

PRIVATE TAXPAYER RULING LR02-001

January 18, 2002

The following private taxpayer ruling is in response to your request of July 17, 2001 and the receipt of subsequent information on September 19, 2001. Your letter requests a determination regarding the application of transaction privilege and/or use tax to the sale of Club memberships and the incidental property transferred therewith, by

The following is a restatement of the facts presented in your letter.

Statement of Facts:

. . . sells several lines of figurine collectibles, most notably, . . . figurines. . . has formed collectors' Clubs for three of its product lines.

A prospective Club member generally picks up a membership application at a local retail shop and mails it in, with his or her remittance, to . . . in The company also mails applications to potential Club members from lists that are either developed internally or purchased. The individual may purchase a one or two year membership, payable in advance.

Membership confers a number of benefits. Club members become eligible to purchase exclusive members-only figurines. They receive a quarterly newsletter, and they are invited to attend special shows, to attend member only events at collectors' conventions, and to go on collectors' cruises. The conventions feature seminars on crafts, interactive games, cross-stitching sessions, a paint your own collectible session, a seminar on new products, dinners and a dance. The offerings at particular vary from time to time.

When an individual purchases a membership, he or she receives a "Club Kit". If a two year membership is purchased, a second Club Kit is sent on the first day of the following Club year. The Club Kit generally includes a "symbol of membership" figurine (which is smaller and considerably less expensive to produce than the figurines sold in retail stores), decorative packaging and other ancillary items. The figurines and kits are manufactured and assembled in the

A considerable amount of research has been conducted by and for collectors' Clubs over the years to determine why persons become members of the Clubs. In a recent survey conducted by an independent research firm that included a survey of . . . collectors, the most common reason for joining the Club was the opportunity to purchase members-only collectibles. Although 74% of members responded that they joined the Club in order to be eligible to purchase members-only pieces, only 20-40% of members actually make such purchases. The

low purchase rate is attributable to several factors. A collector is not obligated to purchase the members-only pieces and therefore only purchases one that the collector truly likes. Moreover, the members-only pieces must be obtained by taking a specially provided form to a retail store and having the retail store order the piece. It is therefore not particularly easy or convenient for a member to actually make the members only purchases. Despite the relatively low purchase, it is believed by the marketing professionals for collectors' Clubs that the status of being permitted to buy the members-only pieces, rather than the actual purchase of those pieces, motivates most members to join the Clubs.

At the same time, the surveys make clear that obtaining the Club Kits, including the free membership piece, are not a primary motivator of the collectors. With the ability to identify multiple reasons for joining the Club, only about half of the members indicated that a motivating factor was to obtain the free membership piece.

The cost of the free membership pieces is approximately 25% of the total cost of the Club Kits. The other costs consist of the decorative box, a few ancillary items such as pens and paper, and various forms that are sent to the collectors.

Your Position:

1. The "true object" of . . . 's sale of Club memberships is the sale of an intangible and/or a service rather than the sale of tangible personal property; therefore, . . . 's membership fee is not subject to sales or use tax, and . . . is deemed to be the consumer of the Club Kits.
2. . . . is not subject to use tax on its cost of the Club Kits shipped to Arizona Club members by common carrier from outside Arizona.
3. If . . . is subject to use tax on its cost of Club Kits shipped to Arizona Club members by common carrier from outside Arizona, then . . . is entitled to a credit for tax properly paid to the state in which the Club Kits were manufactured, purchased or shipped.

Applicable Statutory Authority:

Arizona Revised Statutes (A.R.S.) § 42-5061 imposes the transaction privilege tax on the business of selling tangible personal property at retail.

A.R.S. § 42-5061(V)(3) defines "selling at retail" as a sale for any purpose other than for resale in the regular course of business. All sales of tangible personal property are subject to tax unless specifically exempted by statute. The tax base for the retail classification is the gross proceeds of sales or gross income derived from the business.

A.R.S. § 42-5155(A) imposes Arizona's use tax on purchases of tangible personal property from out-of-state retailers that are used, stored, or consumed in Arizona.

A.R.S. § 42-5161 states that under Arizona's use tax, a retailer is responsible for collecting the use tax on behalf of the state.

Discussion and Analysis:

Arizona's *transaction privilege tax* is a tax on the privilege of conducting business in the State of Arizona. It is a tax on the seller, not on the purchaser. The seller may pass the burden of the tax on to the purchaser; however, the seller is ultimately liable to Arizona for the tax. The Arizona transaction privilege tax is imposed under 17 separate business classifications, including *retail* sales of tangible personal property. Additionally, county excise taxes "piggyback" the imposition of the state's transaction privilege tax. All sales that are subject to the transaction privilege tax are also subject to applicable county excise taxes.

If a company does not have an Arizona business presence or nexus for transaction privilege tax purposes, Arizona's *use tax* applies. The use tax usually applies to purchases from an out-of-state retailer or job printer. A.R.S. § 42-5155(A) imposes Arizona's use tax on purchases of tangible personal property from out-of-state retailers that are used, stored, or consumed in Arizona. Under A.R.S. § 42-5161, a retailer is responsible for collecting the use tax on behalf of the state. Finally, A.R.S. § 42-5159 provides specific exemptions from the use tax for certain purchases of tangible personal property.

The department does not issue rulings which determine nexus issues. See Arizona General Tax Procedure GTP 01-3 at page 7. Attached to this ruling is a nexus questionnaire that can be used to request that the Transaction Privilege Tax and Use Tax Function determine whether . . . has sufficient nexus to be liable for transaction privilege tax or have a use tax collection responsibility.

Treatment of the Club Kits under Arizona's Transaction Privilege Tax

It is your position that the "true object" of . . .'s sale of Club memberships is the sale of an intangible and/or a service rather than the sale of tangible personal property; therefore, . . .'s membership fee is not subject to transaction privilege or use tax, and . . . is deemed to be the consumer of the Club Kits.

A similar transaction was addressed in Walden Books Company v. Arizona Department of Revenue, 12 P.3d 809. In this case, Waldenbooks, a retail business that sells books, periodicals, and related merchandise throughout the United States, offered a Preferred Reader

Program to customers. In return for a ten dollar annual fee, Program members received an informational brochure with sales promotion information, interviews with authors, and previews of upcoming titles, check writing privileges, telephonic book ordering services using a toll-free number, sale merchandise offers available to members only, a ten percent discount at all Waldenbooks stores on purchases of books and certain other merchandise and an additional purchase discount of five dollars for every one hundred dollars spent. Program members received a card containing a membership number, an expiration date, and a bar code for electronic scanning.

The Walden court, in deciding that the Preferred Reader Program was not a service in addition to selling tangible personal property at retail and thus the fee was taxable under Arizona's transaction privilege tax, looked at the purpose to which the Program was instituted. The court found that since the Program was "designed to encourage Program members to buy more merchandise" that it was not a service in addition to selling tangible personal property at retail. The court took into account the fact that Waldenbooks admitted that the Program was aimed at encouraging its members to purchase its merchandise. The court concluded "such incentives cannot rationally be characterized as separate and apart from the sale of tangible personal property at retail. Services intended to induce customers to buy more goods are not provided in addition to selling goods; they are a part of the sales of those goods, and are included in retail gross income."

The Walden case is very similar to your Club memberships. You state in your letter dated July 17, 2001 that "membership confers a number of benefits," including the ability to purchase "exclusive members-only figurines" and "invitations to attend special shows, to attend members' only events at collectors' conventions and to go on collectors' cruises." These activities allow for special opportunities to purchase items sold by . . . and provide special marketing opportunities for the sale of . . .'s products. These activities, in the words of the Walden court are "designed to encourage Program members to buy more merchandise" and thus "such incentives cannot rationally be characterized as separate and apart from the sale of tangible personal property at retail." Therefore, the fees charged for the Club memberships are a part of the sale of

those goods and are included in gross income. If there is sufficient nexus, the fees are subject to tax under the retail classification of Arizona's transaction privilege tax.

Treatment of the Club Kits under Arizona's Use Tax

If a company does not have a sufficient nexus for transaction privilege tax purposes, Arizona's use tax applies. A.R.S. § 42-5155(A) imposes Arizona's use tax on purchases of tangible personal property from out-of-state retailers that are used, stored, or consumed in Arizona.

Purchases under Arizona's use tax include items purchased for a particular purchase price.

Purchase price under A.R.S. § 42-5151(14) is defined as:

The total amount for which tangible personal property is sold, including any services that are a part of the sale, valued in money, whether paid in money or otherwise, and any amount for which credit is given to the purchaser by the seller without any deduction on account of the cost of the property sold, materials used, labor or services performed, interest charged, losses or other expenses.

If it is determined that . . . is not subject to transaction privilege tax, the fees charged by . . . for its Club memberships would be subject to use tax. The taxability arises from the definition of the term "purchase price" under Arizona's use tax statute. Under A.R.S. § 42-5151(14), . . .'s Club membership fees are the purchase price of the Club membership. The purchase price includes the fees charged for both tangible personal property and any services provided. Since Arizona's use tax includes in the purchase price the amount charged for services that are a part of the sale as well as the amount charged for tangible personal property, . . .'s Club membership fees are subject to use tax. Thus, Club membership purchasers are liable for use tax.

Arizona's use tax is a tax on the purchaser who purchased from a retailer, not a tax on the retailer. Under A.R.S. § 42-5161, a retailer is responsible for collecting the use tax on behalf of the state. The state cannot, however, impose a collection obligation unless the retailer has nexus with the state.

. . .'s Entitlement to a Credit for Tax Properly Paid to the State in which the Club Kits were Manufactured, Purchased or Shipped

It is your position that if . . . is subject to use tax on its cost of Club membership kits, then . . . is entitled to a credit for tax properly paid to the state in which the Club membership kits were manufactured, purchased or shipped. As seen above, Arizona's use tax is a tax on the purchaser who purchased from a retailer, not a tax on the retailer. The retailer is, however, responsible for collecting the use tax on behalf of the state. The responsibility of collection does not allow for any credits or exemptions for taxes paid in other states. Thus, . . . is not entitled to a credit or exemption for taxes paid to other states.

Ruling:

The department rules that fees received from the sale of . . .'s Club membership kits are taxable under either Arizona's transaction privilege tax or Arizona's use tax. Should . . . have a sufficient nexus to the state, transaction privilege tax would apply. If . . . does not have sufficient nexus for transaction privilege tax, but has sufficient nexus for use tax collection, . . . must collect use tax from the purchasers.

The conclusion in this private taxpayer ruling does not extend beyond the facts as presented in the request for a private taxpayer ruling dated July 17, 2001 and supplemented by your letter dated September 19, 2001.

This response is a private taxpayer ruling and the determinations herein are based solely on the facts provided in your request. The determinations are subject to change should the facts prove to be different on audit. If it is determined that undisclosed facts were substantial or material to the department's making of an accurate determination, this taxpayer ruling shall be null and void. Further, the determination is subject to future change depending on changes in statutes, administrative rules, case law or notification of a different department position.

The determinations in this private taxpayer ruling are only applicable to the taxpayer requesting the ruling and may not be relied upon, cited nor introduced into evidence in any proceeding by a taxpayer other than the taxpayer who has received the private taxpayer ruling.