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S.C. SUPREME COURT

THE STATE OF SOUTH CAROLINA
In the Supreme Court

APPEAL FROM THE ADMINISTRATIVE LAW COURT

John D. McLeod, Administrative Law Judge

ALC Case No. 16-ALJ-17-0113-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.

REPLY BRIEF OF PETITIONER

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ISSUES ON APPEAL

Petitioner Books-A-Million ("Petitioner" or "BAM") agrees with the Respondent South Carolina Department of Revenue's ("Respondent" or "Department" or "DOR") issues on appeal, except that Respondent has not included the second issue, to wit, even if the initial Membership Fee is subject to sales taxes, are renewals subject to sales taxes.

STATEMENT OF THE CASE

Petitioner agrees with Respondent's statement of the case.

STANDARD OF REVIEW

Petitioner incorporates the Standard of Review contained in Respondent's Brief.

"Determining the proper interpretation of a statute is a question of law, and this Court reviews questions of law *de novo*", *Town of Summerville v. City of N. Charleston*, 378 S.C. 107, 110, 662 S.E.2d 40, 41 (2008), "without any deference to the court below." *CFRE, LLC v. Greenville Cty. Assessor*, 395 S.C. 67, 74, 716 S.E.2d 877, 881 (2011). *Accord Duke Energy Corp. v. Dep't of Rev.*, 415 S.C. 351, 355, 782 S.E.2d 590, 592 (2016).

STATEMENT OF FACTS

Petitioner agrees with Respondent's Statement of Facts with one exception. Respondent states that "BAM presented no evidence to the ALC establishing that any customers pay the Membership Fee without also purchasing tangible personal property." Respondent's Brief at 3-4. True, but there was also no evidence (*see* Stipulation of Facts, App. pp. 438-40) that any customers purchased tangible personal property at the same time as purchasing a membership. Renewals were automatic with BAM running the credit card a year later after the initial purchase. If BAM is simply charging a credit card on file one year following the customer's initial membership

purchase, then any correlation between that charge and the purchase of tangible property would be purely coincidental.

ARGUMENTS

I. INTRODUCTION

The Respondent has substantially changed its argument in this matter. Before the Administrative Law Court ("ALC") and Court of Appeals, the Respondent argued that Membership Fees were included in the sales tax base because the Membership Fees were inextricably linked to the sale of tangible personal property and "but for" the sale of tangible personal property no one would purchase a Membership Fee. Perhaps given that Membership Fees are more inextricably linked at Sam's Club and Costco (membership clubs), where you cannot get in the door without a membership card, the Respondent now argues for the first time that Membership Fees are taxable because members receive a discount. The Respondent never raised this issue a single time in its Brief filed with the Court of Appeals. Respondent's Brief before the Court of Appeals used the word "discount" or "discounted" eleven times, but its Brief before the Supreme Court uses the terms 65 times. To repeat, the Respondent did not argue a single time before the ALC or Court of Appeals that discounts to members rendered the transactions subject to sales taxes.

Additionally, the Respondent never really addressed the Appellant's second issue that renewals of the membership are not subject to sales tax.

II. THE SALES AND USE TAX ACT DOES NOT REQUIRE THAT BAM INCLUDE THE PROCEEDS FROM ITS SALES OF MILLIONAIRE'S CLUB MEMBERSHIPS, INCLUDING RENEWALS, IN THE GROSS PROCEEDS OF SALES.

A. Millionaire's Club Membership Fees do not Constitute Value Proceeding or Accruing from the Sale of Tangible Personal Property.

The Respondent's Brief states: "The ALC and the Court of Appeals correctly concluded that the Millionaire's Club membership fees are part of BAM's gross proceeds of sales because the fees are a substitute for or an advanced payment on the subsequently discounted merchandise." Respondent's Brief at 6.

The Respondent's Brief also states: "The proceeds from BAM's sale of Club memberships (initial and renewal) are so closely associated with the sale of tangible personal property that the fees must be included in BAM's gross proceeds of sales. The customers must pay the Membership Fee in order to receive these benefits and the benefits are only available to those who pay the fee." *Id.* at 7. True, the benefits are only available to those who pay the Membership Fee, but the same is equally true for membership clubs (Sam's and Costco) where purchasers are required to pay a Membership Fee to get their "wholesale pricing." And this analysis overrides or wipes out all the sales tax exemptions where an exempt item (e. g. real estate) is purchased in the same transaction as taxable items (furniture, fixture, machinery and equipment).

B. S.C. Code Ann. § 12-36-90 is unambiguous.

The DOR Brief states:

> BAM argues, contrary to the findings of the ALC and the Court of Appeals, that section 12-36-90 is ambiguous and should be construed to exclude the Membership Fees from BAM's gross proceeds of sales. When determining whether a statute is ambiguous, courts look at whether the language in the statute can have more than one reasonable interpretation. If the language of a statute only has one reasonable interpretation, then it is unambiguous and the court need not apply any rules of statutory construction.

> Here, the language in Section 12-36-90 has only one reasonable interpretation – gross proceeds of sales include *all* value that proceeds or accrues to a taxpayer from the sale of tangible personal property.

Id. (internal citations omitted and emphasis in original). The Respondent's Brief also states: "Thus, BAM's reading of section 12-36-90 requires deleting from the statute the phrase 'proceeding or accruing.' This interpretation must fail because it renders the 'value proceeding or accruing' language meaningless." *Id.* at 9.

Perhaps S.C. Code Ann. § 12-36-90 is not ambiguous. The Section defines "gross proceeds" of sales as "the value proceeding or accruing from the sale, lease, or rental of tangible personal property." What is "the value proceeding or accruing" from the sale of tangible personal property? The Department argues that it includes "*all* value that proceeds or accrues to a taxpayer" (emphasis in original), thus including the sale of all items excluded or exempted in the rest of the Sales Tax Act, which are purchased in the same transaction as a non-exempted item. Thus, according to the Department, the purchase of chicken wings (exempt under § 12-36-2120(75) as unprepared food) in the same transaction as a Fry Daddy (taxable) renders the chicken wings subject to sales tax.

Did the General Assembly mean to subject all exempted and excluded items to sales taxes by using the language "proceeding or accruing" in Section 12-36-90? No, in fact, the General Assembly provides a lengthy definition of "proceeding or accruing," in the Section. Section 12-36-90 states:

> **SECTION 12-36-90.** "Gross proceeds of sales".
>
> Gross proceeds of sales, or any similar term, means the value proceeding or accruing from the sale, lease, or rental of tangible personal property.
>
> (1) The term includes:

> (a) the proceeds from the sale of property sold on consignment by the taxpayer, including property sold through a marketplace by a marketplace facilitator;
>
> (b) the proceeds from the sale of tangible personal property without any deduction for:
>
> (i) the cost of goods sold;
>
> (ii) the cost of materials, labor, or service;
>
> (iii) interest paid;
>
> (iv) losses;
>
> (v) transportation costs;
>
> (vi) manufacturers or importers excise taxes imposed by the United States; or
>
> (vii) any other expenses;

"Proceeding or accruing" accordingly refers to (i) cost of goods; (ii) the cost of materials, labor or services; (iii) interest; (iv) transportation; (v) losses; (vi) transportation costs; and (vii) excise taxes. A lengthy list, to be sure, but it does not include exempted or excluded (intangibles) items. Section 12-36-130, which defines "sales price" includes similar language. It states that "'sales price' means the total amount for which tangible personal property is sold without any deduction for the cost of the property sold, the cost of the materials used, labor service cost, interest paid, losses or other expenses. (1) the term includes: (a) Any services or transportation costs that are a part of the sale . . ."

Section 12-36-130 is presumably the statute at issue in this case, as it defines "sales price." The section does not include exempted or excluded items, and specifically references "the total amount for which tangible personal property is sold." BAM paid sales taxes on "the total amount

for which tangible personal property is sold." Section 12-36-30 (2)(a) specifically exempts "A cash discount allowed and taken on the sale."

C. The "inextricable link" test does not show that Club Membership Fees are property included in BAM's gross proceeds of sales.

Footnote 4 of the Respondent's Brief (p. 9) states:

> BAM states that the Department has conceded that the club membership is an intangible. (Appellant's Br., p. 6.) The Department has made no such concession and previously made that clear in its opposition to BAM's Petition for Certiorari. Of course a membership cannot be held or sensed, but 'intangible' in the tax context is a term of art that is inapplicable here."

The Department has given the Supreme Court an easy way out to reverse the Court of Appeals' decision if it agrees that Membership Fees are an intangible. The decision can be reversed on the simple basis that the Department has incorrectly characterized Membership Fees as tangible personal property.

The Respondent's Brief states:

> "Nevertheless, BAM misconstrues the ALC's Order and contends "the ALC Order is premised on the notion that sales of [Club memberships] are 'inextricably linked' to sales of tangible personal property." (Appellant's Brief, 28). This is simply untrue... It is the *discounted price* that is inextricably linked to the Millionaire's Club membership. The ALC (and by way of affirmation the Court of Appeals) did not base its decision on the fact that the Club membership is inextricably linked to BAM's sale of *all* tangible personal property."

Respondent's Brief at 10 (emphasis in original). Is this accurate? Did the ALC and Court of Appeals' Order turn on "discounted price?" Well, here is what the Court of Appeals said, quoting the ALC decision:

> 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.

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

The ALC held in its Order that:

> But for the Petitioner's sale of tangible personal property, the Petitioner would not be able to sell Millionaire's Club memberships and, therefore, would not collect Membership Fees. The Membership Fees are payment for services or benefits that are incident to the sale of tangible personal property. Moreover, the Membership Fees are inextricably linked to, and incapable of being separated from, the sale of tangible personal property.

Books-A-Million v. SC Dept. of Rev., 2017 WL 2540343, at *7 (S.C. Admin. Law Ct. 2017). Furthermore, the Court of Appeals cited to the ALC Order with approval, including it verbatim within their analysis:

> But for the Petitioner's sale of tangible personal property, the Petitioner would not be able to sell Millionaire's Club memberships and, therefore, would not collect Membership Fees. The Membership Fees are payment for services or benefits that are incident to the sale of tangible personal property. Moreover, the Membership Fees are inextricably linked to, and incapable of being separated from, the sale of tangible personal property.

Books-A-Million, 430 S.C. at 395, 844 at 402 (quoting *Books-A-Million v. SC Dept. of Rev.*, 2017 WL 2540343, at *7 (S.C. Admin. Law Ct. 2017)). Contrary to the Respondent's Brief (p. 10), there is not a single reference in the ALC's or Court of Appeals' decisions that "[i]t is the *discounted price* that is inextricably linked to the Millionaire's Club membership."

The Respondent's Brief (p. 11) further states:

> BAM compares itself to veterinarians' offices, doctors' offices, and other similar professionals who provide services that are wholly distinct from the sale of tangible personal property and who do not offer discounts on purchases that are connected to the provision of a

> non-taxable service. For example, a veterinarian may sell pet food and supplies without offering veterinarian services. Conversely, a veterinarian does not have to offer pet supplies in order to complete its veterinarian services... The same is true for ophthalmologists and funeral homes. Thus, a proper application of the "inextricable link" test demonstrates that the sale of tangible personal property and the provision of services by these professionals are not inextricably linked.

The DOR accordingly distinguishes not including the veterinarian's service fee in the sales tax base for the sale of pet food by noting that (1) a "veterinarian may sell pet food and supplies without offing veterinarian services"; and (2) may offer veterinarian services without offering pet supplies. True, but what if the veterinarian does sell both? Lawyer Maybank takes his basset hound, one Frankie Maybank, into the vet for skin rashes. The vet diagnoses the problem and tells Lawyer Maybank, "Frankie has hot spots and is overweight. You need to get the skin rash hand cream and 'collar of shame' we sell on the way out. You also need to get a bag of the diet dog food. See you in six months." Lawyer Maybank purchases all three and all four items (services and supplies) are rung up in the same transaction – same cash register receipt. Are the services now included in the sales tax base? Clearly, they are inextricably related and "but for" the sale of services, Lawyer Maybank would not have purchased the supplies.

Hellerstein & Hellerstein, *State Taxation* discusses bundled and mixed transactions at length, although it primarily deals with the sale of tangible personal property and the sale of a service (and not intangible). Hellerstein §12.08 [1][c] accordingly states:

> [c] **Services Coupled With a Transfer of Separate Property**
>
> In deciding whether a transaction involves the sale of tangible personal property or the sale of services, courts sometimes confuse services that are *separate and apart from the property* transferred or licensed with services *that are embodied in the property*. One may illustrate this point by comparing two different types of transactions – the licensing of motion picture films by producers to exhibitors, and transactions engaged in by landscape designers. Motion picture producers employ a large amount of

> expensive talent in producing films, including directors, actors, and others. Since the results of such work are embodied in the films that are delivered to exhibitors, however, most states tax motion picture rentals as licenses to use tangible personal property.
>
> Landscape designers also use services in preparing the land and planting trees, shrubs, and flowers. Although they transfer shrubs, trees, and plants to their customers, the services are not embodied in those articles in the typical case in which landscape designers purchase trees and shrubs from a nursery. The trees and shrubs are thus separate and apart from the services, except for the service involved in planting them, in contrast to the motion picture negative and prints, which embody the services. Consequently, if a landscape designer separates the price of the trees and shrubs from the planting and other service charges, the sales tax will apply only to the price of those articles. No sales tax will be payable on the general landscaping work or the planting of trees and shrubs.

South Carolina follows the rules stated in Hellerstein. South Carolina does not include service charges in the sales tax base. When Vets sell pricey dog good, Ophthalmologists sell eye glasses, jewelry repairmen sell jewelry, barbershops and beauty shops sell shampoos, undertakers sell caskets or interior decorators sell mirrors or curtains, sales tax is imposed on the tangible personal property and not on the services, even if they charged in the same transaction. And this is so regardless if it is all contained in one bill, i.e. the value proceeding or accruing from the sale of the mirrors and curtains includes interior decorating services. And it doesn't matter if they are "inextricably linked," i.e. the customer wouldn't have purchased the mirror or curtains but for the interior decorator's services, or the services constitute value proceeding or accruing the sale of tangible personal property.

Regarding the vet's option to sell – or not sell – pet supplies, this was the basis of the Tennessee Court of Appeals' decision on *Barnes & Noble Superstores, Inc. v. Huddleston*, 1996 WL 596955 (Tenn. Ct. App. 1996), holding that Barnes & Noble Membership Fees were not subject to sales taxes. The Court noted that the "member has no obligation ever to purchase any

merchandise," and "(t)he club member may ultimately elect not to avail himself of the privilege of buying anything."

III. THE DEPARTMENT'S LONGSTANDING INTERPRETATION AND APPLICATION OF THE SOUTH CAROLINA SALES AND USE TAX ACT IS NOT ENTITLED TO DEFERENCE.

The two SC DOR Policy Documents which make optional Membership Fees subject to sales taxes are SC Revenue Ruling #90-6 and SC PLR #92-11. Both rely on the same Virginia Department of Taxation Policy Document 87-50, Feb. 26, 1987. SC Rev. Rul. #90-6 cites the same Virginia Policy Document. The Virginia statute relied upon defines sales as the "lease or rental, . . . in any manner or by any means whatsoever, of tangible personal property and any rendition of a taxable service for a consideration." The deluxe video club membership at issue entitled members to a number of free rentals. The Tax Commission deemed the deluxe membership taxable because the memberships entitled the members to free rentals of video tapes. The Virginia statute is considerably more expansive than South Carolina law, and the BAM membership does not entitle members to free rentals.

The Virginia Department of Taxation held that sales of Membership Fees by BAM were not subject to sales tax in guidance provided to Petitioner in 2009. Commonwealth of Virginia Dep't of Taxation Letter to Books-A-Million, Inc. (Feb. 4, 2009) (App. p. 202-03). As described by the Virginia agency:

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

Id.

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." *Id.* Based on the foregoing, the Virginia Department of Revenue concluded the Appellant's sales of Millionaire's Club memberships were exempt from Virginia's sales and use tax.

Given that the SC DOR Policy Documents relied on a Virginia Policy Document which does not apply to BAM, and the Virginia Department of Revenue explicitly told BAM that its Membership Fees are not included in the sales tax base, the Department's "long standing interpretation" is not entitled to deference.

IV. ALL APPLICABLE SOUTH CAROLIA CASE LAW DOES NOT SUPPORT THE INCLUSION OF THE MILLIONAIRE'S CLUB MEMBERSHIP FEES IN BAM'S GROSS PROCEEDS OF SALES

The Department argues that all South Carolina case law supports its determination. The Department cites the following cases:

A. Meyers Arnold

Both the ALC and Court of Appeals' decision principally rely on the "But For" dicta contained in *Meyers Arnold v. S.C. Tax Commission*, 285 S.C. 303, 328 S.E. 2d 920 (1985). At issue was whether a layaway fee inextricably linked to the sale of certain merchandise was included in the sales tax base. As stated at length in Petitioner's Briefs before both the Court of Appeals and Supreme Court, the taxpayer argued that the layaway fee was a finance charge and thus exempt. The Tax Commission and Court of Appeals determined it was not a finance charge and held it was taxable under the wording of Section 12-36-90, which states that gross proceeds includes the "value proceeding or accruing from the sale of tangible personal property . . . without

any deduction for service cost." The layaway fee was taxable in the same sense as Brooks Brothers cannot pay sales taxes on a $1,200 suit by deducting $400 for tailoring charges. The case, simply put, had nothing to do with the "proceeding or accruing" language of Section 12-36-90. It relied on "without any deduction for service cost."

B. Rent-A-Center East, Inc.

In *Rent-A-Center East, Inc. v. Department of Revenue*, 425 S.C. 582, 824 S.E.2d 217 (2019) Rent-A-Center was in the business of renting electronics and appliances to consumers. When a customer rents an item, the customer may also choose to purchase a "liability waiver" from Rent-A-Center. "The Waiver gave the customer the option to pay an additional fee along with the rental term payment ... If a customer chose to pay the Waiver fee, Taxpayers would waive the customer's liability for the value of the rental property in the event of certain enumerated conditions...." *Id.* at 585, 824 S.E.2d at 218-19. The dispute was about whether the waiver fee was subject to sales tax.

The Court of Appeals stated the historical interpretation of gross proceeds of sales:

> In our view, because substantial evidence supports the ALC's finding that the Waivers were merely incidental to the Rental Agreements, the Waivers must also be subject to the sales tax as gross proceeds of the Rental Agreements. Put differently, because the Waivers and Rental Agreements were inextricably linked, the value proceeding from the Rental Agreements included the value Taxpayers received from the Waivers, and the Waivers are not exempt from the sales tax.

Id. at 592-93, 824 S.E.2d at 222-23 (internal citations omitted).

Accordingly, the customer in *Rent-A-Center* leased furniture and purchased a liability waiver for the same furniture in the exact same transaction rung up in the same cash register receipt. Liability waivers were not deductible as they constituted a service cost.

C. Travelscape, LLC

Similarly, in *Travelscape, LLC v. Department of Revenue*, 391 S.C. 89, 705 S.E. 2d 28 (2011), an online travel agency alleged that it was not required to pay sales tax on the service and facilitation fees it retained from online hotel reservations because such fees are "derived from" the services it provides, not from the rental charge for the hotel rooms. In evaluating the case, the South Carolina Supreme Court applied the plain meaning rule to § 12-36-920(A), which imposes a tax on the "gross proceeds derived from the rent charge for any room." The Court then looked to § 12-36-90(1)(b)(ii), which explicitly defined gross proceeds as "the value obtained from the rental of accommodations *without deduction for the cost of services*" (emphasis added). Thus, given the explicit language of the statutes in relation to services, the Court applied the plain meaning rule and decided service and facilitation fees retained from online hotel reservations were subject to sales tax.

Travelscape, Rent-A-Center and *Meyers Arnold* are distinguishable from the case at hand because they involve the imposition of sales tax on fees charged by a retailer providing services where the fees were inextricably linked to the sale of specific tangible personal property. In each case, there was no way the customer could pay the layaway fee or the room booking fee or liability waiver separately—the fee could only possibly be charged if the underlying transaction occurred.[1]

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[1] Indeed, even the DOR concedes that layaway fees are not subject to sales tax where there is not an accompanying sale of tangible personal property. In S.C. PLR #11-4, dealing with sales taxation of Layaway Sales, Layaway fees and Partial Payment Sales, the DOR states:

> The non-refundable layaway fee is only subject to the sales tax if there has been a layaway sale – a transfer of title or possession of the tangible personal property to the customer. If the layaway agreement is nullified because the customer failed to make a required payment and therefore no layaway sale occurs (no transfer of title or possession of tangible personal property occurs), then the non-refundable layaway fee and any layaway payments received are not subject to the sales tax.
>
> Note: If the layaway fee were refundable (i.e. the layaway fee is returned to the customer if the layaway sale does not occur), the application of the sales tax to the layaway fee would be the same as described in the above conclusion. In other words, if a layaway sale occurs (transfer of title or possession of tangible personal

However, neither case addresses whether intangibles, such as optional Membership Fees, are included in gross proceeds of sale, and neither of the cases address an optional fee. Specifically, *Meyers Arnold*, *Travelscape* and *Rent-A-Center* simply stands for the proposition that a retailer cannot lower the sales tax base by separately itemizing cost of materials or services inextricably linked to the tangible personal property. It in no way stands for the proposition that the purchase of an entirely separate intangible is included in the sales tax base. This issue remains novel in South Carolina.

Moreover, contrary to the Department's assertion in its Brief (p. 20-21), there are substantial and "meaningful difference[s] between the money Rent-A-Center collects for a liability waiver" and the Membership Fee at issue in this case. First and most importantly, the fee for renting the tangible personal property and the fee for the optional waiver were always "paid together during each rental term." *Rent-A-Center*, 425 S.C. at 591, 824 S.E.2d at 222. As described above, the Membership Fee could be purchased along with other items or as a standalone item. Second, the waiver fee was calculated as a fixed percentage of Rent-A-Center's rental fee and could not be purchased until the customer entered into a rental agreement—thus a *sine qua non*. This means that the rental transaction is an essential and indispensable prerequisite to the purchase of the waiver and that waiver fee could never stand alone; in other words, it would be impossible for the Rent-A-Center customer to purchase only the waiver. *Id.* On the other hand, BAM's Membership Fee contained no such link to the purchase of underlying property, and a BAM customer certainly could purchase only the Membership (in fact, since renewals were a recurring

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property occurs), then the layaway fee and the layaway payments received would be subject to the sales tax. If no layaway sale occurs (no transfer of title or possession of tangible personal property occurs), then the refundable layaway fee and any layaway payments received would not be subject to the sales tax.

charge on a customer's credit card, all renewal purchases purchased in this manner had no linked purchase of tangible personal property). Finally, the customer could not utilize the purchased waiver unless and until he made all payments under the rental agreement. *Id.* Again, BAM's Membership Fee contained no such link.

V. IS DISCOUNTED PRICE THE CENTRAL ISSUE BEFORE THE COURT?

As stated in the Introduction, the Department has asserted an entirely new issue before the Supreme Court. The Department now argues that it is the discounted price that is "inextricably linked" to the sale of tangible personal property. The Respondent's Brief (p. 10) states:

> Nevertheless, BAM misconstrues the ALC's Order and contends "the ALC Order is premised on the notion that sales of [Club memberships] are "inextricably linked" to sales of tangible personal property." (Appellant's Brief, 28). This is simply untrue; the sale of tangible personal property at BAM is available to members and non-members alike. It is the *discounted price* that is inextricably linked to the Millionaire's Club membership. The ALC (and by way of affirmation the Court of Appeals) did not base its decision on the fact that the Club membership is inextricably linked to BAM's sale of *all* tangible personal property. Rather, the "inextricable link" analysis is simply a tool for demonstrating how the Membership Fee is value proceeding or accruing from the sale of tangible personal property. (R.p. 12.)

The Department never raised this issue a single time before the Court of Appeals. Does the fact that BAM offers discounts to members which are not available to non-members suddenly render the cost of the intangible membership card subject to sales taxes? (We know from the Membership Club Policy documents that if members and non-members purchased the membership card, it would not be subject to sales taxes.) The DOR contends sales taxes are accordingly imposed on the purchase price because the member will receive a discount if the customer presents the card. Is this the law?

Well, only members of Costco and Sam's Club (discount warehouses) receive their discounts ("wholesale" pricing.) Non-members do not.

And, are discounts subject to sales tax? If a store that normally sells chicken wings for $3.85 per pack has a 4th of July sale, and sells said wings for $3.10, is the sales price $3.85 or $3.10? According to the General Assembly, the sales price is $3.10 as Section 12-36-90(2) plainly states:

> Gross proceeds of sales, or any similar term, means the value proceeding or accruing from the sale, lease or rental of tangible personal property.
>
> (1) The Term includes:
>
> * * *
>
> (2) The term does not include:
>
> (a) a cash discount allowed and taxed on sales.

So the oft cited 12-36-90, "the value proceeding or accruing from the sale" explicitly excludes "cash discounts"! And it's that simple and unambiguous. It does not say "cash discounts but only those given to members and non-members alike," as the DOR reads it.

If a customer presents a $10 off coupon and purchases a $50 item for $40, are sales taxes imposed on $50 or $40? Sales tax is imposed on $40 unless the seller is reimbursed by the manufacturer for the $10 discount.

The DOR has issued several policy documents, including S.C. Rev. Rul. # 98-15 and S.C. Rev. Rul. #99-9 on coupons and discount cards and there is an Attorney General Opinion, 1982 S.C. Op. Atty. Gen. 35, 1982 WL 155000.

These policy documents all say that the discounted sales price is the price subject to sales taxes (self-redeeming coupon, Discount Card Programs based upon Purchases by the Retailer) unless the retailer is reimbursed by the manufacturer for the discount (Manufacturer's Coupon).

S.C. Rev. Rul. #99-9 discusses Self-Redeeming Coupons as follows:

> If a consumer purchases a product from a local retailer using a retailer's self-redeeming coupon as described in the facts, and the price charged the consumer by the retailer is reduced by the value assigned the coupon by the retailer, then the amount received by the retailer from the consumer is includable in "gross proceeds of sales," and therefore, subject to the sales tax. The value of the retailer's self-redeeming coupon is not includable in "gross proceeds of sales," and therefore, not subject to the sales tax. For example, if an item normally sells for $5.00 and the customer pays $4.00 and presents the store's self-redeeming's coupon valued at $1.00, then the sales tax is based on $4.00 ("gross proceeds of sale") since the retailer only receives the $4.00 from the customer.

Nowhere do the two Policy Documents require the coupons be given to every customer, nor do they state this rule does not apply if only a select group of customers receive them. The Policy Documents are also silent on the origination of the coupons, i.e., whether they are free (e.g., included in Sunday newspaper inserts) or effectively purchased (e.g., given at the cash register after the customer has purchased a certain amount of goods). The Policy Documents are completely silent on this point.

S.C. Rev. Rul. #99-9 discusses a Discount Card program as follows:

> One method used by the retailer to promote certain products is a discount card program. This program was developed by the retailer to direct discounts to *a select group of customers* and to promote customer loyalty. Under this program, the retailer issues an encoded electronically-readable card to its customers. The card is similar in appearance to and functions like a bank automatic teller card. Each card carries unique information about each customer and enables the retailer to collect data related to the customer's buying habits.
>
> When a customer makes a purchase, he or she presents the card to the cashier. The retailer then *discounts the price of selected products purchased by the cardholder.*
>
> While the supplier allowances provide funds for the retailer to pass additional discounts to its cardholders, the use of the card does not affect the amount of allowances the suppliers pay to the retailer. The allowances received are based on past purchases from, or previous negotiations with, a supplier. There is no direct connection between a customer using his or her card to buy a particular product and the amount the retailer receives from the product's supplier.

Id. (emphasis added). The Ruling holds that this is not subject to sales taxes as follows:

> As stated in the facts, some allowances, unlike manufacturer's rebates which are paid to the retailer as the result of a customer buying a particular product, are paid based on purchases made by the retailer during the previous year or as a result of previous negotiations with the supplier. They are received based on the purchases of the manufacturer's products by the retailer, not on sales of those products by the retailer to the retailer's customers. Therefore, these allowances are not includible in the retailer's gross proceeds of sales and are not subject to sales tax. In contrast to the above "manufacturer's rebate" example, if the retailer were to give each customer a 15 cent discount on a product that normally sells for $1.00 when a customer uses his or her card to buy the product, the measure of the sales tax on the sale would be 85 cents.

In summary, the value of self-redeeming coupons are not included in the sales tax base regardless of whether all customers – or only a select group of customers receive them (at checkout after making purchases), and it does not matter if the coupons are free or only come after purchase of goods from the retailer.

And the value of discount cards available only to a "select group of customers" which "discounts the price of selected products purchased by cardholder" are also not included in the retailer's sales tax basis. S.C. Rev. Rul. #99-9.

And this plainly follows the definition of "gross proceeds," "mean[ing] the value proceeding or accruing from the sale ... of tangible personal property" except for "a cash discount."

So in summary, according to the DOR, the discount pricing exception contained in 12-36-90 (2)(a) applies as follows:

1. Membership fees for membership warehouses offering wholesale pricing – allowed
2. Self-redeeming coupons (whether free or effectively purchased) – allowed
3. Discount cards given to a select group of customers which discounts prices on selected products purchased by the cardholder – allowed

4. Membership fees optionally purchased by BAM shoppers – NOT allowed

And who receives such discounts?

1. Membership warehouses – only the members who purchase the membership card; non-members not entitled to discounts.

2. Self-redeeming coupons – in many cases, only customers who make purchases (coupons given only after checking out), and

3. Discount cards – only "a select group of customers."

Finally, as a practical matter, Respondent's position that the member fee is advance payment for the discounts to be taken in the future would be nearly impossible to administer from an accounting standpoint. For any given customer, BAM could not know how much of that discount would be used, and creates an unworkable situation to the extent a customer's use of the discount and access to free shipping is greater than the Membership Fee.

VI. CONCLUSION

Walmart is the largest retailer in the United States. Walmart sells taxable goods, exempt goods (groceries) and services (optician services, services performed by pharmacy). A person who purchases groceries (exempt unprepared food), a crock pot to cook the groceries, and an eye exam at Walmart is charged sales taxes only on the crock pot, regardless of whether they are rung up in the same transaction at the cash register. It doesn't matter if the groceries were value proceeding or accruing the purchase of the crock pot or if the purchases were inextricably linked.

The Department is correct – sections 12-36-90 and 12-36-130 are plain and unambiguous. Both only tax intangibles only to the extent that "the sale or use of which is subject to tax under" Chapter 36 (§ 12-36-60), and neither tax intangible membership cards. And certainly neither exempt "warehouse-only" membership clubs but tax optional memberships. No basis exists to exempt membership only warehouses which are indeed inextricably linked to retail purchases and tax optional membership cards. *Meyers Arnold* simply stands for the proposition that you can't

lower the sales tax base by separately itemizing cost of materials or services inextricably linked to the tangible personal property. It in no way stands for the proposition that the purchase of an entirely separate intangible is included in the sales tax base.

As stated in Petitioner's Brief filed with the Court of Appeals, sales of memberships in the United States is huge. Many retailers, including museums and art galleries, offer discounts to those who purchase optional memberships. Are they all required to add Membership Fees when one purchases a discounted item at e.g. Riverbanks Zoo gift shop?

The DOR has revised Section 12-36-90, the proceeding or accruing language, to delete all the exclusions and exemptions in the sales tax act if a non-exempt item is purchased in the same transaction as exempt items. And the Court of Appeals' Ruling agrees! It cited *Tronco's Catering, Inc. v. SCDOR*, 2010 WL 5781622 (S.C. Admin. L. Ct., April 12, 2010) in support of its decision. That case held that the rental (and thus sale) of real property is included in the sales tax base where the retailer also sold non-exempt tangible personal property in the same transaction!

And the DOR, ALC and Court of Appeals' rulings all hold that proceeding or accruing includes transactions (renewal of BAM membership) which occur one year later!

Most retailers use Point of Sale cash register software. The software is written for South Carolina retailers and is annually updated to include any amendments to the Sales Tax Act by the General Assembly. The software identifies via bar code whether a specific item is subject to sales tax or is exempt. According to the Court of Appeals, the software will have to process whether the exempt item was purchased within a year of a non-exempt item! And it will have to determine for each discounted item whether the general public was entitled to the discount, or just selected customers!

Respectfully submitted,

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