THE STATE OF SOUTH CAROLINA
In the Supreme Court

APPEAL FROM THE ADMINISTRATIVE LAW COURT

John D. McLeod, Administrative Law Judge

Opinion No. 5721 (S.C. Ct. App. Filed April 29, 2020)

Books-A-Million, Inc. ..... Petitioner.

v.

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

BRIEF OF PETITIONER

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TABLE OF CONTENTS

TABLE OF AUTHORITIES ii

QUESTION PRESENTED 1

STATEMENT OF THE CASE 2

STATEMENT OF FACTS 3

STANDARD OF REVIEW 5

ARGUMENTS 6

A. INTRODUCTION 6

B. THE ALC AND COURT OF APPEALS ERRED IN HOLDING THAT THE AMOUNTS COLLECTED BY BOOKS-A-MILLION FOR THE SALE OF MEMBERSHIP CARDS ARE SUBJECT TO SALES TAX, WHEREAS AMOUNTS COLLECTED BY SAM'S CLUB (WALMART) AND COSTCO FOR SALE OF MEMBERSHIPS ARE NOT. 7

C. THE ALC ERRED IN HOLDING THAT RENEWALS OF MEMBERSHIPS ARE SUBJECT TO SALES TAXES. 34

D. THE COURT OF APPEALS ERRED IN HOLDING THAT THE STATUTES ARE NOT AMBIGUOUS. 35

E. WALMART/COSTCO ARE NOT SUBJECT TO SALES TAXES – BUT BAM IS - THE STATUTES ARE AMBIGUOUS ISSUE 37

CONCLUSION 39

TABLE OF AUTHORITIES

Cases

A.H. Benoit and Co. v. Johnson, 302 A.2d 1 (1964) 27
Alltel Communications, Inc. v. S.C. Dep't of Rev., 399 S.C. 313, 731 S.E.2d 869 (2012) 9, 39, 43
Alltel Communications, Inc. v. S.C. Dep't of Rev., Docket No. 11-ALJ-17-0603 (filed November 13, 2015) 28
Barnes & Noble Superstores, Inc. v. Huddleston, 1996 WL 596955 (Tenn. Ct. App. filed Oct. 18, 1996) 12
Belvedere Sand and Gravel Co. v. Heath, 536 S.W.2d 312 (1976) 26
Books-A-Million, Inc. v. S.C. Dep't of Rev., 430 S.C. 388, 393 844 S.E.2d 399, 401-02 (Ct. App. 2020) 20, 23, 35, 41
Centex Int'l, Inc. v. S.C. Dep't of Revenue, 406 S.C. 132, 750 S.E.2d 65 (2013) 6
CFRE, LLC v. Greenville Cty. Assessor, 395 S.C. 67, 716 S.E.2d 877, 881 (2011) 6
Charleston Cnty. Sch. Dist. v. State Budget & Control Bd., 313 S.C. 1, 437 S.E.2d 6 (1993) 10
Cooper River Bridge, Inc. v. S.C. Tax Comm'n, 182 S.C. 72, 188 S.E. 508 (1936) 39
Dine Out Tonight Club v. Dep't of Revenue Servs., 210 Conn. 567 (1989) 14
DirecTV, Inc. v. S.C. Dep't. of Rev., 421 SC 59, 804 S.E.2d 633 (Op. No. 5513 2017) 5
Fairfield Waverly, LLC v. Dorchester Cnty. Assesor, Docket No. 14-ALJ-17-0602-CC (filed February 1, 2017) 40
Kennedy v. S.C. Ret. Sys., 345 S.C. 339, 549 S.E.2d 243 (2001) 39
Mead v. Beaufort Cnty. Assessor, Docket No. 13-ALJ-17-0585-CC (filed Aug. 19, 2014) 40
Media Gen. Commc'ns, Inc. v. S.C. Dep't of Rev., 388 S.C. 138, 694 S.E.2d 525 (2010) 6, 9
Meyers Arnold v. S.C. Tax Commission, 285 S.C. 303, 328, S.E.2d 920 (1985) 22, 29, 42
Multi-Cinema, Ltd. v. S.C. Tax Comm'n, 292 S.C. 411, 357 S.E.2d 6 (1987) 9
Original Blue Ribbon Taxi Corp. v. S.C. Dep't of Motor Vehicles, 380 S.C. 600, 670 S.E.2d 674 (Ct. App. 2008) 6
Rich's Inc., v. Blackmon, 133 Ga. App. 665, 211 S.E.2d 916 (1975) 26
Risher v. S.C. Dep't of Health & Envtl. Control, 393 S.C. 198, 712 S.E.2d 428 (2011) 5
S.C. Nat'l Bank v. S.C. Tax Comm'n, 297 S.C. 279, 376 S.E.2d 512 (1989) 39
SCANA Corp. v. S.C. Dep't of Rev., 384 S.C. 388, 394 n. 3, 683 S.E.2d 468 (2009) 39
Southeast Cinema v. S.C. Dep't of Rev., 2014 WL 2417715 (S.C. Admin. Law Ct. May 28, 2014) 29, 30
State v. Amn. West Comty. Promotions, Inc., 645 N.W.2d 196 (2002) 15
Travelscape v. S.C. Dep't. of Rev., 391 S.C. 89, 705 S.E.2d 28 (2011) 29
Tronco's Catering, Inc. v. S.C. Dep't of Rev., 2010 WL 5871622 (S.C. Admin. Law Ct. Apr. 12, 2010) 34

Statutes

Fla. Stat. § 212.02 14
Fla. Stat. § 212.05 14
S.C. Code § 12-36-910 ..... 7, 12
S.C. Code Ann. § 12-35-30 ..... 27, 28

S.C. Code Ann. § 12-36-10 33
S.C. Code Ann. § 1-23-610 5
S.C. Code Ann. § 12-36-2110 12
S.C. Code Ann. § 12-36-2120 33
S.C. Code Ann. § 12-36-60 ..... 9, 10, 11, 31
S.C. Code Ann. § 12-36-90 ..... passim
S.C. Code Ann. § 12-36-910 ..... 9, 10, 44
S.C. Code Ann. § 12-36-920 35
S.C. Code Ann. §12-35-120 24
S.C. Code Ann. §12-35-30 24
Tenn. Code Ann. § 67-6-102 ..... 11, 12
Tenn. Code Ann. § 67-6-202 11
Tenn. Code Ann. § 67-6-203 11
Tenn. Code Ann. § 67-6-401 11

Other Authorities

Fla. Dept. of Rev., Tech. Asst. Adv. 17A-017 (2017) 15
Hellerstein & Hellerstein, State Taxation (3rd ed.) 17
Ind. Dep't of State Rev. Rev. Rul. 2014-01ST (2015) 15
Ind. Dep't of State Rev. Rev. Rul. 2017-055T (2017) 15
Okla. Tax Comm'n Ltr. Rul. 14-001 (2014) 15
S.C. Dep't of Rev. PLR #11-5 18
S.C. Dep't of Rev. PLR #LR5754 (2009) 15
S.C. PLR #16-1 ..... 20, 22, 44
S.C. Rev. Rul. #15-10 27
S.C. Rev. Rul. #2004 17
S.C. Rev. Rul. #90-6 22
S.C. Rev. Rul. #93-6 37
S.C. Sales and Use Tax Manual (2016 Ed.) 20
Sutherland Statutory Construction § 66:1 43
Technical Assistance Advisements 89 13
Tenn. Dep't of Rev. PLR #14-08 (2014) 14, 15
Utah State Tax Comm'n PLR 12-010 (2012) 15

Regulations

S.C. Reg. 117-174.48 37
S.C. Reg. 117-308.11 36
S.C. Reg. 117-308.13 36
S.C. Reg. 117-308.7 36
S.C. Reg. 117-309.10 36
S.C. Reg. 117-309.8 36
Tax Commission Regulation §117-174.5 25
Tax Commission Regulation §117-174.59 25

QUESTION PRESENTED

Did the Court of Appeals err in holding that Book-A-Million should have included the amounts collected from its sale of club membership fees, including renewals, in the gross proceeds of sales subject to sales tax?

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 Petitioner Books-A-Million, Inc. ("Petitioner," or "Books-A-Million" or "BAM") challenging the South Carolina Department of Revenue's ("Respondent's," "the Department's" or "the DOR's") final determination, in which the Department assessed Petitioner 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 Petitioner $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 (App. pp. 429-34), and Petitioner timely appealed to the ALC. The sole issue before the ALC was whether the proceeds from Petitioner's South Carolina sales of Millionaire's Club memberships should have been included in Petitioner's gross proceeds of sales and, therefore subject to sales taxes. The parties filed Stipulations of Facts with the Court on September 13, 2016 (App. pp. 438-41). On March 6, 2017, both parties filed Motions for Summary Judgment (App. pp. 173-206, 207-21). 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 (App. p. 14-24). On June 6, 2017, the ALC issued an amended Order which vacated the prior Order but still ruled in favor of Respondent (App. p. 3-13). The ALC Order upheld the Department's entire Assessment of taxes, penalties, and interest.

Petitioner filed a Motion for Reconsideration, App. pp. 151-167, which was denied, App. p. 25, and subsequently timely appealed to the Court of Appeals. The Court of Appeals affirmed

the ALC decision on April 29, 2020. App. pp. 525-36. Petitioner timely filed a Petition for Rehearing, App. pp. 537-45 which was denied by the Court of Appeals on July 14, 2020. App. p. 545-46. Petitioner filed a Petition for a Writ of Certiorari which was granted by the Supreme Court on March 26, 2021.

STATEMENT OF FACTS

The parties entered into a Stipulations of Facts (App. p. 438-40), which stated in relevant part:

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

2. The Petitioner 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 Petitioner'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 renew each year for one-year periods unless the customer affirmatively opts out of the automatic renewal or the membership is otherwise canceled or terminated. So long

as the customer does not opt-out, the Petitioner bills the annual Membership Fee annually to the credit or debit card provided when the customer initially enrolled in the Club. The Petitioner may unilaterally terminate a customer's membership at any time and without notice for any reason in its sole discretion.

4. The Petitioner 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 Petitioner, 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; App. 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; App. 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; App. 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 South Carolina. 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. An Appellate Court 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).

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)). This case involves a pure error of law.

ARGUMENTS

A. INTRODUCTION

The Court of Appeals affirmed the ALC Decision that sales of memberships are included in a retailer's sales tax base. All sides concede that memberships are intangibles and that intangibles with certain exceptions (communications and electricity) are not subject to sales taxes. The Court of Appeals principally relied on the concept that memberships are included in the sales tax base because they are "inseparable" from the sale of tangible personal property (which is, of course, subject to sales tax). The Department's entire case relies upon the wording of S.C. Code Ann. § 12-36-90, which includes in the sales tax base all consideration "proceeding or accruing from the sale...of tangible personal property."

Rightly or wrongly, South Carolina's sales tax base contains numerous exclusions and exemptions. Indeed, § 12-36-120 alone contains some 80 exemptions. The Court of Appeals' decision essentially overrides these 80 exemptions any time an exempt item is purchased simultaneously (same cash register receipt) as a non-exempt item. And intangibles are an exclusion – not an exemption – as sales taxes are imposed only on the sale of tangible personal property.

Read literally, a grocery store should impose sales taxes on groceries (exempt), a slow cooker to cook the groceries (non-exempt) and prescription medicine (exempt) if they are rung up in the same cash register receipt.

In fact, groceries and prescription medicine purchased a year later than the crock pot are subject to sales taxes! (The Court of Appeals held that automatic renewals of memberships a year later were subject to sales taxes.)

B. THE ALC AND COURT OF APPEALS ERRED IN HOLDING THAT THE AMOUNTS COLLECTED BY BOOKS-A-MILLION FOR THE SALE OF MEMBERSHIP CARDS ARE SUBJECT TO SALES TAX, WHEREAS AMOUNTS COLLECTED BY SAM'S CLUB (WALMART) AND COSTCO FOR SALE OF MEMBERSHIPS ARE NOT.

1. General

The ALC and Court of Appeals 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.

2. Aren't Membership Fees the Sale of an Intangible?

Yes. S.C. Code Ann. § 12-36-910 provides that sales taxes are "imposed upon every person...in the business of selling *tangible* personal property at retail." (Emphasis added.) It was uncontroverted that membership fees, as discussed below, are intangibles. For example, the All States Tax Guide provided by the RIA also confirms that memberships would be excluded from tangible property. It closely tracks § 12-36-60 of the S.C. Code but with the addition of "membership":

> Nearly all sales and use taxes are levied on tangible personal property—sometimes also referred to as tangible personalty. This doesn't include real property such as buildings, ... Nor does it include intangible personal property consisting of mere rights of action and having no intrinsic value—such as contracts, deeds, mortgages, money, stocks, bonds, certificates of deposit, or ***membership***.

All States Tax Guide: Sales, Use, Receipts, and Similar Taxes, Section 5280 ("Tangible Personal Property Defined") (emphasis added).

If a "membership"—described above as a "mere right[] of action... having no intrinsic value"—appears as a nontaxable intangible in a manual providing state-by-state tax guidance, it is evident that § 12-36-60 excludes membership fees from its definition of tangible personal property.

3. If Membership Fees are an Intangible, are they Subject to Sales Tax?

The simple answer is no. All sides agree that Membership Fees are an intangible. Intangibles (with certain exceptions) are not subject to sales tax. No South Carolina statute or DOR regulation imposes a sales tax on Membership Fees.

If no statute or DOR regulation imposes a sales tax on Membership Fees and intangibles (with certain exceptions) are excluded, what is the basis of the Court of Appeals' ruling that they are subject to sales tax? And if they are subject to sales tax, why aren't Sam's Club and Costco liable for sales tax?

The Orders hold 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. In fact, most memberships are automatically renewed using the customer's credit card on file. Tr. p. 12, lines 11-14; App. p. 399, lines 11-14. 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." (Emphasis added.) 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." (Emphasis added.) 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; App. p. 414, lines 14-16).

As a threshold matter, the Court of Appeals' 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." § 12-36-60 (emphasis added). 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. And if they do, then the Court of Appeals has repealed the 80 sales tax exemptions contained in the Sales Tax Act. 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; App. 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. Tenn. Code Ann. § 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* S.C. Code Ann. §§ 12-36-60, 12-36-910, and 12-36-2120.

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 Petitioner in 2009. As described by the Virginia agency:

> [Petitioner] 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 [Petitioner] through the use of a discount card. Sales Tax was assessed on the [Petitioner'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 Petitioner'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). Fla. Dept. of Rev., Tech. Asst. Adv. 17A-017 (Aug. 30, 2017) (fee for membership program providing favorable shipping terms and discounts for various products and services nontaxable); Ind. Dep't of State Rev. Rev. Rul. 2017-055T (Dec. 20, 2017) (fee for membership program providing favorable shipping terms for various products and services nontaxable); Mo. Dep't of Rev. PLR No. LR5754 (July 16, 2009) (sale of prescription discount card nontaxable); Okla. Tax Comm'n Ltr. Rul. 14-001 (June 5, 2014) (charges for discount club membership not taxable, citing statute); Tenn. Dep't of Rev. PLR 14-08 (Aug. 28, 2014) (membership fees nontaxable); and Utah State Tax Comm'n PLR 12-010 (Sept. 27, 2012) (sales of "gift codes" that may be redeemed to purchase goods and services from internet retailers nontaxable).

The Indiana Department of Revenue in Rev. Rul. 2014-01ST (2015) addressed the sales tax treatment of a membership program bearing an unmistakable resemblance to Amazon Prime. The taxpayer seeking the ruling was a "Washington state corporation that sells a variety of products over the internet." *Id.* The taxpayer offered a paid membership program entitling members to

receive free two-day shipping and other discounted shipping benefits; discounted product and advance purchase benefits; free streaming video content; a free e-book monthly, selected by taxpayer's editors; free unlimited access to more than a million songs and albums; free unlimited storage for photos and SGB storage for videos and other files.

After separately reviewing each membership benefit, the department concluded that only the permanent download of a free e-book would generally be taxable, while many of the remaining benefits would be considered nontaxable services. The department held that the membership fees were not taxable, stating:

> With all this being said, while Customers have access to all of these features, a customer will not necessarily utilize each feature. As with optional warranty contracts, which are not subject to sales tax because *there is no certainty whether any tangible personal property will be provided, there is no certainty that all of the features offered under a Product Membership will be utilized by each Product Member that pays an annual fee, and thus there is no certainty whether tangible personal property or specified digital products will be transferred either.*

Id. (emphasis added).

If the Court of Appeals' 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.

4. The Department Agrees 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 nontaxable purchase of an intangible (a 'cash equivalent')".

In S.C. 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 added).

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 S.C. Private Letter Ruling #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 which were subject to sales taxes. 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.

Similarly, in S.C. PLR #11-2, at issue was whether a fee, called a "Standardized Services Charge" imposed by a country club that offers golf, tennis and swimming to its members was subject to sales tax. The fee was applied to members with dining privileges, was billed monthly and was non-refundable.

The DOR held that it was not subject to sales taxes as follows:

> The measure of the tax is the gross proceeds of the sale. "Gross proceeds of sales" means the proceeds from the sale of tangible personal property without any deduction for the cost of materials, labor or service, or any other expenses. S.C. Code §12-36-90(1)(b).
> ***
>
> Here, the Standardized Service Charge is imposed without respect to any sale of prepared food. The standardized Service Charge is billed and paid in advance. By contrast, dining charges are not incurred unless and until there is actual consumption and so are billed at the end of the month in which they are incurred. Thus, the Standardized Service Charge is not a service charge associated with the sale of tangible personal property.
>
> For these reasons, the Standardized Service Charge is not included in the gross proceeds of the sale of prepared food. It is not subject to sales tax.

5. If Voluntary (optional) Membership Fees are Subject to Sales Taxes, why are Mandatory Membership Fees Exempt?

In affirming the decision, the Court of Appeals quotes the ALC decision as follows:

> If [BAM] . . . were to stop selling tangible personal property, its [Club Membership] would not be able to survive as the [Club Membership] only exists as a means to provide discounts on BAM's sales of tangible personal property. *Because the [Club Membership] cannot exist without [BAM] offering tangible personal property for sale, I conclude [BAM's Club Membership] and sales of tangible personal property are inseparable.* Thus, I conclude [BAM] is in the business of selling tangible personal property at retail, and [BAM's] business is subject to South Carolina sales tax. (Emphasis added.)
>
> The ALC continued.
>
> When applying the plain meaning rules to the words in the statute, it is clear that *the statute is broad and encompasses the total value of a sale, not simply the amount paid for tangible personal property.* Moreoever, a review of the case law demonstrates that gross proceeds of sales can include the value of services and intangibles that are derived from the sale of tangible personal property . . . Therefore, I agree with [SCDOR] and conclude that gross proceeds of sales includes all value that comes from or is direct result of the sale, lease, or rental of tangible personal property, including

> proceeds from fees related to incidental services, intangibles, or other benefits. (Emphasis added.)

Books-A-Million, Inc. v. S.C. Dep't of Rev., 430 S.C. 388, 393 844 S.E.2d 399, 401-02 (Ct. App. 2020).

The Court of Appeals also quoted the ALC Order, which held that "membership fees are inextricably linked to, and incapable of being separated from, the sale of tangible personal property." *Id.* at 395, 844 S.E.2d at 402.

Are Petitioner's membership fees subject to sales taxes because, as the Court of Appeals' Order states, they "are so intertwined with and inseparable from the [Petitioner]'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 10 of the DOR's most recent South Carolina Sales and Use Tax Manual (December 2020) states that sales of certain memberships (e.g., Sam's Club and Costco) 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]

Id. (citations omitted). In the very recent S.C. 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 63 of the Department's Sales Tax Manual 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 monthly 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.

Id. 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 Petitioner'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 Petitioner'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.

6. The Court of Appeals' Reliance on *Meyers Arnold* is Misplaced.

As argued below, the Court of Appeals' reliance on *Meyers Arnold* is misplaced as the Court of Appeals merely held that the layaway fee charged by the retailer was subject to sales tax as former Code Section 12-35-30 stated that gross proceeds could not be reduced by the cost of labor services and former Section 12-35-120 defined sales price as including any services that are a part of the sale. The case had absolutely nothing to do with the language of current § 12-36-90, which defines "gross proceeds of sales" as "the value proceeding or accruing from the sale . . . of tangible personal property." This is a critical point, as the Department's entire case has relied on "the value proceeding or accruing" language.

The Court of Appeals' 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 and Court of Appeals' Orders principally rely on *Meyers Arnold v. S.C. Tax Commission*, 285 S.C. 303, 328, S.E.2d 920 (1985), in support of its contention. The Court of Appeals held as well:

> In *Meyers Arnold, Inc. v. South Carolina Tax Commission*, 285 S.C. 303, 307, 328 S.E.2d 930, 923 (Ct. App. 1985), the issue was whether a layaway fee was part of the gross proceeds of sales. The court reasoned that "[b]ut for the law away [sic] sales, Meyers Arnold would not receive the layaway [sic] fees. The fees are

> obviously charged for the service rendered in making law away [sic] sales." *Id.* Thus, the court held the layaway fees were part of the gross proceeds of sales and subject to the sales tax. *Id.*

Books-A-Million, 430 S.C. at 394, 844 S.E.2d at 402.

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 layaway 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 layaway plan are subject to sales tax." *Id.*

The parties in *Meyers Arnold* entered into a Stipulation of Facts. *See* Petitioner's Correspondence to Judge McLeod dated May 26, 2017 Enclosing Proposed Order and Portions of *Meyers Arnold* Record at pp. 24-25; App. 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 layaway plan. If the layaway 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 layaway 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; App. 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, non-refundable fee which is included on the layaway form as a separate charge.
>
> We find that the layaway 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 non-refundable.
>
> *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.

Petitioner's Correspondence to Judge McLeod dated May 26, 2017 Enclosing Proposed Order and Portions of *Meyers Arnold* Record at pp. 20-22; App. p. 89-90 (emphasis added).

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 (Petitioner's Correspondence to Judge McLeod dated May 26, 2017 enclosing Proposed Order and Portions of *Meyers Arnold* Record at pp. 48-49; App. pp. 116-17) as follows:

> II. Did the trial court err in not finding that the layaway 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 layaway 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 layaway 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 layaway, a non-refundable fee is charged, which is shown as a separate item on the bill.

The Tax Commission denied the layaway 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 (Petitioner's Correspondence to Judge McLeod dated May 26,

2017, Enclosing Proposed Order and Portions of *Meyers Arnold* Record at pp. 57-58; App. 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 layaway plan provided by Meyers Arnold.* The fee for the layaway service is charged to cover additional expenses incurred by Meyers Arnold for such items as storage and additional paperwork associated with a sale on layaway. Thus, if the layaway 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 layaway fee represents.

Id. (emphasis 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 in *Meyers Arnold* were charged **for the service rendered** in making layaway sales, and were accordingly part of the gross proceeds of sales and subject to the sales tax. *Meyers Arnold*, 285 S.C. 307, 328 S.E.2d at 923. Indeed, the DOR so described *Meyers Arnold* in relatively recent S.C. Rev. Rul. #15-10:

> The principle of what is includable in "gross proceeds" was established in *Meyers Arnold, Inc. v. South Carolina Tax Commission*, 285 S.C. 303, 328 S.E. 2d 920 (ct. App. 1985). In this case, the Court of Appeals reasoned:

> But for the layaway sales, Meyers Arnold would not receive the lay away fees. The fees are obviously charged for the service rendered in making layaway sales. For these reasons, this court holds the layaway fees are part of the gross proceeds and subject to the sales tax.
>
> This principle was followed in Commission Decision S-D-175 (1986), where the Department concluded that services provided by a commercial photography studio in producing original transparencies for a customer are part of the sale and may not be exempted from the gross proceeds of sale.

The holding in *Meyers Arnold* does not support the ALC or Court of Appeals' Orders. 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, "[t]he 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 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 costs.' . . . 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 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 layaway 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.

Petitioner's sale of a membership card is a substantively different transaction. In contrast to the facts in both *Meyers Arnold* and *Travelscape*, Petitioner'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.*

The Court of Appeals also erred in relying on the ALC's interpretation of *Southeast Cinema v. S.C. Department of Revenue*, 2014 WL 2417715 (S.C. Admin. Law Ct. May 28, 2014) because although the case involved an intangible (a trademark), the intangible was inextricably linked. In *Southeast Cinema*, the ALC examined whether the proceeds from both the sale of an IMAX theatre system and associated trademark were subject to sales tax. Ultimately, the court found that because the purchase agreement did not itemize the cost of the two items and because the theatre could not be used without the trademark license, the trademarks were "inextricably connected to" the theatre. No Appellate Court decision has ever so ruled.

However, the case at hand is readily distinguishable from *Southeast Cinema* because membership fees are optional and the purchase of a book does not depend on the Membership Fee. Indeed, it is hard to reconcile why mandatory membership fees charged by competing retailers would not be inextricably linked under this analysis. In *Southeast Cinema*, it is evident that the theatre system and its trademark are fundamentally connected because the two cannot be broken up to respectively determine the value of each. The ALC noted that his decision may have been different if the trademarks had been separately priced and the transaction structured differently. Books-A-Million's memberships do not share this difficulty. Memberships are optional, voluntary, and do not depend on the purchase of a book. A customer may purchase a membership and never purchase a book. On the contrary, a customer may purchase a book without ever purchasing a membership. Further, the value of the membership fee can be calculated independently at $25 per year. Accordingly, the Court of Appeals erred in finding an inextricable link between membership fees and the purchase of tangible personal property because, as explained above, such a conclusion is based on the misapplication of law.

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.

7. Inextricably Linked

As stated above, the ALC and Court of Appeals' Orders are 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 specific 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.

And many transactions involve the purchase of taxable and exempt items in the same sale. Are the exempt items now subject to sales taxes because they are "value proceeding or accruing from the sale of [non-exempt] tangible personal property"?

Even if membership fees could be subject to sales taxes if "inextricably linked" to sales of tangible personal property, the memberships at issue can be readily distinguished from other fees found "inextricably linked." Recently, the Court of Appeals ruled that amounts collected from a company's voluntary waivers were subject to sales tax under the true object test in *Rent-A-Center*

East, Inc. v. S.C. Department of Revenue, 425 S.C. 582, 824 S.E.2d 217 (Ct. App. 2019) (certiorari denied Feb. 19, 2020). In that case, a retail store operated a business which allowed its customers to rent-to-own various consumer goods after entering into a rental agreement with the store. *Id.* at 585, 824 S.E.2d at 218-19. In addition to the agreement, the retail store also offered a voluntary waiver for an additional cost. *Id.* The waiver allowed customers to waive liability for the rented item in the event of certain identified circumstances. The Court of Appeals ruled, under the true object test, the waivers were inextricably linked to the rental agreement, therefore, subject to sales tax. *Id.* at 591, 824 S.E.2d at 222. The Court of Appeals relied on the following factors in finding the waiver fee subject to sales tax:

- Waiver and rental fee were always paid for together during each rental term
- Waiver could only be enforced if all payments under rental agreement were made
- Rental agreement contained line item for the waiver fee
- Waiver fee was calculated as a fixed percentage of the rental fee
- Customers could not purchase the waiver without first entering into a rental agreement
- Terms of the waiver described it as "an additional part of the Rental Agreement"

Id. at 591-92, 824 S.E.2d at 222.

None of these factors are present in this case. Unlike the facts in *Rent-A-Center*, where waivers were purchased together during each rental term, the purchase of a membership and the purchase of a book can occur completely independently, and the membership is only an annual fee. The membership is also enforceable regardless of whether a book purchase is made, and, in fact, no book purchase need to be made in order to purchase a membership. Further, unlike waivers which were calculated as a fixed percentage of the rental agreements, Books-A-Million's membership fees are offered at a flat rate regardless of the purchase. The memberships are optional, may be cancelled at any time without cancelling the purchase of tangible personal property, and did not count toward the purchase of tangible personal property. According to the

Court of Appeals, these factors support the notion that membership fees are separate and distinct from purchases of tangible personal property and should not be included as part of the taxable gross proceeds.

8. The Court of Appeals Erred in Holding § 12-36-90 Required the Deletion of "Proceeding or Accruing" under Books-A-Million's Interpretation of the Statute.

Further, the court of Appeals' decision essentially holds that the words "proceeding or accruing from the sale...of tangible personal property" contained in S.C. Code Ann. § 12-36-90 override all the sales tax exemptions and exclusions contained in the Sales and Use Tax Act (§ 12-36-10 *et seq.*). Under such an interpretation, all the exemptions listed in the Act would be overridden in a bundled transaction if one item, a taxable item, was subject to sales taxes and the second item was not.

Specifically, § 12-36-2120 contains some 80 exemptions. The Court of Appeals has essentially re-written the opening line of the section to read as follows:

> **§ 12-36-2120 Exemptions from Sales Tax**
>
> Unless it is value proceeding or accruing from the sale of non-exempt property, exempted from the taxes imposed by this chapter are the gross proceeds of sales, or sales price of ...

To take a simple example, suppose a manufacturer builds a facility in South Carolina for a total capital investment of $20 million. It purchases $8 million of machinery and equipment (M&E) and $2 million of material handling equipment from the same vendor in the same transaction. Normally M&E would be exempt from sales taxes under § 12-36-2120(17), but material handling equipment is subject to sales tax as the manufacturer does not qualify for the material handling sales tax exemption under § 12-36-2120(51). Is the sales tax base $2 million (material handling only) or $10 million (material handling and M&E)? Under the Court of Appeals' decision, the sales tax base $10 million, as the M&E is value proceeding or accruing

from the purchase of non-exempt material handling equipment. (In our example, purchased from the same vendor in the same transaction, all included in one invoice.) And in this example, M&E is an exempted item – the burden of proof falls on the taxpayer to establish the exemption, whereas in BAM's case, intangibles are an exclusion and not included in the Sales Tax Act.

Example Two: Suppose a retailer goes out of business and sells its six stores in South Carolina to a former competitor. Sale one is a store with a real estate value of $1.2 million dollars together with furniture, fixtures and equipment (FF&E) of $60,000. Sales taxes are owed on the FF&E. Is the sales tax base $1,260,000 (real and tangible personal property) or $60,000 (tangible personal property only)? Real property is not subject to sales taxes as the Sales Tax Act only includes tangible personal property. Assuming the closing statement includes both the real and personal property, the Court of Appeals' decision states the sales tax base is $1,260,000 as the real property was purchased as value proceeding and accruing from the sale of tangible personal property.

A ridiculous example? ("Lawyer Maybank, you ain't gonna convince the Court with absurd examples!") No – the Court of Appeals' decision includes this exact example! The decision cites *Tronco's Catering, Inc. v. S.C. Department of Revenue*, 2010 WL 5871622 (S.C. Admin. Law Ct. Apr. 12, 2010) with approval, noting the "court held 'the value of the sale of catered meals includes service, labor, *and room charges* [because] [s]uch charges are incidental to and merely enhance the value of the sale of catered meals'" and that "'[§ 12-36-920] further expressly states that the value of the sale must include costs for materials, labor, service, transportation, *or for any other expense*." *Books-A-Million*, 430 S.C. at 394, 844 S.E.2d at 402 (emphasis added).

The ALC – noted approvingly by the Court of Appeals – held in *Tronco* that the rental of real property was included in the sales tax base! If the *rental* of real property is included in the sales tax base, so is the *sale* of real property if it is value proceeding and accruing from the sale of

tangible personal property. The ALC expanded the sales tax limitation of tangible personal property to include real property, just as the Court of Appeals has expanded the limitation in this case to include intangibles. So in our example, the sales tax base is $1,260,000!

The classic example of a service 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 Court of Appeals' 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 nontaxable 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 that 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, even though they are purchased in the same transaction and are inextricably linked.

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 due to statutory change)) 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 same 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 the 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.

C. THE ALC ERRED IN HOLDING THAT RENEWALS OF MEMBERSHIPS ARE SUBJECT TO SALES TAXES.

The Court of Appeals erred in finding BAM's renewals of membership cards are subject to sales taxes because the renewals are automatic, rarely done in connection with the purchase of tangible personal property, and are automatically renewed 12 months after purchase. According to the Stipulations of Facts, "[m]emberships automatically renew each year for one-year periods unless the customers affirmatively opts out of the automatic renewal.... So long as the customer does not opt out, the Petitioner bills the annual membership fee to the credit or debit card provided when the customer initially enrolled in the Club." App. pp. 4-5, 439. Such renewals are not inextricably linked to the sale of merchandise nor is their value proceeding or accruing from the sale of tangible personal property. Accordingly, renewals should not be included in the sales tax base even if the original membership purchase was so included.

The General Assembly states that consideration "proceeding or accruing from the sale... of tangible personal property" is included in the sales tax base. S.C. Code Ann. § 12-36-90. No

Department policy documents, regulation or case (Administrative Law Court, Court of Appeals, or Supreme Court case) has ever held that twelve months later is "proceeding or accruing" under § 12-36-90. (Obviously, it is not proceeding, so the question is whether it is "accruing".)

The Court of Appeals decision holds without explanation that twelve months is "accruing." Read literally, every purchase of exempt goods twelve months after the purchase of a taxable item is subject to the sales tax base. The Court of Appeals' decision holds that the purchase of a toaster, canned goods and an exempt prescription in the same transaction renders not only the initial purchase of the prescription in the same transaction subject to sales tax but also the regular renewal of the prescription for the next year!

D. THE COURT OF APPEALS 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

> Petitioners. This doubt must be resolved in favor of Petitioners. 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."

Tr. p. 32, line 17 – p. 34, line 10; App. p. 419, line 17 – p. 421, line 10 (emphasis added).

E. WALMART/COSTCO ARE NOT SUBJECT TO SALES TAXES – BUT BAM IS - THE STATUTES ARE AMBIGUOUS ISSUE

The General Assembly, by adoption of the Sales Tax Act, has not once mentioned the taxation of membership fees, other than to exclude intangibles. The Sales Tax Act is simply silent.

The Department, in a policy document, states that membership fees by a member–only warehouse is exempt from the sales tax base. *See* South Carolina Sales and Use Tax Manual (Dec. 2020), Chapter 6, p. 10, and recent PLR #16-1. Accordingly, WalMart (Sam's Club) and Costco are exempt from sales tax on their sale of membership fees – but BAM is not. And where does the Sales Tax Act give WalMart and Costco a huge (up to 9%, considering state and local sales taxes) competitive advantage over retailers offering voluntary membership programs?

The Court of Appeals' decision does not address the WalMart/Costco competitive advantage, other than to cite an irrelevant example contained in a footnote of the Department's most recent Sales and Use Tax Manual, where the "membership fee is the sales price for tangible personal property." *Books-A-Million*, 430 S.C. at 397, 844 S.E.2d at 404. (Both the Court of Appeals and the ALC ignored Petitioner's vehement objection on this point in its Motions for Reconsideration.)

Yet, virtually every quote in the decision says BAM should stand in the same shoes as WalMart/Costco. For example, the Court of Appeals finds:

> South Carolina case law provides that gross proceeds of sales includes all value that comes from or is a direct result of the sale of tangible personal property. The Membership Fee is a direct result of the sale of tangible personal property because BAM would not be able to sell Club Memberships but for BAM's sale of tangible personal property.

Id. at 398, 844 S.E.2d at 404. WalMart (Sam's Club) and Costco could not sell membership fees but for their sale of tangible personal property:

> *"'Because the [Club Membership] cannot exist without [BAM] offering tangible personal property for sale, I conclude [BAM's Club Membership] and sales of tangible personal property are inseparable.'"*

Id. at 393, 844 S.E.2d at 401 (emphasis in original). Sam's Club and Costco are even more inseparable—a customer cannot get in the door without a membership card! Hard to be more inseparable than that.

The Court of Appeals' decision also notes:

> In *Myers Arnold, Inc. v. South Carolina Tax Commission*, 285 S.C. 303, 307, 328 S.E.2d 920, 923 (Ct. App. 1985), the issue was whether a layaway fee was part of the gross proceeds of sales. The court reasoned that "[b]ut for the layaway [sic] sales, Meyers Arnold would not receive the law away [sic] fees. The fees are obviously charged for the service rendered in making layaway [sic] sales.

Id. at 394, 844 S.E.2d at 402. "But for" the sale of tangible personal property, neither Sam's Club nor Costco could sell memberships.

The Sales Tax Act and specifically § 12-36-90 do not mention membership fees. Neither the Department, the Administrative Law Court, nor the Court of Appeals provides a rationale why if membership fees (an intangible) are to be included in the sales tax base, optional membership fees are included but mandatory fees charged by membership-only warehouses (Sam's Club/Costco) are not. Mandatory fees are obviously more inseparable than voluntary fees, and but for the purchase of a membership, a customer cannot get in a membership-only warehouse to purchase tangible personal property. By definition, the statute is therefore ambiguous and the ambiguity must be resolved against the government. *See Alltel Comms., Inc. v. S.C. Dep't of Rev.*, 399 S.C. 313, 321, 731 S.E.2d 869, 873 (2012).

The Department could provide no explanation why Costco and WalMart (Sam's Club) are not liable for sales taxes and Petitioner 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

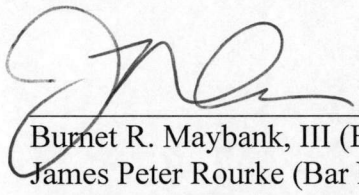
ambiguity, especially in the case of general tax administration and not a credit or exemption, must be resolved in favor of the taxpayer. See *Hadden v. S.C. Tax Comm'n*, 183 S.C. 38, 190 S.E. 249 (1937) (noting that "where a tax statute is ambiguous or is reasonably susceptible of an interpretation 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 but Petitioner 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 Petitioner's membership cards are subject. But the Department and the Court of Appeals' Orders offer no such explanation. Based upon the DOR Policy documents, Petitioner 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 Court of Appeals Order's "inextricable link" analysis?

The ALC Order states that "other than pointing out that the Department reads the statutes differently from the [Petitioner], the [Petitioner] 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 has historically so construed such statutes in its Sales Tax Manuals and PLR #16-1.

Respectfully submitted,



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