangible personal property to members.

H. Critical Time Frames

The proposed amendments represent an interpretation of existing statutes and, therefore, have no operative date. Implementation will take place 30 days following approval of the regulation by the State Office of Administrative Law.

VI. Alternative 1

A. Description of the Alternative

Do not amend Regulation 1584, *Membership Fees*.

B. Pros of the Alternative

No regulatory change is required.

C. Cons of the Alternative

Does not address current interpretation of the application of tax when a membership is sold by a person other than the retailer selling tangible personal property to members.

D. Statutory or Regulatory Change

None.

E. Administrative Impact

None.

F. Fiscal Impact

1. Cost Impact

None.

2. Revenue Impact

None. See Revenue Estimate (Exhibit 1).

G. Taxpayer/Customer Impact

Could mislead taxpayers into believing that tax does not apply to sales of a retailer's memberships when these are sold by a person other than the retailer, or that the retailer is not responsible for the tax on such sales.

H. Critical Time Frames

None.

Prepared by: Tax Policy Division, Sales and Use Tax Department

Current as of: January 9, 2004

REVENUE ESTIMATE

STATE OF CALIFORNIA
BOARD OF EQUALIZATION



**APPLICATION OF TAX TO MEMBERSHIP FEES
WHEN THE PERSON SELLING THE MEMBERSHIP
IS NOT THE PERSON SELLING THE TANGIBLE
PERSONAL PROPERTY
REGULATION 1584, MEMBERSHIP FEES**

Staff Recommendation

Add new subdivision (a)(2) to explain that when persons other than retailers make sales of memberships and the retailer's sales meet the criteria established under subdivisions (a)(1)(A) or (a)(1)(B) of Regulation 1584, the gross receipts from such membership sales should be included in the taxable measure of the retailer selling tangible personal property to members and not the person selling the membership.

Renumber former subdivisions (a)(2) and (a)(3) as (a)(3) and (a)(4) respectively and make a minor correction.

Other Alternative(s) Considered

Do not amend Regulation 1584, *Membership Fees*.

Background, Methodology, and Assumptions

Staff Recommendation:

There is nothing in the proposed change to Regulation 1584 that would impact revenues because the proposal clarifies in the regulation the Board's current policy that the retailer of the tangible personal property sold to members is responsible to report and pay tax on the gross receipts from the sale of memberships fees.

Revenue Estimate

Alternative 1

Alternative 1 will not impact revenues. Staff would continue to include the sale of membership fees as taxable gross receipts.

Revenue Summary

The staff recommendation has no revenue effect because the regulation clarifies current treatment of membership fees.

Alternative 1 will not impact revenues.

Preparation

Bill Benson, Jr., Research and Statistics Section, Legislative Division, prepared this revenue estimate. Mr. Dave Hayes, Manager, Research and Statistics Section, Legislative Division, and Mr. Jeff McGuire, Tax Policy Division, Sales and Use Tax Department, reviewed this revenue estimate. For additional information, please contact Mr. Benson at (916) 445-0840.

Current as of December 22, 2003

Regulation 1584. MEMBERSHIP FEES.**(a) APPLICATION OF TAX**

(1) IN GENERAL. Membership fees related to the anticipated retail sale of tangible personal property are includible in taxable gross receipts when either

(A) the retailer sells its products only to members and the membership fee exceeds a nominal amount,

or

(B) regardless of the amount of the membership fee, the retailer sells its products for a lower price to a person who has paid the membership fee than to a person who has not paid the fee.

(2) The membership fees described in subdivision (a)(1)(A) or (a)(1)(B) are part of the gross receipts of the person selling tangible personal property to a member. It is immaterial that the person who sold the membership is not the person who sells the tangible personal property to a member. Any sale of a membership described in subdivision (a)(1)(A) or (a)(1)(B) is regarded as related to the retail sale by the retailer selling tangible personal property to a member, not by the person selling the membership, measured by the amounts received by the person selling the membership.

~~(2)~~(3) INCIDENTAL SALES. Charges for memberships fees not related to anticipated retail transactions are not subject to tax. For example, when a country club or similar organization charges fees (dues) to members and provides substantial service benefits, e.g., the use of golfing, tennis and swimming facilities, the membership fees are not related to sales even though the organization may establish minimum meal and drink purchase requirements for its members.

~~(3)~~(4) CONSUMER COOPERATIVES. Initial or periodic membership fees received by consumer cooperatives, as defined in sections 6011.1 and 6012.1 of the Revenue and Taxation Code, are not subject to tax.

(b) NOMINAL AMOUNT.

(1) For purposes of this regulation, beginning January 1, 2001, the term "nominal amount" means an amount totaling \$45 or less per year subject to increase as provided in subdivision (b)(2). For periods prior to January 1, 2001, the term "nominal amount" for purposes of this regulation meant an amount totaling \$40 or less per year. Amounts received for memberships which are in conjunction with a basic membership (add-ons) are not considered a part of the basic membership fee in determining the nominal amount of the basic membership. Additional cards issued under the same membership number are sales of separate memberships.

(2) During September in the year 2000, and every five years thereafter, the threshold for the nominal amount will be adjusted effective the following January 1, rounded to the nearest \$5, to reflect changes in the California Consumer Price Index (CCPI) whenever that change is more than 5 percent higher than any previous adjustment. For purposes of computing the CCPI increase, the June 30 CCPI index of the computation year will be compared with the June 30 CCPI index of the computation year which resulted in an adjusted nominal amount. For example, for the January 1, 2006 adjustment computation, the CCPI index on June 30, 2005, will be compared with the CCPI index on June 30, 2000. If no adjustment is made at that time, the next comparison will be of the CCPI index on June 30, 2010 with the CCPI index on June 30, 2000.

(c) OPERATIVE DATE.

The provisions of this regulation are operative January 1, 1996.