

1 CALIFORNIA STATE BOARD OF EQUALIZATION

2 APPEALS DIVISION BOARD HEARING SUMMARY

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

8 Type of Business: Sales of merchandise to members only

9 Liability period: 11/01/08 – 03/31/09

10 Item Disputed Amount

11 Unreported taxable sales \$26,565

| | <u>Tax</u> | <u>Penalty</u> |
|--------------------------------------|--------------------|------------------|
| 12 | | |
| 13 As determined | \$19,593.75 | \$1,959.38 |
| 14 Finality penalty | | 1,959.38 |
| 14 Post-D&R adjustment | <u>- 17,402.12</u> | <u>-3,918.76</u> |
| 15 Adjusted determination, protested | <u>\$ 2,191.63</u> | <u>\$ 0.00</u> |
| 16 Adjusted tax | \$2,191.63 | |
| 16 Interest through 12/31/12 | <u>572.66</u> | |
| 17 Total tax and interest | <u>\$2,764.29</u> | |

18 Monthly interest beginning 01/01/13 \$ 10.96

19 This matter was scheduled for Board hearing in June 2012, but was postponed at taxpayer's
 20 request because of medical issues and to allow additional time to prepare for the hearing. It was
 21 rescheduled for hearing in September 2012 but was postponed at petitioner's request to allow
 22 additional time to review the Department's recent adjustments.

23 **UNRESOLVED ISSUES**

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

26 Taxpayer, an IRC section 501(c)(3) non-profit organization, provided various services to its
 27 local community. The activity at issue here is a storehouse shopping program which was open only to
 28 paid members and member churches. Taxpayer had two large warehouses stocked with various types

1 of merchandise, such as clothing, household items, personal care items, furniture, appliances, and
2 school and office supplies, which, according to taxpayer, had been donated by various non-profit
3 groups, churches, and retail stores. Taxpayer offered memberships only to individuals, families, or
4 faith-based or community-based organizations or churches that were in financial need. In order to
5 participate, individuals or families were required to establish that they were on a fixed income, were on
6 some type of county, state, or federal low-income program, or came within the current year's federal
7 poverty guidelines. Each participant paid membership fees of \$25 or more per month and received
8 shopping points in exchange, which could be used to purchase items in the storehouse, at deeply
9 discounted prices. For example, a \$25 fee entitled the participant to 200 shopping points (equivalent to
10 \$200.00). Only points were used in transactions at the storehouse; no cash was accepted from
11 members in exchange for goods.

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

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

25 The Department established three separate audit items, unreported taxable sales of goods other
26 than office furniture, unreported taxable sales of office furniture, and unreported taxable membership
27 fees. The Department estimated the amounts of each audit item, using average selling prices, as
28 observed in the Department's visit to the warehouse, and an estimated number of sales of certain items

1 per month. We conclude that the consideration paid by the purchasers was the membership fees since
2 the points received by the purchasers for paying those fees, which points were used to purchase the
3 goods, were not additional consideration for the purchases. Since the only consideration paid by the
4 purchasers for the purchases was the membership fees, those membership fees comprise the taxable
5 measure. However, taxpayer has provided minimal, incomplete information regarding the amount of
6 membership fees received, and the Department's estimate of membership fees used in its audit was not
7 based on reliable information. The D&R therefore recommended that the Department perform a
8 reaudit to recalculate taxpayer's gross receipts based on the Department's observation of the types of
9 items sold, the volume sold, and the average price listed for the types of items sold. In the reaudit, the
10 Department computed that the amount of membership fees (represented by points purchased) used to
11 pay for purchases other than office furniture was \$21,875 and the amount of membership fees used to
12 pay for purchases of office furniture was \$31,250. Accordingly, the total amount of unreported taxable
13 measure was decreased in the reaudit by \$184,375, from \$237,500 to \$53,125.

14 In preparation for the Board hearing scheduled for September 2012, the Department concluded
15 that the correct adjustment should have been based on the 8:1 ratio noted in the D&R for the basic
16 membership level (e.g., \$25 paid for 200 points). Applying this ratio, the Department computed that
17 the amount of membership fees (represented by the points purchased) used to pay for purchases other
18 than office furniture was \$10,940 and the amount of membership fees used to pay for purchases of
19 office furniture was \$15,625. Accordingly, the total amount of unreported taxable measure was further
20 decreased by \$26,560, from \$53,125 to \$26,565.

21 Our understanding is that the reaudit performed after the D&R used a 4:1 ratio, which is the
22 ratio applicable to certain additional purchases *beyond* the basic membership level (\$25 to purchase
23 100 additional points or \$75 to purchase 300 additional points, with a ratio of 5.71:1 applicable to the
24 highest level of additional points, \$175 to purchase 1000 additional points). Since *all* purchasers
25 started with an 8:1 ratio and only *additional* purchases were at a ratio as low as 4:1, the overall ratio
26 was never as low as 4:1, which means that the 4:1 ratio apparently used by the Department in the
27 original reaudit was too low. However, by the same token, the 8:1 ratio was only applicable with
28 respect to purchasers who did not purchase any additional points. Since the ratio for purchases of

1 additional points was less than 8:1 and some purchasers did purchase additional points, the overall
2 ratio for the business was less than 8:1. Since the Department has now used a ratio of 8:1, to
3 petitioner's benefit, we conclude that there is no basis for any further adjustment in petitioner's favor.

4 **RESOLVED ISSUES**

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

17 **OTHER MATTERS**

18 None.

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