CALIFORNIA STATE BOARD OF EQUALIZATION

APPEALS DIVISION BOARD HEARING SUMMARY

In the Matter of the Administrative Protest Under the Sales and Use Tax Law of: POINT OF CONTACT, INC. Taxpayer	Account Number SR CH 52-038418 Case ID 494400 Hayward, Alameda County

Type of Business: Sales of merchandise to members only

Liability period: 11/01/08 – 03/31/09

Item	Disputed Amount
Unreported taxable sales	$26,565

	Tax	Penalty
As determined	$19,593.75	$1,959.38
Finality penalty		1,959.38
Post-D&R adjustment	- 17,402.12	-3,918.76
Adjusted determination, protested	$ 2,191.63	$ 0.00
Adjusted tax	$2,191.63	
Interest through 09/30/12	539.78	
Total tax and interest	$2,731.41	
Monthly interest beginning 10/01/12	$ 10.96	

This matter was scheduled for Board hearing in June 2012, but was postponed at taxpayer's request because of medical issues and to allow additional time to prepare for the hearing.

UNRESOLVED ISSUES

Issue 1: Whether taxpayer is a qualified charitable organization entitled to exemption from tax on its gross receipts from retail sales of tangible personal property. We find it is not.

Taxpayer, an IRC section 501(c)(3) non-profit organization, provided various services to its local community. The activity at issue here is a storehouse shopping program which was open only to paid members and member churches. Taxpayer had two large warehouses stocked with various types of merchandise, such as clothing, household items, personal care items, furniture, appliances, and school and office supplies, which, according to taxpayer, had been donated by various non-profit groups, churches, and retail stores. Taxpayer offered memberships only to individuals, families, or faith-based or community-based organizations or churches that were in financial need. In order to participate, individuals or families were required to establish that they were on a fixed income, were on some type of county, state, or federal low-income program, or came within the current year's federal poverty guidelines. Each participant paid membership fees of $25 or more per month and received shopping points in exchange, which could be used to purchase items in the storehouse, at deeply discounted prices. For example, a $25 fee entitled the participant to 200 shopping points (equivalent to $200.00). Only points were used in transactions at the storehouse; no cash was accepted from members in exchange for goods.

The Sales and Use Tax Department (Department) found that taxpayer was selling tangible personal property at retail. Taxpayer contends that its retail sales of tangible personal property are exempt from sales tax because it is an organization with section 501(c)(3) status. Taxpayer's assertion is incorrect: there is no automatic or general exemption in the law for sales to, or sales by, a charitable organization. However, Revenue and Taxation Code section 6375 provides an exemption from sales and use tax on the sale and use of "tangible personal property made, prepared, assembled, or manufactured by organizations formed and operated for charitable purposes qualifying for the exemption provided by Section 214 known as the 'welfare exemption,' which are engaged in the relief of poverty and distress, and make the sales and donations as a matter of assistance to the purchasers and donees." Since taxpayer has not established that it qualifies for the welfare exemption, we conclude that it does not qualify for the section 6375 exemption from sales tax on its retail sales.

Issue 2: Whether adjustments are warranted to the amount of unreported taxable sales. We find no further adjustment is warranted.

The Department established three separate audit items, unreported taxable sales of goods other than office furniture, unreported taxable sales of office furniture, and unreported taxable membership fees. The Department estimated the amounts of each audit item, using average selling prices, as observed in the Department's visit to the warehouse, and an estimated number of sales of certain items per month. We conclude that the consideration paid by the purchasers was the membership fees since the points received by the purchasers for paying those fees, which points were used to purchase the goods, were not additional consideration for the purchases. Since the only consideration paid by the purchasers for the purchases was the membership fees, those membership fees comprise the taxable measure. However, taxpayer has provided minimal, incomplete information regarding the amount of membership fees received, and the Department's estimate of membership fees used in its audit was not based on reliable information. The D&R therefore recommended that the Department perform a reaudit to recalculate taxpayer's gross receipts based on the Department's observation of the types of items sold, the volume sold, and the average price listed for the types of items sold. In the reaudit, the Department computed that the amount of membership fees (represented by points purchased) used to pay for purchases other than office furniture was $21,875 and the amount of membership fees used to pay for purchases of office furniture was $31,250. Accordingly, the total amount of unreported taxable measure was decreased in the reaudit by $184,375, from $237,500 to $53,125.

In preparation for the Board hearing, the Department concluded that the correct adjustment should have been based on the 8:1 ratio noted in the D&R for the basic membership level (e.g., $25 paid for 200 points). Applying this ratio, the Department computed that the amount of membership fees (represented by the points purchased) used to pay for purchases other than office furniture was $10,940 and the amount of membership fees used to pay for purchases of office furniture was $15,625. Accordingly, the total amount of unreported taxable measure was further decreased by $26,560, from $53,125 to $26,565.

Our understanding is that the reaudit performed after the D&R used a 4:1 ratio, which is the ratio applicable to certain additional purchases *beyond* the basic membership level ($25 to purchase 100 additional points or $75 to purchase 300 additional points, with a ratio of 5.71:1 applicable to the highest level of additional points, $175 to purchase 1000 additional points). Since *all* purchasers started with an 8:1 ratio and only *additional* purchases were at a ratio as low as 4:1, the overall ratio was never as low as 4:1, which means that the 4:1 ratio apparently used by the Department in the original reaudit was too low. However, by the same token, the 8:1 ratio was only applicable with respect to purchasers who did not purchase any additional points. Since the ratio for purchases of additional points was less than 8:1 and some purchasers did purchase additional points, the overall ratio for the business was less than 8:1. Since the Department has now used a ratio of 8:1, to petitioner's benefit, we conclude that there is no basis for any further adjustment in petitioner's favor.

RESOLVED ISSUES

Since taxpayer did not file sales and use tax returns for the entire liability period and did not timely pay the determination or file a petition for redetermination, a failure to file penalty and a finality penalty were applied. Taxpayer filed requests for relief of both penalties, stating in each request that it did not believe that sales from its nonprofit membership program were subject to tax because it was a qualified nonprofit organization. We accept that taxpayer had a good faith belief that its sales were not taxable, and thus recommend that the failure-to-file penalty be relieved. In its request for relief of the finality penalty ($219.16 after all adjustments), taxpayer asserts that it timely faxed a petition for redetermination to the Department. Although taxpayer did not establish that it timely mailed the appeal, we note that it did file an appeal five days after the due date, and we give taxpayer the benefit of doubt that it thought it timely petitioned the determination. On this basis, we recommend that the finality penalty be relieved, provided that taxpayer pays the tax due within 30 days of the mailing of the notice of final decision in this appeal.

OTHER MATTERS

None.

Summary prepared by Deborah A. Cumins, Business Taxes Specialist III