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S.C. SUPREME COURT

THE STATE OF SOUTH CAROLINA
In The Supreme Court

APPEAL FROM THE ADMINISTRATIVE LAW COURT

Honorable John D. McLeod, Administrative Law Judge

Case No. 16-ALJ-178-0113-CC
Appellate Case No. 2017-001519
Opinion No. 5721 (S.C. Ct. App. filed April 29, 2020)
Supreme Court Case No. 2020-001102

Books-A-Million, Inc. Petitioner,

v.

South Carolina Department of Revenue Respondent.

PETITIONER BOOKS-A-MILLION, INC'S REPLY TO RESPONDENT SOUTH CAROLINA DEPARTMENT OF REVENUE'S RETURN TO PETITIONER'S PETITION FOR A WRIT OF CERTIORARI

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Columbia, South Carolina
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I. PETITIONER HAS ESTABLISHED A BASIS FOR GRANTING ITS PETITION FOR CERTIORARI UNDER RULE 242(B), SCACR.

A. There is a Novel Question of Law.

Membership loyalty programs come in several different flavors: (i) free voluntary memberships (CVS, BiLo); (ii) paid optional memberships (Books-A-Million, Barnes & Noble and many others) (see attached Exhibit A); and (iii) paid mandatory membership (Sam's, Costco) and they are big business. According to the Retail Prophet, (Exhibit B) in 2016, the consumer loyalty, management market was valued at $1.93 billion. In the U.S. alone consumers collectively hold more than 3.8 billion loyalty program memberships.

According to Investopedia (Exhibit C) Costco alone had $3.35 billion in revenue from membership fees in 2019. Given that its net income was $3.66 billion, you can see why membership fees were so important to Costco and the Department of Revenue, as stated below, holds that Costco's membership fees are exempt from sales tax, whereas Books-A-Million's voluntary fees are not.

It is not just large retailers. Many museums, zoos, aquariums, golf courses, etc. have membership programs which entitle holders to discounts at their gift shops. According to the Court of Appeals' decision, all of these retailers must now add back their membership fees to their sales tax returns. (It is a safe bet that none are currently doing so today.)

Petitioner Books-A-Million, Inc. (hereinafter "Petitioner" or "Books-A-Million") agrees with the assertion of Respondent Department of Revenue (hereinafter "Respondent" or "Department") that South Carolina's sales tax structure is found in Chapter 36 of Title 12. "A sales tax, equal to five percent of the gross proceeds of sales, is imposed upon every person engaged or continuing within this State in the business of selling tangible personal property as

retail." S.C. Code Ann. § 12-36-910(A). Books-A-Million is a "retailer" selling "tangible personal property." *See* §§ 12-36-70 and 12-36-60. Therefore, Books-A-Million is required to remit sales tax in South Carolina. S.C. Code Ann. § 12-36-90 defines "gross proceeds of sales" as "the value proceeding or accruing from the sale, lease, or rental of tangible personal property." Books-A-Million is a retailer. The only issue is whether it is required to collect sales tax on sales of intangibles such as gift cards and memberships.

The Department's Return to Petitioner's Petition for a Writ of Certiorari (hereinafter the "Return") states:

> Books-A-Million argues extensively that the sale of the Millionaire's Club membership along with other items is a bundled transaction. Although not defined in South Carolina outside of the "transmission of the voice or messages," a "bundled transaction" is routinely defined as a transaction involving distinct taxable and non-taxable items, which are sold for one *non-itemized* price. A "non-itemized" price is also a requirement for a bundled transaction according to the Multistate Tax Commission and the Streamlined Sales Tax Governing Board. The Millionaire's Club membership fee is not combined with the price of other merchandise sold; each item is priced separately. (R. p. 438.) Therefore, the sales of the Millionaire's Club along with other merchandise is not a bundled transaction. Both the merchandise and the related discount membership club are taxable. Moreover, because there is no bundled transaction at issue, Books-A-Million's argument that the Court of Appeals' interpretation of "gross proceeds of sales" undercuts other statutory sales tax exemptions is unsupportable.

Return at pp. 1-2, fn 1 (citations omitted). The Department's Return makes plain: if a retailer sells a good subject to sales tax, all other otherwise items subject to statutory sales tax exemptions by the General Assembly purchased in the same transaction are also subject to sales taxes. The exemptions are voided.

The Court of Appeals' decision is novel because, as stated below, it is the first appellate court case to include the rental (or sale) of real property in the sales tax base. Thousands, if not tens of thousands, of such transactions occur annually in South Carolina.

The Court of Appeals' decision is also the first to hold that Sam's/Costco membership fees are not subject to sales tax whereas optional membership fees are included in the sales tax base – thus giving these large retailers a huge competitive advantage over thousands of smaller retailers in South Carolina.

The case contains another novel issue of law regarding renewals of memberships. Both the ALC and the Court of Appeals held that the renewal of membership fees were included in the sales tax base. Renewals are generally automatic, and the purchaser is typically billed twelve months after the initial purchase. Section 12-36-90 provides that consideration "proceeding or *accruing* from the sale" of tangible personal property is included in the sales tax base. Prior to the Court of Appeals' decision, no ALC or appellate case had ever held that an otherwise exempt purchase made twelve months later was considered *accruing* from the initial purchase.

B. There is a Constitutional Issue in this Litigation.

In deciding whether to grant a petition for certiorari, this Court may consider whether "substantial constitutional issues are directly involved." The Department argues "Books-A-Million raises the specter of a constitutional issue, but it fails to describe why that issue is 'substantial.' More importantly, however, the supposed constitutional issue is not a genuine issue." Return at p. 13.

The Department's Return also states, "Books-A-Million contends that, 'although strenuously argued at both the ALC and Court of Appeals level, neither Court addressed the obvious due process question of why Walmart (Sam's Club) and Costco's mandatory membership fees are not included in the sales tax base but Books-A-Million's options fees are.'" *Id.*

Lastly, the Department's Return argues "[f]irst, to the extent that an issue is raised but not ruled upon by a lower court is it not preserved for review. *Elam v. S.C. Dep't of Transp.*, 361 S.C.

9, 23,602 S.E.2d 772, 779 (2004). Therefore, the issue should not serve as a basis for granting [Books-A-Million]'s Petition." *Id.*

Sam's, Costco and Books-A-Million compete by selling the same items, books, CDs, calendars and the like. All provide membership fees. Sam's/Costco's membership are mandatory, whereas Books-A-Million's membership fees are voluntary. DOR Private Letter Ruling #16-1 provides that membership fees charged by a membership-only warehouse are not included in the sales tax base.

And where does the Sales Tax Act so provide? Mandatory membership fees are value proceeding or accruing from the sale, lease or rental of personal property. "But for" the purchase of a Sam's/Costco membership, you cannot get in the store to purchase goods. The Department, as is stated in their Return, may have taken this position for decades, but what statute or case law supports it?

There are obvious due process concerns over allowing two huge retailers to not to have to pay sales tax on membership fees but requiring other smaller retailers to have to pay them for the exact same intangible (membership fee).

The Department is correct – the Court of Appeals failed to rule on this issue. But it is preserved for review as Petitioner's Petition for Rehearing argued this issue at length. *See* Petition for Rehearing at pp. 5-6. Obviously an appellant cannot force a court to rule on an issue, it can only argue before the court and file a Petition for Rehearing if the court fails to address it. Indeed, the Court of Appeals' failure to address this central issue should be grounds for this court to accept the appeal.

II. PETITIONER HAS ESTABLISHED AN EXCEPTIONAL CIRCUMSTANCE THAT WOULD JUSTIFY GRANTING THE PETITION FOR WRIT OF CERTIORARI.

"[A] writ of certiorari may be issued when exceptional circumstances exist." *Laffitte v. Bridgestone Corp.*, 381 S.C. 460, 471, 674 S.E.2d 154,160 (2009) (citing *In re Breast Implant Product Liability Litigation*, 331 S.C. 540, 503, S.E.2d 445 (1998)).

The Department argues that when two or more exempt items are purchased with a taxable item, the entire transaction is taxable, notwithstanding the General Assembly's creation of numerous sales tax exemptions. The Department argues that the words contained in § 12-36-90, "gross proceeds of sale" include "the value proceeding or accruing from the sale, lease or rental of tangible personal property" override the numerous exemptions and exclusions contained in the sales tax code, all of which are far more specific than the language above, and many enacted years, if not decades, after the enactment of § 12-36-90 and its predecessor statute. This is certainly an exceptional circumstance.

In this case the Department has prevailed in reading out the taxation of "*tangible* personal property" found in § 12-36-90 as memberships are intangible.

Even more egregiously, the Court of Appeals' decision holds that the rental – and thus sale – of real property is contained in the sales tax base. See *Books-A-Million v. S.C. Dep't of Revenue*, Op. No. 5721 (S.C. Ct. App filed April 29, 2020 Shearouse Adv. Sh. No. 17 at 50-51) and its discussion of *Tronco's Catering, Inc. v. S.C. Dep't of Revenue*, 2010 WL 5871622 (S.C. Admin. Law Ct. April 12, 2010) which held that the rental of real property was contained in the sales tax base. This certainly meets the novel standard for Supreme Court review, as no appellate decision has heretofore ever held that the sale or rental of real property is contained in the sales tax base.

The Department says the test is simple – value proceeding or accruing from the sale, lease or rental of tangible personal property. This test is typically met anytime an item exempt from sales tax is rung up in the cash register, closing document or contract for sale as a non-exempt item.

The Department also asserts that sales tax exemptions and exclusions are overridden whenever "the sale of the thing the Department contends is subject to sales tax would occur 'but for' the sale of the tangible personal property."

Section 12-36-2120 contains numerous sales tax exemptions. Subsection (4) exempts "livestock." Is the sale of livestock now taxable if the farmer also purchased non-exempt hay from the seller with the same transaction?

Subsection 10(a) exempts meals or foodstuffs used in furnishing meals to certain school children. Are meals subject to sales tax if the vendor also sells in the same transaction non-exempt knives, forks, napkins and the like?

Subsection (16) exempts farm machinery but explicitly does not include automobiles and trucks. Is farm machinery subject to sales tax where the vendor also sells a truck in the same transaction?

Subsection (28) exempts certain prescription medicine. Is such medicine subject to sales tax if the patient also purchases non-exempt items (pain relievers) in the same transaction?

Subsection (60) exempts a lottery ticket. Is a lottery ticket subject to sales tax where the purchaser purchases gasoline and a cold beer in the same transaction?

Finally, unprepared food (groceries) are exempt under subsection (75). If a person purchases potatoes (exempt) and a Fry Daddy to cook them in (non-exempt), are the potatoes now subject to sales tax?

Is the cash register attendant supposed to inquire, "Sir, would you have purchased that lottery ticket 'but for' your purchase of gasoline and a cold beer?"

The above examples may seem ridiculous. But many if not most, retailers sell exempt as well as non-exempt goods in the same transaction, and the value of the exempt good proceeds or accrues from the sale, lease or rental of the non-exempt goods. The cash register Point of Sale system is programmed to comply with the South Carolina Sales Tax Act and the bar code tells the POS system whether the General Assembly has subjected each item to sales tax or whether it is exempt. The cash register POS systems charges sales tax on the non-exempt item (Fry Daddy) and not on the exempt item (potatoes). No POS is programmed to override the exemption if the potato is "value proceeding or accruing from the sale" of the Fry Daddy. No person operating the cash register has ever been instructed or trained to ask "sir, would you have purchased that potato 'but for' the purchase of that Fry Daddy?"

Ridiculous? Absurd? That is exactly the DOR's position in their Return! An otherwise exempt intangible – membership – is subject to sales tax as it is value proceeding or accruing from the sale of a non-exempt item (book or CD).

The DOR denies that membership fees are an intangible. See Return at p. 14, fn. 3. Indeed, this is a major thrust of their argument. Yet other Courts and Department of Revenues, both in the Southeast and across the country, have uniformly held that memberships are an intangible and thus not subject to sales tax. *See Barnes & Noble Superstores, Inc. v. Huddleston*, 1996 WL 596955 (Tenn. Ct. App. 1996); Fla. Dep. of Rev. Technical Advisements 89(A)-022 (issued April 12, 1989); Tenn. Rev. Rul. #14-08; *Dine-Out Tonight Club v. Dept. of Revenue Servs.*, 210 Conn. 567 (1989); *State v. Ann. West County, Promotions, Inc.*, 645 N.W. 2d 196 (N.D. 2002) and Oklahoma Tax Comm'n LTR-14-001 ("Taxability of Discount Club Membership").

The Department's position in this case is an attempt to replace a straightforward and predictable system of sales tax exemptions with a vague and amorphous alternative test focused on the purchaser's mind at the time of sale. The Department is essentially molding a subjective and unknowable taxation scheme out of what should strive to be an objective system. It undoubtedly will put the Department on the offensive with respect to future audits and create an uncertainty amongst retailers in this state that could lead to overtaxation. Faced with fear of audit, retailers could simply assess sales tax on everything, rendering exemptions irrelevant.

CONCLUSION

This case is novel. Until the Court of Appeals' decision, no appellate court had ever held that sale or rental of real property was subject to sales tax.

No one expects as a result of the "parade of horribles" given above that merchants will recalibrate their POS cash register systems. They will rightfully ignore the Court of Appeals' decision. But every day in commercial and industrial transactions, exempt items are sold in the same transaction as taxable items, e.g. manufacturers buy exempt and non-exempt M&E from the same vendor in the same sales contract. The manufacturer typically self-assesses the use tax which it remits to the Department. The manufacturer has to calculate the use tax which in many cases is hundreds of thousands of dollars. Does it follow the Court of Appeals' decision? Or ignore it? To repeat, the non-exempt items are in the same contract as the exempt M&E. The exempt M&E is value proceeding or accruing the non-exempt furniture/fixtures/material handling equipment and would not have been purchased "but for" the purchase of the non-exempt. (The factory could not run without all of the above.)

The Court of Appeals' decision has implications far beyond membership fees.

Respectfully submitted,

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