THE STATE OF SOUTH CAROLINA
In the Court of Appeals

John D. McLeod, Administrative Law Judge

Case No. 16-ALJ-17-0113-CC
Appellate Case No. 2017-001519

Books-A-Million, Inc. ..... Appellant.

v.

South Carolina Department of Revenue ..... Respondent.

FINAL BRIEF OF APPELLANT

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TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES

Cases

Statutes

Other Authorities

Regulations

STATEMENT OF THE CASE

This matter was before the South Carolina Administrative Law Court (the "ALC" or "the Court") pursuant to a Request for a Contested Case Hearing filed by Appellant Books-A-Million, Inc. ("Appellant" or "Books-A-Million") challenging the South Carolina Department of Revenue's ("Respondent's," "the Department's" or "the DOR's") final determination, in which the Department assessed Appellant taxes, penalties, and interest following a sales tax audit for periods beginning January 1, 2012 and ending August 31, 2015. In its determination, the Department assessed Appellant $226,310.70 in income taxes, $15,703.13 in related interest, and $63.14 in related penalties.

The Department issued its final determination on March 15, 2016 (Department Determination at pp. 1-6; R. pp. 429-34), and Appellant timely appealed to the ALC. The sole issue before the ALC was whether the proceeds from Appellant's South Carolina sales of Millionaire's Club memberships should have been included in Appellant's gross proceeds of sales and, therefore subject to sales taxes. The parties filed Stipulations of Facts with the Court on September 13, 2016 (Stipulation of Facts at pp. 1-3; R. pp. 438-41). On March 6, 2017, both parties filed Motions for Summary Judgment (Respondent's Motion for Summary Judgment at pp. 1-2; R. pp. 208-09; Appellant's Motion for Summary Judgment at p. 1; R. p. 173). The parties agreed there were no material facts in dispute but disagreed as to the application of the law to the undisputed facts.

A Motions hearing was held before the Court on May 9, 2017. On June 1, 2017, the ALC issued its Order ruling in favor of the Department (Final Order and Decision at pp. 1-11; R. p. 14-24). On June 6, 2017, the ALC issued an Order vacating the Previous Order and amending Order granting Respondent's Motion for Summary Judgment (Order Vacating Previous Order and

Amending Order Granting Respondent's Motion for Summary Judgment at pp. 1-11; R. p. 3-13). The ALC Order upheld the Department's entire Assessment of taxes, penalties, and interest.

Appellant filed a Motion for Reconsideration, which was denied, and subsequently timely appealed.

STATEMENT OF FACTS

The parties entered into a Stipulations of Facts (Stipulations of Fact at pp. 1-3; R. p. 438-40), which stated in relevant part:

1. The [Appellant] operates a discount book retail business headquartered in Birmingham, Alabama. The [Appellant] sells books, magazines, collectible supplies, cards, and other gifts in retail stores throughout the country and online. The [Appellant] operates thirteen (13) retail locations in South Carolina.

2. The [Appellant] offers a discount program to its customers called the Millionaire's Club (the "Club"). A customer must pay a $25.00 annual fee to belong to the Club (the "Membership Fee"). A customer will either pay the fee separately or along with other purchases. The Club membership expires one (1) year from the date of payment of the Membership Fee, unless the membership is automatically renewed as described below. The payment of the Membership Fee entitles Club members to the following benefits on purchases made at the [Appellant]'s retail and online locations (collectively, the "Discounts"):

    a. 40% off the list price of current hardcover Books-A-Million Store Bestsellers;
    b. 20% off the list price of all Books-A-Million designated adult hardcover books;
    c. 10% off the marked Books-A-Million sale price of other eligible items;
    d. Free Shipping with online purchases;
    e. Up to 40% off bestsellers and featured items online;
    f. Periodic special promotions online and at Books-A-Million Stores; and
    g. New members are eligible to receive a $5.00 Reward Card, which expires 30 days after activation.

3. The Membership Fee may be refunded if cancelled during the first 30 days of a customer's membership term and the customer has not used the membership to obtain an applicable discount or benefit. Memberships automatically review each year for one-year periods unless the customer affirmatively opts out of the automatic renewal or the membership is otherwise cancelled or terminated. So long as the customer does not opt out, the [Appellant] bills the annual Membership Fee annually

to the credit or debit card provided when the customer initially enrolled in the Club. The [Appellant] may unilaterally terminate a customer's membership at any time and without notice for any reason in its sole discretion.

4. The [Appellant] does not charge sales tax on the cost of the Membership Fee.

[END OF STIPULATION]

Many membership groups sell tangible personal property. According to retail reports submitted by Appellant, US consumers held 3.3 billion memberships in 29 major customer loyalty programs in 2015, spread among retail, financial services, travel and other economic sectors (Petitioner's Memorandum of Law in Opposition to DOR's Motion for Summary Judgment at p. 5 and Exhibit A p. 1; R. pp. 226 and 237).

Specialty store loyalty memberships total 434 million (*Id.*). Types of customer loyalty programs include discounts, rebates, cash-back, points, free shipping, free gifts, free services and upgrades. Some customer loyalty programs require members to pay a fee, including Costco, Barnes & Noble, and Sam's Club. Others are free (*Id.* at pp. 5-6 and Exhibits B, C, D, and E; R. pp. 238-65).

EdVenture, the South Carolina State Museum, and Riverbanks Zoo have membership programs in the Midlands (*Id.* at p. 6 and Exhibits F and G; R. pp. 226 and 265-81). All three of these institutions have retail gift shops. In some cases, members receive discounts on merchandise (*Id.*).

A number of private country clubs with membership fees are located in the Midlands. Many, if not most, have a restaurant as well as a retail shop, which sell golf and clothing merchandise. But for the membership, one could not purchase food at the restaurant or items at the golf stores.

Membership cards are not tangible personal property—instead, they represent an intangible right to receive a discount.

STANDARD OF REVIEW

The Administrative Procedures Act governs appellate review of decisions from the ALC. *DirecTV, Inc. v. S.C. Dep't of Revenue*, 421 S.C. 59, 804 S.E.2d 633 (Ct. App. 2017); *Risher v. S.C. Dep't of Health & Envtl. Control*, 393 S.C. 198, 203, 712 S.E.2d 428, 431 (2011). The review of the [ALC]'s order must be confined to the record. The court may not substitute its judgment for the judgment of the [ALC] as to the weight of the evidence on questions of fact. The court of appeals may affirm the decision or remand the case for further proceedings; or it may reverse or modify the decision if the substantive rights of the petitioner have been prejudiced because the finding, conclusion, or decision is:

> (a) in violation of constitutional or statutory provisions;
>
> (b) in excess of the statutory authority of the agency;
>
> (c) made upon unlawful procedure;
>
> (d) affected by other error of law;
>
> (e) clearly erroneous in view of the reliable, probative, and substantial evidence on the whole record; or
>
> (f) arbitrary or capricious or characterized by abuse of discretion or clearly unwarranted exercise of discretion.

S.C. Code Ann. § 1-23-610(B) (Supp. 2016).

An appellate court should only reverse the ALC's order if it is unsupported by substantial evidence in the record or contains an error of law. *Original Blue Ribbon Taxi Corp. v. S.C. Dep't of Motor Vehicles*, 380 S.C. 600, 604, 670 S.E.2d 674, 676 (Ct. App. 2008); see also *Media Gen. Commc'ns, Inc. v. S.C. Dep't of Revenue*, 388 S.C. 138, 144, 694 S.E.2d 525, 528 (2010) ("A

reviewing court may reverse the decision of the ALC [when] it is in violation of a statutory provision or it is affected by an error of law."). Questions of statutory interpretation are questions of law, which [the appellate court is] free to decide without any deference to the court below." *Centex Int'l, Inc. v. S.C. Dep't of Revenue*, 406 S.C. 132, 139, 750 S.E.2d 65, 69 (2013) (first alteration in original) (quoting *CFRE, LLC v. Greenville Cty. Assessor*, 395 S.C. 67, 74, 716 S.E.2d 877, 881 (2011)).

I. ARGUMENTS

A. The ALC Erred in Holding that the Amounts Collected by Books-A-Million for the Membership Cards are Subject to Sales Tax.

1. General

The ALC Order held that "Membership Fees" (defined in the Stipulations of Fact above) collected by Books-A-Million for the sale of membership cards were subject to sales tax. The Order holds that the Membership Fee is subject to sales tax as gross proceeds of sale because the membership cards are sometimes sold in conjunction with the sale of tangible personal property (books, CDs and the like). Books-A-Million asserts that under the plain meaning of S.C. Code Ann. § 12-36-910, the Membership Fees collected are not subject to sales tax because membership cards are not tangible personal property under § 12-36-60, and therefore the Membership Fees cannot constitute gross proceeds of sales under § 12-36-90. Books-A-Million also argues that renewals of membership cards are not subject to sales taxes as the renewals are automatic and rarely done in connection with the purchase of tangible personal property. Based upon the plain meaning of the applicable provisions of Chapter 36 of Title 12, sales and renewals of memberships are not included in the "gross proceeds of sales" of tangible personal property.

As explained by the Supreme Court in *Alltel Communications, Inc. v. South Carolina Department of Revenue*, 399 S.C. 313, 731 S.E.2d 869 (2012), "[t]he usual rules of statutory

construction apply to the interpretation of tax statutes." *See also Multi-Cinema, Ltd. v. S.C. Tax Comm'n*, 292 S.C. 411, 413, 357 S.E.2d 6, 7 (1987). "The cardinal rule of statutory construction is to ascertain and effectuate the intent of the legislature." *Media Gen. Commc'ns v. Dep't of Revenue*, 388 S.C. 138, 147, 694 S.E.2d 525, 529 (quoting *Charleston Cnty. Sch. Dist. v. State Budget & Control Bd.*, 313 S.C. 1, 5, 437 S.E.2d 6, 8 (1993)) (internal quotations omitted).

S.C. Code Ann. § 12-36-910 provides that the sales tax "is imposed upon every person engaged or continuing within this State in the business of selling tangible personal property at retail." In order to determine whether the amounts collected for the Membership Fees constitute "gross proceeds of sales" subject to sales tax under § 12-36-910, the statutory definition of the term "gross proceeds of sales" must be applied. That definition is provided by § 12-36-90, which defines "gross proceeds of sales" as "... the value proceeding or accruing from the sale, lease or rental of tangible personal property." Therefore, in order to ascertain whether gross proceeds of sales exist, this court must first ascertain whether the membership itself constitutes tangible personal property. Section 12-36-60 defines the term as follows:

> "Tangible personal property" means personal property which may be seen, weighed, measured, felt, touched, or which is in any other manner perceptible to the senses. It also includes services and intangibles, including communications, laundry and related services, furnishing of accommodations and sales of electricity, the sale or use of which is subject to tax under this chapter and does not include stocks, notes, bonds, mortgages, or other evidences of debt.

At the oral argument on this matter, the DOR's attorney conceded, "The Department has never argued that the membership program is tangible personal property." (Tr. p. 27, lines 14-16; R. p. 414, lines 14-16).

As a threshold matter, the ALC Order is not supported by the plain language of the statutes, which make clear that only the gross proceeds of sales of tangible personal property are subject to sales tax. Under the statute, tangible personal property includes only two categories: "*personal*

property which may be seen, weighed, measured, felt, touched, or which is in any other manner perceptible to the senses" and "*services and intangibles* ... the sale ... of which is subject to tax under this chapter." (Emp. added) *See* § 12-36-60. Such intangibles are communications and electricity. Thus, the amounts charged for a Membership Fee cannot constitute "value proceeding or accruing from the sale . . . of tangible personal property" under the plain meaning of the language enacted by the General Assembly. As discussed at length below, the Department agrees that Membership Fees charged by membership only warehouses (Sam's Club and Costco) are not subject to sales taxes (Tr. p. 32, line 17 – p. 34, line 10; R. p. 419 line 17 – p. 421, line 10).

Tennessee and South Carolina have remarkably similar statutes with respect to sales tax administration. Tennessee's statutes under the Retailer's Sales Tax Act define the terms of sales tax before describing the technical handling of the tax. See Tenn. Code Ann. §§ 67-6-102, 67-6-203, and 67-6-401. The Tennessee sales tax rate is 7% applied in the business of selling tangible personal property at retail the state. § 67-6-202. South Carolina's Sales and Use Tax Act similarly outlines the definitions and terms of the tax before specifically listing the procedural elements and exceptions. *See* §§ 12-36-60, 12-36-910, and 12-36-2110.

Both states exercise the sales tax on the retail of tangible personal property. Tenn. Code Ann. § 67-6-102(85) outlines tangible property as:

> ...personal property that can be seen, weighed, measured, felt or touched, or that is any other manner perceptible to the senses. Tangible personal property includes electricity, water, gas, steam, and pre-written computer software.

Both statutes attribute physical characteristics that are readily perceptible to the senses as indicative of tangible property. The statutes start the definition with almost the exact same language that emphasizes sight, touch, or any perceptible sensation as elements of tangible property. Furthermore, both statutes list goods like electricity and services that may not readily

discernable by the senses as tangible property. Finally, both Tennessee and South Carolina have expansive descriptions of the "sales price" or "gross proceeds" on which the sales tax is imposed.

Analyzing a nearly identical issue to the case at bar, the Tennessee Court of Appeals arrived at the conclusion that memberships are not tangible property. In *Barnes & Noble Superstores, Inc. v. Huddleston*, 1996 WL 596955 (Tenn. Ct. App. 1996), a bookstore sold "Reader's Choice" membership cards to customers. This membership program entitled customers for the annual fee of $10.00 to 10% discount on the bookstore's merchandise in stores across the country. *Id.* at 1. Customers could either present the membership card or give the membership number and expiration date of the card to utilize the membership. *Id.* Based on these facts, the Court held that "the true object of the subject transactions... is to bestow upon club members the intangible right to receive a discount on merchandise." *Id.* at 2. The court found the membership card was "merely an indicia of that intangible right and incidentally aids in the exercise of that right." Thus, the memberships could not be subject to sales tax. *Id.* Here, like in *Barnes & Noble*, Books-A-Million offers customers the opportunity to purchase a membership that would entitle them to discounts. The main object of this membership is to gain an intangible right to receive exclusive discounts.

Similar to the Department in this case, the Tennessee Commissioner of Revenue attempted to characterize the Membership Fee in *Barnes & Noble* as a "prepayment for merchandise." The Tennessee court rejected this argument because, identical in this case, the "member has no obligation ever to purchase any merchandise." According to the court, "[t]he club member may ultimately elect not to avail himself of the privilege of buying anything." Based on the foregoing, the Tennessee Court of Appeals found Barnes & Nobles' membership fee to be intangible property, which was disconnected from the purchase of any underlying tangible personal property.

The Florida Department of Revenue has ruled that a similar membership program involved a sale of intangible personal property, and thus was not subject to Florida sales tax. In Technical

Assistance Advisements 89(A)-022, the Florida Department of Revenue addressed whether the following discount card program, as described by the taxpayer at issue in the ruling, was subject to sales tax:

> Corporation A is a discount bookseller operating various stores in Florida. As a part of our sales and marketing of books and other merchandise, Corporation A offers its customers a discount card. Customers purchase the discount card in order to purchase merchandise at additional discounted prices offered by Corporation A. The card has an established price of $10 with an annual renewal fee of $10.

During the periods at issue, Florida assessed a sales tax on the total selling price of tangible personal property sold at retail in Florida. Fla. Stat. § 212.05. Florida statutes defined the term "sales price" as "the total amount paid for tangible personal property . . . discounts allowed and taken at the time of sale shall not be included with the purview of this [definition]." Section Fla. Stat. § 212.02(17).

The Florida Department of Revenue found the sale of the discount card was "not the sale of tangible personal property but rather the sale of intangible property." According to that agency, "[t]he discount card has no value in and of itself but only has worth when used in conjunction with the purchase of merchandise from Corporation A."

The Virginia Department of Taxation came to a similar result in guidance provided to Appellant in 2009. As described by the Virginia agency:

> [Appellant] sells annual memberships in a discount card program called the Millionaire's Club. The Millionaire's Club membership entitles the member to discounts on purchases of the [Appellant] through the use of a discount card. Sales Tax was assessed on the [Appellant's] sales of Millionaire's Club memberships.

The Virginia Department of Taxation based its findings on Virginia's definition of "sale," which included the "transfer of title or possession of tangible personal property or the rendition of a taxable service for a consideration." Citing two prior agency rulings, the agency determined the

sale of the Millionaire's Club membership "did not include the transfer of tangible personal property or the provision of a taxable service." Based on the foregoing, the Virginia Department of Revenue concluded the Appellant's sales of Millionaire's Club memberships were exempt from Virginia's sales and use tax. See also Tenn. Rev. Rul. #14-08; *Dine Out Tonight Club v. Dep't of Revenue Servs.*, 210 Conn. 567 (1989); *State v. Amn. West Comty. Promotions, Inc.*, 645 N.W.2d 196 (2002); and Oklahoma Rev. Rul. #14-001.

If the ALC Order is correct, then sales of food, drink, and golf clubs by every membership golf club in South Carolina would include membership fees in the sales tax base. Under the Department's logic, even though the payment of the membership fee is not directly connected with the sale of tangible personal property and is in no way predictive of whether a member will actually purchase tangible personal property, the fees must be included in the value "proceeding or accruing" from the sale of refreshments and golf equipment. A similar rule would apply to sales of retail goods by every museum, art gallery, and zoo in South Carolina, which has a membership program which provides discounts to its members for purchase of tangible personal property.

2. The Department Has Established that Sales of Other Intangibles are Not Subject to Sales Tax.

A membership card is clearly an intangible, and the Department agrees. As stated below, the Department has ruled that sales of other intangibles are not subject to sales taxes. The Department has also stated that sales of other memberships are not subject to sales taxes.

For example, as stated below, South Carolina follows the national rule that the sale of gift cards – which, unlike Books-A-Million membership cards, have actual monetary value – are not subject to sales taxes. Gift Cards, like Books-A-Million membership cards, are viewed as an intangible and therefore not subject to sales taxes even when sold with books, CDs and other tangible personal property.

Hellerstein & Hellerstein, State Taxation (3rd ed.) at ¶ 13.08[5], states the rule as follows: "States generally treat the purchase of a gift card or gift certificate as the non-taxable purchase of an intangible (a 'cash equivalent')".

In SC Rev. Rul. 2004-4, the DOR held that the sale of a prepaid telephone calling card was not subject to sales tax as an intangible notwithstanding that it was inextricably linked to the subsequent sale of a taxable service (telecommunications service). The Ruling states: "Prepaid Telephone Calling Card for Use with Land-Based Phones. The sale or recharge at a retail of a prepaid telephone calling card as described in the facts for use in making local, long distance, or international telephone calls, that can be used to make a call from a land-based phone, is not subject to sales tax since this transaction is not a sale of tangible personal property. The transaction is merely the exchange of money for an intangible evidence of debt – a future right to telephone service" (emphasis in original).

The Ruling also states: "Other similar nontaxable transactions include the sale of gift certificates or traveler's checks," even though gift certificates and Traveler's checks are inextricably linked to the subsequent purchase of tangible personal property.

Similarly, in SCDOR PLR #11-5 subscribers to a wireless telecommunications service could receive loyalty points under a "123" Loyalty plan. "Subscribers to these plans accrue points over time which can be exchanged for a discounted new phone, discounts on phone accessories" and other goods and services. At issue was whether "the value allowed for the loyalty points used for the discount were subject to the [sales] tax as part of the 'gross proceeds of sales' or 'sales price' of the tangible personal property." The DOR held that it was not, stating:

> 2. When loyalty points are exchanged under a JKL Company "123 Plan" for discounts on the sale of tangible personal property, the value allowed for the loyalty points used for the discount is not a part of the "gross proceeds of sales" or "sales price" of the tangible personal property and is therefore not subject to the sales and use

> tax. In other words, the "gross proceeds of sales" or "sales price" of the tangible personal property subject to the sales and use tax does not include the discount allowed for the "123 Plan" loyalty points.
>
> For example, if a cell phone otherwise sells for $200, but a "123 Plan" subscriber can purchase the cell phone for $175 by exchanging a certain number of loyalty points, then the "gross proceeds of sales" or "sales price" upon which the tax is calculated is $175.

3. The Department Fails to Distinguish between the Sales at Issue in this Case and Sales of Other Memberships.

The thrust of the ALC Order is as follows:

> Customers pay the Membership Fee to obtain discounts and free shipping on their purchases of tangible personal property. Thus, the Membership Fee is a direct result of the sale of tangible personal property. But for the [Appellant]'s sale of tangible personal property, the Appellant's would not be able to sell Millionaire's Club memberships and, therefore, would not collect Membership Fees. The Membership Fees are payment for services or benefits that are incident to the sale of tangible personal property. Moreover, the Membership Fees are inextricably linked to, and incapable of being separated from, the sale of tangible personal property. See *Walden Books Co. v. Ariz. Dept. of Rev.*, 12 P.3d 809, 813 (Ariz. Ct. App. 2000) (holding that the taxpayer's "Preferred Reader Program membership fees...were taxable as 'services that are a part of the sales.'"). Because the Membership Fees are so intertwined with and inseparable from the [Appellant]'s sales of tangible personal property, such are a part of the sales of that tangible personal property. *Id.* Said differently, the Membership Fees are a direct result of the [Appellant]'s sales of discounted tangible personal property. (Order Vacating Previous Order and Amending Order Granting Respondent's Motion for Summary Judgment at pp 9-10; R. p. 11-12).

Are Appellant's membership fees subject to sales taxes because, as the ALC Order states, they "are so intertwined with and inseparable from the [Appellant]'s sales of tangible personal property?" Is "inextricably linked" to the sale of tangible personal property the test? Not according to the DOR.

Chapter 6, page 9 of the DOR's South Carolina Sales and Use Tax Manual (2017 Ed.) states that sales of certain memberships are not included in the sales tax base. The Manual first states:

> Examples of charges not includable in "gross proceeds" or "sales price" and therefore not subject to the sales and use tax are:
>
> * * *
>
> **Membership fees charged by a membership-only warehouse** offering a selection of brand-name merchandise to business owners and others where all membership types receive the same benefits;[57]

In the very recent SC Private Letter Ruling #16-1, the DOR similarly stated:

> In certain circumstances, the Department has determined that membership fees related to the anticipated sales of tangible personal property are not includable in gross proceeds of sales and, therefore, are not subject to the sales and use tax. Examples include:
>
> 1. A retailer sells its product only to members and charges a membership fee that is in lieu of a security deposit or constitutes only a nominal processing fee.
>
> 2. A retailer sells its product only to members and charges a membership fee that allows all members to purchase the tangible personal property at the same lower price.

Books-A-Million offers a selection of brand-name merchandise to business owners and others where all membership types receive the same benefits. It does not have a "membership-only warehouse" but under the ALC's "inextricable link" analysis, this would make it less subject to sales taxes than a "membership-only warehouse."

Footnote 57 cited above further provides that "[a] membership fee would be includable in gross proceeds and subject to the tax if the membership fee is the sales price for the tangible personal property," and then provides an example:

> For example, if a direct mail movie rental company charged an annual or month[ly] fee to receive movies for short term use of movies and no other charges are paid by the customers to receive

> the movies, then the annual or monthly fee is the sales price of the tangible personal property and subject to the tax.

This logic makes sense and is consistent with the statute's intent to capture value proceeding or accruing from the sale of personal property. In the example, the customer only pays a monthly fee for the ability to access movie rentals, so that monthly fee should be taxable because it is essentially, as the Department provides, "the sales price for the tangible personal property." In the example, what the seller characterizes as a "membership fee" is really just a proxy for the sales price. In Appellant's case, the Membership Fee is not directly connected to the sale or receipt of tangible personal property. The member could separately purchase 1,000 books as a member, or he could purchase 0 books.

Furthermore, while the ALC Order holds the Membership Fees must be taxable as they are "so intertwined with and inseparable from the Appellant's sale of tangible personal property," the Department's guidance in both S.C. Rev. Rul. #90-6 and the Rev Rul # 16-1 clearly identifies situations where membership fees, though considerably more intertwined, should not be taxable. So while the ALC Order holds the Membership Fees at issue in this case should be taxable because they are "inextricably linked to the sale tangible personal property," certain other "membership fees" are not taxable because they are better characterized as "nominal processing fees" or "in lieu of a security deposit" even if they are included as part of the value paid for tangible personal property.

4. The ALC's and Department's Reliance on *Meyers Arnold* is Misplaced.

The ALC Order holds that notwithstanding the lack of statutory language subjecting membership cards to sales tax, the amounts collected for membership cards become subject to sales tax as gross proceeds of sale because the coverage was sold in conjunction with the sale of

tangible personal property. The ALC Order principally relies on *Meyers Arnold v. S.C. Tax Commission*, 285 S.C. 303, 328, S.E.2d 920 (1985), in support of its contention.

In *Meyers Arnold*, the taxpayer was a merchandise retailer who allowed customers to purchase its merchandise either outright or under a layaway plan, for which the retailer charged a non-refundable lay away fee. *Id.* at 307, 303 S.E.2d at 923. The retailer "retain[ed] the goods purchased until the full price [of the retail merchandise was] paid." Id. The retailer paid sales tax on the layaway fees and sought a refund from the Tax Commission. *Id.* at 304, 307, 303 S.E.2d at 921, 923. The pertinent question before the Court of Appeals was whether the "fees charged by Meyers Arnold on sales made under its lay away plan are subject to sales tax." *Id.*

The parties in *Meyers Arnold* entered into a Stipulation of Facts (Appellant's Correspondence to Judge McLeod dated May 26, 2017 Enclosing Proposed Order and Portions of *Meyers Arnold* Record at pp. 24-25; R. p. 92-3. The Stipulation stated in relevant part:

> 6. The customer selects the merchandise he desires to purchase and elects to pay the full price in cash or by charge and take delivery, or not pay the full price and not take delivery by paying for the item on the lay away plan. If the lay away plan is elected, Meyers Arnold agrees to hold the merchandise for a period of time, while the customer makes monthly payments on the account.
>
> 7. The customer makes payments, and when the purchase price has been paid in full, the customer is entitled to possession of the merchandise.
>
> 8. The lay away fee for part of the audit period was Two and 00/100ths ($2.00) Dollars, and for part of the period was One and 00/100ths ($1.00) Dollar. (*Id.* at 25; R. p. 93)

The Tax Commission ruled against the Taxpayer on this issue, stating:

> The final issue concerns the taxability of the gross proceeds from layaway sales. If a customer wishes to make a purchase and pay for the item over a period of time, Meyers-Arnold provides a layaway plan in which the property is kept by the store and the customer makes periodic payments until the full purchase price is paid. Upon final payment, the customer receives the property. The customer

> pays a One Dollar, nonrefundable fee which is included on the layaway form as a separate charge.
>
> We find that the lay-away fee of One Dollar is subject to the sales tax. The tax is measured against the gross proceeds of sales and §12-35-30 states that gross proceeds of sales mean the value proceeding from the sale of tangible personal property *and that no reduction shall be given for the cost of labor or service or any other expense whatsoever*. Here the One Dollar fee is to cover the cost of the layaway plan and is part of the gross proceeds of sales and no reduction of the gross proceeds is allowed. The One Dollar is charged on all layaway sales and is nonrefundable.
>
> *We find further support for our position in §12-35-120 which defines sales price as including any services that are a part of the sale*. Here the One Dollar charge is made on all sales under the layaway plan and the evidence shows that a sale would not be made unless the One Dollar fee were charged. Thus the statutory definition of sales price requires the inclusion of the One Dollar since such charge is a required part of the sale.
>
> Finally, we do not find the taxpayer's argument that the fee is a finance charge or carrying charge to be persuasive. A finance charge is a charge for loaning money and a carrying charge is the interest charged on the balance owed when paying installments. Thus, both require the loaning of money. Here no funds have been advanced by Meyers-Arnold and thus there are no finance or carrying charges. (Emp. added) (Appellant's Correspondence to Judge McLeod dated May 26, 2017 Enclosing Proposed Order and Portions of *Meyers Arnold* Record at pp. 20-22; R. p. 89-90).

On appeal, the taxpayer principally argued that the layaway fee was a finance charge, and thus exempt from taxation. The taxpayer argued in pp. 6-7 of its brief (Appellant's Correspondence to Judge McLeod dated May 26, 2017 Enclosing Proposed Order and Portions of *Meyers Arnold* Record at pp. 48-49; R. pp. 116-17) as follows:

> II. Did the trial court err in not finding that the lay-away fee charged by Meyers Arnold is a finance charge, carrying charge, or option to purchase within the meaning of Tax Commission Regulation §117-174.5. exempting such charges from sales tax? (Exceptions 2, 4 and 5)

Tax Commission Regulation §117-174.59 exempts the lay-away fee charged by Meyers Arnold from the definition of gross proceeds of sales. That regulation provides, in pertinent part:

> Tax Commission Regulation §117-174.59; Carrying Charges – Financing Charges.
>
> When the seller has an established price for the goods he sells, and that price is the amount to be included in gross proceeds of sales even though the established price may include an amount to cover a carrying charge.
>
> When the seller has an established cash price and when selling on an extended basis, adds a separate charge for financing, the additional charge is not to be included in gross proceeds of sales.
>
> In no event may finance or carrying charges be deducted from gross proceeds of sales when not shown as a separate item in the seller's billing to his customer.

From this, the lower court determined that, "these requirements dictate that Meyers Arnold must extend credit to the customer since the regulation contemplates a finance charge." (Transcript of record, P. 14). However, there is nothing in the language of the regulation to require that the seller extend credit in order to come within the meaning of the regulation. Rather, if he adds a separate charge for financing, in addition to his established cash price, when selling on an extended payment basis, such additional charge is not to be included in the gross proceeds of sales if it is shown as a separate item in the seller's billing.

The lay-away fee charged by Meyers Arnold is a finance charge within the meaning of this regulation. Meyers Arnold has an established price for the goods it sells. If the customer elects to place an item on lay-away, a non-refundable fee is charged, which is shown as a separate item on the bill.

The Tax Commission denied the lay away fee was a finance charge, and argued in its brief before the Court of Appeals that the charge was a service fee for the sale of merchandise, and thus taxable. On pp. 4-5 of its brief (Appellant's Correspondence to Judge McLeod dated May 26, 2017

Enclosing Proposed Order and Portions of *Meyers Arnold* Record at pp. 57-58; R. pp. 125-26) the Tax Commission argued:

> *The statutory definition specifically states that the value proceeding from the sales shall not be reduced by "any deduction on account of ***labor or service cost***or any other expenses whatsoever***." Such a definition is very broad and includes the service of a lay-away plan provided by Meyers Arnold.* The fee for the lay-away service is charged to cover additional expenses incurred by Meyers Arnold for such items as storage and additional paperwork associated with a sale on lay-away. Thus, if the lay-away fee is part of "the value proceeding or accruing from the sale," then such fee is part of gross proceeds and may not be reduced by the expenses which the lay-away fee represents. (Emp. added).

The Tax Commission argued in support of its argument *Rich's Inc., v. Blackmon*, 133 Ga. App. 665, 211 S.E.2d 916 (1975), which held that freight charges were part of the sales tax base. The Commission also cited *Belvedere Sand and Gravel Co. v. Heath*, 536 S.W.2d 312 (1976), to the same effect. Lastly, the Commission argued *A.H. Benoit and Co. v. Johnson*, 302 A.2d 1 (1964), where the Court that alteration charges were included in the sales tax base for the sale of garments.

In summary, § 12-36-90 defines gross proceeds of sales as "the value proceeding or accruing from the sale of tangible personal property...without any deduction for service cost." (Emp. added) The fees were charged **for the service rendered** in making lay away sales, and were accordingly part of the gross proceeds of sales and subject to the sales tax. *Meyers Arnold*, supra, 285 S.C. 307, 328 S.E.2d at 923. The holding in *Meyers Arnold* does not support the ALC Order. Instead, this holding reflects that the Court of Appeals was applying the definition of gross proceeds found in S.C. Code Ann. § 12-35-30 (1976), which is "the value proceeding or accruing from the sale of tangible personal property...without any deduction for service cost." *Meyers Arnold, supra* (emphasis added). In other words, the Court of Appeals' holding in *Meyers Arnold* addresses an attempt by a taxpayer to exclude from gross proceeds a cost of service directly

provided by the retailer in the sale of tangible personal property. Here, Books-A-Million has not excluded any costs associated with the selling of its books or CDs from its revenues.

The Administrative Law Court ruled to the same effect in *Alltel Communications, Inc. v. South Carolina Department of Revenue*, Docket No. 11-ALJ-17-0603 (filed November 13, 2015). At issue was whether indemnification coverage in the form of repair or replacement if a cell phone was lost, stolen or damaged was included in the sales tax base (which principally included communications services and sales of phones.) As noted in the ALC Order, "The Department argues that the amounts collected by insurance coverage are subject to sales tax as gross proceeds of sale because the coverage was sold in conjunction with the sale of tangible personal property." The Department principally relied on *Meyers Arnold.*

The ALC ruled against the Department holding that to rule for the Department "the Court would be required to read language into the statute that is absent," and the Department's argument would result in "the statute would then be rendered ambiguous and therefore inapplicable to Alltel." The ALC distinguished *Meyers Arnold* by finding the decision "reflects the Court of Appeal was applying the definition of gross proceeds found in S.C. Code Ann § 12.35-30 (1976), which is 'the value proceeding or accruing from the sale of tangible personal property . . . without any deduction for service costs.' . . . In other words, the Court of Appeal's holding in *Meyers Arnold* addresses an attempt by a taxpayer to exclude from gross proceeds a cost of service provided by the retailer in the sale of tangible personal property."

The facts in *Meyers Arnold* and *Travelscape v. S.C. Dep't of Revenue*, 391 S.C. 89, 705 S.E.2d 28 (2011), both involve the imposition of sales tax on fees charged by a retailer providing a service where the fees were inextricably intertwined with the sale of specific tangible personal property or accommodations. In *Meyers Arnold*, the customer could not purchase the lay away merchandise without paying the subject fee. Likewise, in *Travelscape*, the customer could not

purchase the accommodation without paying the fee. The charge for layaway/service fee in each case occurs only after the purchase of the underlying tangible personal property. In addition, neither customer would only pay the fee—presumably, neither taxpayer could charge only the fee, since that fee is so inextricably linked to the underlying purchase of tangible personal property or services.

Appellant's sale of a membership card is a substantively different transaction. In contrast to the facts in both *Meyers Arnold* and *Travelscape*, Appellant's membership could be purchased by customers regardless of whether they ultimately bought books or CDs, and the renewals of the membership fees were automatic and not done in connection with the purchase of merchandise. In any event, optional membership cards are not a "Labor or service cost" associated with the purchase of books or CDs, which was the finding in *Meyers Arnold.*

There simply is no provision of the statute which provides for the imposition of sales tax on anything other than tangible personal property as defined in § 12-36-60. There is no statutory provision that subjects sales of membership cards to sales taxes. Therefore, no statutory exemption is needed in order for membership cards to be excluded from the imposition of sales tax. Only by reading into the statutory language that includes within the base of the sales tax items not constituting tangible personal property, but sometimes sold incident to the sale of tangible personal property, can the Department's position be accepted. Such an interpretation goes beyond the plain meaning of the statutory language – and is contrary to the Department's Regulations cited below, as well as the Department's Membership policy documents cited above.

5. Inextricably Linked

As stated above, the ALC Order is premised on the notion that sales of Memberships are "inextricably linked" to sales of tangible personal property. Membership fees are not subject to sales taxes even if they "are inextricably linked to the sale of tangible personal property." With the

exception of certain statutory exceptions, unrelated services, like intangibles, are not subject to sales taxes even when they are performed in connection with the sale of tangible personal property. Even the DOR concedes that many services which are inextricably linked to the sale of tangible personal property are not included in the sales tax base.

The classic example is a visit to the vet. Many veterinaries now sell high-end dog food, collars and non-prescription pet medicine. A person who takes his dog to the vet for a checkup may also purchase dog food or pet medicine. The dog food or medicine is subject to sales taxes but not the vet services, even though the vet services are "inextricably linked" to the sale of dog food and medicine. (In many cases, the dog owner wouldn't be in the vet office but for the services.) According to the ALC's logic in this case, if a customer purchased dog food at the same time he got vet services, then the cost of the vet services should be included in the sales tax bill.

The DOR recognizes that many businesses both sell at retail (for which sales tax is owed) as well as render non-taxable labor and services. For example, ophthalmologists and optometrists who sell eye glasses owe sales taxes on the sale of eye glasses but not on related services, see Reg. 117-308.7, even though the services and sale of eye glasses are inextricably linked. Jewelry repairmen who also sell jewelry are not liable for sales taxes on their repair services. Reg. 117-308.11. Barber and beauty shops who sell tangible personal property (cosmetics, shampoos, etc.) are not liable for sales taxes on the services they perform, see Reg. 117-308.13, although sales tax is owing on the shampoo and cosmetics. Reg. 117-309.8 relating to undertakers states:

> Caskets, grave vaults, shrouds, and other tangible personal property furnished by undertakers and funeral directors in rendering burial services are sold by them at retail. These sales are subject to the sales tax.
>
> Where there is a separation of services from the sale of tangible personal property in invoices rendered, and where receipts from sales and receipts from services are properly identified on the books and records of the undertaker, the sales tax will not apply to receipts

> accruing from the rendering of such services as embalming, hearse service, transportation of family, etc.
>
> In complying with the provision for the separation of charges, a detailed itemization is not required.

As such undertakers are not required to include the cost of their services in the retail sales tax base for sale of caskets. Reg. 117-309.10 deals with interior decorators. It states:

> Interior decorators are generally engaged in the business of selling home or office furnishings of which many, such as portieres, curtains, draperies and seat and slip covers, are made to a customers' specifications. The total charge for such made-to-order merchandise is subject to the tax without any deduction for fabrication labor whether such labor is performed by the decorator or by others for the decorator's account.
>
> * * * *
>
> It may also be necessary to remodel interiors such as by painting or papering walls, hanging mirrors, pictures and lighting fixtures or other accessories, or replacing floor coverings. Labor for these purposes is not subject to the tax provided it is separately shown from the sales price of tangible personal property on the invoice to the customer. Other exempt charges when separately invoiced to the customer are consultation fees and reimbursement for travel expenses.

Again, interior decorators who sell such items as mirrors, curtains and draperies are not required to include in that sales tax base the cost of such services as hanging the mirrors, curtains and draperies, nor for painting or papering walls.

One final example where the Department openly ignores the "inextricable link" analysis is with sales of warranty contracts. The Department has concluded through regulation (S.C. Regs. 117-174.48 (later withdrawn)) and guidance (S.C. Rev. Rul. #93-6) that the taxability of charges for extended warranties (whether optional or mandatory) depends on the date the warranty is sold. So for example, if the warranty contract is sold "in conjunction with" the sale of the tangible personal property, then the warranty is taxable. If, on the other hand, the warranty is sold at a later

date, it is not subject to sales tax. It is difficult to identify two transactions that are more "inextricably linked" than a sale of tangible personal property and a warranty covering that property. However, according to the Department, the timing of the sales trumps the "inextricable link" between the products.

In each of the examples above, the sale of services was "inextricably linked" to the sale of tangible personal property. In some cases, e.g. caskets, the sale of the tangible personal property would and could not occur but for sale of services. These are more inextricably linked than the sale of optional Books-A-Million memberships. Yet in every case the DOR states in its own regulations that the sale of services is not included in the sales tax base for the sale of tangible personal property notwithstanding the inextricable link.

B. The ALC Erred in Holding that Renewals of Memberships are Subject to Sales Taxes.

As stated above, renewals of memberships are generally automatic (unless either the customer or the store cancels the membership). Such renewals are not inextricably linked to the sale of merchandise nor are they value proceeding or accruing from the sale of tangible personal property. Accordingly, renewals would not be included in the sales tax base even if the original membership purchase was so included.

C. The ALC Erred in Holding that the Statutes are Not Ambiguous.

In the context of a tax statute, it is a settled rule that ambiguities are resolved "against the government and in favor of the taxpayer." As the South Carolina Supreme Court stated in *Alltel Communications, Inc.*, 399 S.C. 313, 731 S.E.2d 869 (2012):

> Generally, a court must apply the rules of statutory interpretation to resolve the ambiguity and discover the intent of the legislature. Kennedy v. S.C. Ret. Sys., 345 S.C. 339, 348, 549 S.E.2d 243, 247 (2001). However, "[i]n the enforcement of tax statutes, the taxpayer should receive the benefit in cases of doubt." S.C. Nat'l Bank v. S.C. Tax Comm'n, 297 S.C. 279, 281, 376 S.E.2d 512, 513 (1989) (citing

> Cooper River Bridge, Inc. v. S.C. Tax Comm'n, 182 S.C. 72, 188 S.E. 508 (1936)). " [W]here the language relied upon to bring a particular person within a tax law is ambiguous or is reasonably susceptible of an interpretation that will exclude such person, then the person will be excluded, any substantial doubt being resolved in his favor." Cooper River Bridge, Inc., 182 S.C. at 76, 188 S.E. at 509-510; see also SCANA Corp. v. S.C. Dep't of Revenue, 384 S.C. 388, 394 n. 3, 683 S.E.2d 468, 471 (2009) (Beatty, J., dissenting) (noting general rule that where substantial doubt exists as to the construction of tax statutes, the doubt must be resolved against the government). The existence of an ambiguity in section 12-20-100 raises substantial doubt regarding the section's application to Appellants. This doubt must be resolved in favor of Appellants. 731 S.E.2d at 873.

See also *Fairfield Waverly, LLC v. Dorchester Cnty. Assesor*, Docket No. 14-ALJ-17-0602-CC (filed February 1, 2017) (citing *Mead v. Beaufort Cnty. Assessor*, Docket No. 13-ALJ-17-0585-CC (filed Aug. 19, 2014)).

At the oral argument in this case, the Department could provide no rationale why membership fees charged to customers of membership-only warehouses are not included in the sales tax base, whereas sales of memberships by Books-A-Million are included. The Department's attorney plainly stated at the Oral Argument:

> But again, we have to look at the factual differences between a membership only warehouse where you're paying just to get into the door and the petitioner where your membership gets you discounted tangible personal property. And it gets back to whether there is an inextricable link. Is there really an inextricable link between paying what's basically like an admission fee to get into the door from that tangible personal property? Maybe, maybe not. But the Department determined in its policies that there was not an inextricable link between those two and therefore that example wasn't subject to sales tax. *Maybe the Department's policy is too narrow. Because again, if you apply the plain meaning of the statutes here, I would argue that that example actually should be included in the sales tax base.* But again, there's no analysis in our policy documents, so we don't really know where the Department drew that factual distinction. But it really comes down to in this case, is there an inextricable link between a membership that gives you discounted tangible personal property and the tangible personal property? The other example the petitioner went over was the nominal processing fees or the security

> deposit. If you look at regulation 117-318.2, security deposits for carrying or financing charges per regulation have been deemed to be excludable from sales tax. Now again, there's no analysis in the policy document or the sales tax manual. But it's very possible that the Department viewed a security deposit or processing fee like a carrying or finance charge, and chose to exclude those from the sales tax space. But at the same time, under the plain reading of this statute, without the regulation I would argue that those fees would be includable in the sales tax space because they are a direct result from the sale of tangible personal property." (Emp. added) (Tr. p. 32, line 17 – p. 34, line 10; R. p. 419 line 17 – p. 421, line 10)

Memberships at Costco and Sam's and other membership only warehouses are more "inextricably linked" to the sales of tangible personal property than Books-A-Million, as customers at those stores are required to purchase memberships as condition of purchasing retail goods. By contrast, customers at Books-A-Million may purchase merchandise without purchasing a membership card and they can purchase a merchandise card (e.g., for a gift) without purchasing merchandise. The Department could provide no explanation why Costco and WalMart (Sam's Club) are not liable for sales taxes and Appellant is liable. At best, the Retail Sales Tax Act is ambiguous regarding whether optional membership fees are included in the sales tax base. And such ambiguity, especially in the case of general tax administration and not a credit or exemption, must be resolved in favor of the taxpayer. See *Hadden v. S.C. Tax Comm'n*, 183 S.C. 38, 190 S.E. 249 (1937) (noting that "where a tax statute is ambiguous or is reasonably susceptible of an interpretation that would exclude the person or subject sought to be taxed, any substantial doubt must be resolved against the government in favor of the taxpayer"); *see also Clark v. S.C. Tax Comm'n*, 259 S.C. 161, 169, 191 S.E.2d 23, 26 (1972) ("Revenue laws are generally construed in favor of the taxpayer and against the taxing authority."); and Sutherland Statutory Construction § 66:1 (6th ed.).

CONCLUSION

There may be a perfectly good reason why Costco and WalMart are not liable for sales taxes on the sale of memberships and Appellant is. There may be a valid explanation why every golf club, zoo, museum and aquarium are not required to include membership fees in the sales tax base of their gift shops. Similarly, there must be a good reason why sales of prepaid calling cards, gift certificates and the redemption of loyalty points for tangible personal property are exempt from sales taxes whereas sales and renewals of Appellant's membership cards are subject. But the Department and the ALC Order offer no such explanation. Based upon the DOR Policy documents, Appellant would be exempt from sales taxes if it required memberships but is subject to sales taxes if memberships are optional. And where does the Sales Tax Act so provide? And how does this jibe with the ALC Order's "inextricable link" analysis?

The ALC Order states, "other than pointing out that the Department reads the statutes differently from the [Appellant], the [Appellant] failed to point to any ambiguity in either §12-36-910(A) or §12-36-90." Indeed neither statute states that mandatory memberships are exempt from sales taxes whereas optional memberships are subject. Yet the DOR so construed such statutes in its Sales Tax Manual and PLR #16-1.

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