

REQUEST LETTER

06-025

Commissioners
Utah State Tax Commission
210 North 1950 West
Salt Lake City UT 84134

Re: Private letter Ruling Request on Application of the Utah Sales and Use Tax to Web-based Discount and Service Membership Programs/Clubs.

Dear Commissioners:

This letter requests a private letter ruling as to the applicability of the Utah Sales and Use Tax to Web-based Discount and Service Membership Programs/Clubs. However, if the requirements of a private letter ruling are not met by this request, we request that you please provide an information letter addressing these issues.

FACTS

The Company we represent (the “Company”) provides Internet based (“web-based”) discount and service membership programs/clubs. The Company is not located in Utah. To become a member of one of these membership programs/clubs, a person must sign up over the Internet. Moreover, the Company also solicits members through contracts with various web-based service providers and sellers which allow the Company to solicit over the Internet the customers of such sellers and service providers to become members in the Company’s various membership programs/clubs.¹ (The Company itself is not a shopping club or organization that sells tangible personal property.) The Company is not currently being audited by the Commission, nor is it involved in litigation with the Commission on this matter.

In the Company’s membership programs/clubs, for a monthly membership fee, the members receive membership privileges and benefits, such as discounts to hundreds of third party attractions, restaurants, hotels, car rentals and air fares, best price guarantees protection, delivery guarantees, road and towing protection, credit card fraud protection and theft and loss protection on the member’s internet purchases. Some of the membership programs/clubs also offer to the members credit report access, daily credit report monitoring services and identify theft protection. As part of its services and intangible benefits, one of the clubs provides a free weekly e-newsletter and monthly magazine.

¹These sellers and services providers do not receive any of the monthly membership fees, however, a seller or service provider will get one-time cash solicitation fee (depending on the type of solicitation or advertising employed) for each customer solicited that become a new member that joins the club.

The Seven Membership Programs/Clubs are listed below:

1. Club A – provides up to 50% discount at hundreds of attractions, restaurants, retailers, service providers and cinemas for members. The membership benefits also include trip delay, hotel over-booking, baggage delay and loss, road and towing protections.
2. Club B – provides up to 50% discount on hundreds of hotels, up to 25% discount on car rentals, the receipt of road and tow protection, up to \$500 savings (discounts) on airfare and hotel fire/theft protection.
3. Club C – provides discounts and rebates at hundreds of online merchants. It also provides best price guarantee protection of up to \$100 per claim on the difference between the price paid by a member to various retailers and any lower price offered by those retailers within 90 days. Other benefits include delivery guarantees, and protection for credit card fraud and unauthorized charges. It also automatically protects any members' qualifying purchases from retailers, by giving the members free extended limited warranty protection on their purchase equal to the original warranty period provided by the manufacturer. In addition, damage, theft and loss protection is provided for purchases for 90 days.
4. Club D – provides essentially the same benefits and privileges as Club C, except it does not provide discounts and rebates at hundreds of online merchants.
5. Club E – provides free unlimited online credit report access to a member, as well as daily credit monitoring service. The credit report information is available through a third party credit card reporting agency. A ##### Identity Theft Insurance and \$##### in credit card loss and theft protection is included. Dispute forms and tools and assistance services are also provided to assist members in correcting any inaccuracies in their credit reports.
6. Club F – provides a 10% discount to certain race car events, access to insider race car events, special pass programs and pre-race benefits, \$##### in savings (discounts or other offers) for racing related programs, free access to special member related interactive websites, access to special free offers and race related discounts for members, a free subscription to members magazine, a free weekly e-newsletter and up to 50% in discounts at certain attractions, restaurants, etc. In addition, during the free trial period (no fee is charged), the prospective paying member will receive a membership kit which includes a free member decal, referral cards, baseball cap, patch and other items.
7. Club G – provides a twenty-four (24) hour concierge service, discounts at national amusement parks and movies theaters, a complementary magazine

subscription, discounts on hotel and car rentals, and travel related protections including trip delay, hotel overbooking, hotel fire/theft, baggage delay and loss, travel accident insurance and credit card fraud protection.

RELEVANT LAW

Utah imposes a sales and use tax on retail sales of tangible personal property and certain enumerated services in Utah and on the use or consumption of such property and services in Utah. Utah Code Ann. Sec. 59-12-103. In this regard, sales of extended warranties are taxable services under Utah law. Utah Tax Commission Rule R865-19S-78. However, membership fees to discount clubs/programs are not subject to tax, when sold by a third party who is not the vendor for the goods or services provided. Tax Advisory Opinion 96-178 (12/6/96).

In determining whether a transaction is taxable, the “true object” of the transaction must be determined. Eaton Kenway, Inc v. Utah State Tax Comm., 906 P. 2d 882 (Utah, 1995). Therefore, if the true object of the transaction is a nontaxable intangible benefit or service, no tax is due on the price paid for that transaction, but any taxable services or tangible personal property used or transferred in the transaction is taxable on the purchase price paid by the provider. Id.

Significantly, while there is no Utah case law or regulations on the taxability of web-based discount membership clubs, other states have recognized that such membership programs that provide “intangible rights” to receive a discount or other privileges are not subject to sale and use tax. See e.g.s. Texas Ruling Nos. 9105L1113E11 (1991), 200106309L (2201), and 9605290L; Comptrollers Decision Nos. 42,657 (2006) 39,557 (2004) 22,260 (1998) and 22,613 (1988); See similarly New York TSB-A-01 (23) S (Sales Tax) (7/31/01; TSB-A-04(3)S (Sales Tax) (2/24/04); TSB-A-96(7) (Sales Tax) (12/4/92; See also dine Out Tonight Club v. Department of Revenue Services, 210 Conn. 567 (1989) (True object of transaction was the conveyance of non-taxable intangible rights.)

OPINIONS REQUESTED

1. The monthly membership fees paid for the membership program in Clubs A through G are not subject to Utah Sale & Use Tax.
2. Any tangible personal property or taxable services provided without additional charge to Utah members of the Clubs, either in the free trial period or as part of the membership benefits and privileges provided (e.g. a magazine) is taxable at the cost of such property or service to the Clubs.

ANALYSIS

Clubs A through G are membership programs/clubs that provide various intangible benefits, privileges (e.g. third party discounts), and related services to their members. These clubs have no facilities in Utah, nor do they sell amusements or tangible personal property. Under the Utah Sales and Use Tax, the membership fees paid to belong to these clubs are not taxable sales in Utah. Here, the essence of the transaction for the members is the broad array of intangible membership benefits received. Any information transferred merely conveys the nature and extent of the benefits provided (e.g. types and extent of discounts). So no Utah Sales and Use Tax is due on this transaction. See Tax Advisory Opinion 96-178 (12/6/96).

The fact that some tangible personal property or services are transferred by a couple of the clubs incident to the club membership does not change the essence of the transaction. See Eaton Kenway, Inc., supra.; Young Electrical Sign Co. v Utah State Tax Commission., 291 P. 2d 900 (Utah, 1955). Rather, any such property or services transferred to a Utah member are taxable on their cost to the club. Id.

Notably, in applying its similar sales and use tax, the New York Department of Finance and Taxation has stated that similar types of membership fees are not taxable. New York TSB-A-01(23)S (7/31/01), (Sea Tow International, Inc. membership program/club (Advantage Network) which provided numerous intangible benefits, privileges and services, was held to be not taxable). New York TSB-A-04(3)S (2/24/04). (Membership fees paid to Boat U.S., a boater's travel club, was also held not to be subject to New York Sales and Use Tax.)

California's board of Equalization, the New Jersey Division of Taxation and the Ohio Department of Taxation have also ruled for this specific situation that the membership fees paid to Clubs A through G are not taxable, since they are sales of "intangibles" and not tangible personal property. Opinion Letters attached.

CLUBS A, B AND E

Clubs A, B and E provide only non-taxable intangible privileges and benefits to its members. Therefore, there is no Utah Sales or Use Tax due on their membership fees.

CLUBS C AND D

Clubs C and D provide numerous intangible benefits, privileges and related services for their membership fees. All of these benefits, privileges and services are free (no additional charge) to their members. Therefore, the membership fees are not taxable under the Utah Sales and Use Tax. The fact that one of the intangible privileges or benefits available is a free extended limited warranty protection benefit for purchases

made by the member from a wide range of unaffiliated retailers (located throughout the country) does not convert the payment of the membership fees into a taxable transaction for Utah Sales and Use Tax purposes. The clubs do not sell these warranties; they are merely privileges of club membership.² The essence of the transaction is still the same. Simply put, the Company is not in the business of selling extended warranties. Nevertheless, it is understood, that any taxable services or tangible personal property provided to the clubs members may be taxable to the clubs based on the clubs purchase price (if any) of such tangible personal property and taxable services. Id.

CLUBS F AND G

Clubs F and G's membership fees are not subject to Utah Sales and Use Tax. Here, the essence of the transaction is the sale of a non-taxable membership. However, the purchase price Clubs F and G pay to another for tangible personal property provided as part of the intangible membership benefits and privileges provided to their members in Utah may be subject to Utah Sales and Use Tax. Therefore, the cost of any complimentary magazine or the cost of any paper, ink or printing of the members magazine sent to Utah Members may be taxable. Likewise, the cost of the free membership kit provided, by Club F, during the free trial period, for delivery to a Utah member may be taxable.

CONCLUSION

The monthly membership fees paid to the Company for the intangible benefits and privileges provided by membership programs of Clubs through G are not subject to Utah Sales and Use Tax. Rather, to the extent these are any tangible personal property or taxable services purchased at retail by the Company and supplied free to the members as part of the membership benefits and privileges may be taxable based on their cost to the Company.

Please call me if you have any questions concerning the above. Thank you for your time and consideration of this matter.

Very Truly Yours,

NAME
ADDRESS
PHONE
EMAIL

RESPONSE LETTER

²The limited warranty/guarantee protection benefit is not for a specific item purchased but is a general intangible benefit covering a wide category of potential purchase.

February 28, 2007

NAME
ADDRESS

RE: Private Letter Ruling 06-025

Applicability of Utah sales and use tax to web-based discount and service membership programs/clubs

Dear NAME,

We have received your letter requesting a ruling as to the taxability of “web-based discount and service membership programs/clubs.” This letter ruling is not intended to be a statement of broad Tax Commission Policy. It is an interpretation of the tax law as it relates to the facts presented in your request letter and the assumptions stated in this letter. If the facts or assumptions are not correctly described in this ruling, please let us know so we can assure a more accurate response to your circumstances.

FACTS

You stated the following facts in your request letter. Your client, henceforth “Company,” is not located in Utah. Memberships are solicited over the Internet directly and also by entering into contracts with various web-based sellers and service providers that allow Company to solicit their customers. The providers whose customers have become members of Company’s program receive a one-time solicitation fee.

For a monthly fee, members receive various privileges and benefits depending on the particular club he/she has joined. Some examples are: discounts at restaurants, hotels, car rentals and air fares; best price guarantee protection; delivery guarantees; road and towing protection; extended limited warranty protection; credit card fraud protection; internet theft protection; credit report access; and a weekly newsletter and monthly magazine.

Company does not sell any of the tangible personal property provided in the various clubs. Third parties provide all such items.

The request letter outlined the various benefits provided by each of the clubs that Company offers.

APPLICABLE LAW

Utah Code Section 59-12-103(1) imposes tax on the purchaser for amounts paid

or charged for, “(a) retail sales of tangible personal property made within the state; ... (e) sales of prepared food; (f) ... amounts paid or charged for admissions or user fees for theaters, movies, ... (g) amounts paid or charged for services for repairs or renovations of tangible personal property... (i) amounts paid or charged for tourist home, hotel, motel, or trailer court accommodations... (l) amounts paid or charged for tangible personal property if within this state the tangible personal property is: (i) stored; (ii) used; or (iii) otherwise consumed:...”

Tax commission rule R865-19S-62 states that sales of meal tickets, coupon books, or merchandise cards are taxable if they are sold by, “persons engaged in selling taxable commodities or services.” The commission used this provision to apply to discount membership clubs in Private Letter Ruling 96-178.

In a subsequent private letter ruling where the promoter retained a portion of the membership fee and remitted the balance to the provider, the commission reached a different decision: “You state that COMPANY does not retain the entire membership fee. Instead, the party that sells the discounted products and services receives a portion of each membership fee that COMPANY sells. As a result, the membership fees paid to COMPANY would be considered part of the purchase price for the products or services sold by the ‘unrelated’ company. Accordingly, if these goods and services are of a type subject to sales tax, the discount memberships sold by COMPANY are also taxable.”³

You indicated that a seller or service provider will get a one-time cash solicitation fee for each customer solicited. It is not clear from the request how that compensation is determined. Accordingly, we do not address whether all or a portion of those fees may be subject to sales tax when received by the providers. Those payments, however, are sufficiently unrelated to the ongoing membership fees and any potential use of the services or products by club members, that payment of those solicitation fees will not cause the membership fees to be subject to Utah sales tax. If a service provider received a portion of the monthly membership fee, however, the answer as to the taxability of the various club memberships could change.

ANALYSIS

Club A: The attractions, restaurants, and theaters would under normal circumstances be taxable. If they are provided entirely by the third party, the membership fees are for intangibles and are exempt from tax. However, if a portion of the club membership is transferred to the provider, then the membership fee is taxable.

Club B: Same as Club A.

Club C: This club has many of the same items as clubs A and B above and the answer for Club A applies. It also has some additional items of protection and insurance.

³ See Private Letter Ruling 00-003.

Among those are “extended warranty protection.” In general, the sale of an extended warranty is a taxable transaction because it is considered to be for future repair under Tax Commission Rule R865-19S-78. In this case, however, the extended warranty protection is only one of many services provided. There appears to be no reasonable way to calculate what portion of the consideration for the membership fees is allocable to the warranties. Accordingly, the inclusion of extended warranty services in a variety of services, as outlined in your letter, will not cause the membership fees to be taxable. If the terms of the arrangement is for the club to reimburse the customer for repairs the customer is charged for, then the repair would be taxable when purchased by the customer. If, however, the arrangement is for the club to obtain the repair and the customer does not pay for the repair directly or pays only a reduced amount, then the club will be liable for sales tax when it purchases the repair. Any reduced amount paid by the club member would also be subject to tax.

Club D: Same as Club C.

Club E: The items for this club appear to be all for non-taxable services and would be exempt from sales or use tax.

Club F: Same as Club A.

Club G: Same as Club A.

Finally, the complimentary newsletters and magazines would be considered incidental to the transactions and by themselves would not make the membership fees become taxable. However, use tax would be required to the State of Utah for the costs to Company of any such magazines or newsletters shipped to Utah members.

CONCLUSION

Therefore, based on the analysis provided above and in line with the facts provided in your request letter, we agree with your conclusion that:

1. The monthly membership fees paid for the membership programs in Clubs A through G are not subject to Utah sales & use tax;
2. With respect to the warranties provided with Clubs C and D, taxes will be imposed on the payment for the actual repairs that are taxable under Utah Law. If the club member pays for the repairs and is reimbursed by the Company, the club member is required to pay sales or use tax. If the Company pays for the repair directly, it would be obligated for the tax.
3. Any tangible personal property or taxable services provided without additional charge to Utah members of the Clubs, either in the free trial period or as part of the membership benefits and privileges provided is

taxable at the cost of such property or service to the clubs.

Our conclusion is based on the facts you presented. Should the facts be different from those represented in this letter, our opinion may change accordingly. Thank you for your inquiry into this matter.

For the Commission,

Marc B. Johnson
Commissioner

MBJ/BA
06-025