

08-0117  
SALES AND USE  
TAX YEARS: 2004, 2005, 2006, 2007  
SIGNED: 01-13-2009  
COMMISSIONERS: P. HENDRICKSON, R. JOHNSON, D. DIXON  
CONCURRENCE: M. JOHNSON  
GUIDING DECISION

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BEFORE THE UTAH STATE TAX COMMISSION

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<p>PETITIONER,</p> <p>Petitioner,</p> <p>v.</p> <p>AUDITING DIVISION OF THE UTAH STATE TAX COMMISSION,</p> <p>Respondent.</p>	<p><b>INITIAL HEARING ORDER</b></p> <p>Appeal No. 08-0117</p> <p>Account No. ##### Tax Type: Sales and Use Audit period: 9/1/04 – 5/31/07</p> <p>Judge: Phan</p>
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**Presiding:**

Jane Phan, Administrative Law Judge

**Appearances:**

For Petitioner: PETITIONER REP. 1, CPA  
PETITIONER REP. 2, CPA  
PETITIONER REP. 3, Controller, PETITIONER

For Respondent: RESPONDENT REP. 1, Assistant Attorney General  
RESPONDENT REP. 2, Assistant Director, Auditing  
RESPONDENT REP. 3, Manager, Sales Tax Auditing

STATEMENT OF CASE

This matter came before the Utah State Tax Commission for an Initial Hearing pursuant to the provisions of Utah Code Sec. 59-1-502.5, on September 10, 2008. Petitioner (the “Taxpayer”) is appealing Respondent’s (the “Division’s”) audit determination of additional sales and use tax deficiency for the period from September 1, 2004 through May 31, 2007. The amount of the additional tax as indicated from the audit is \$\$\$\$\$, along with the interest accrued thereon. Interest continues to accrue on the unpaid balance.

Appeal No. 08-0117

However, at the hearing the only issue in dispute from the audit was use tax relating to complimentary meals that the Taxpayer provided to its customers who participated in a frequent diner program.

APPLICABLE LAW

Utah Code Ann. § 59-12-103(1) imposes tax on:

the following transactions: (e) sales of prepared food; . . . (l) amounts paid or charged for tangible personal property if within this state the tangible personal property is: (i) stored; (ii) used; or (iii) consumed . . .

Under subsection (e), sales tax applies to sales of prepared food. Under subsection (l), use tax may apply to ingredients that are used for food that is not sold. Utah Admin. Code R865-19S-61 D. (“Rule 61D”) provides an exemption for ingredients of meals subject to tax, stating:

D. Ingredients that become a component part of meals subject to tax are construed to be purchased for resale, and as such the purchase of those ingredients is exempt from sales and use tax.

Utah Admin. Code R865-19S-61 E. (“Rule 61E”) and Utah Admin. Code R865-19S-68 A. (“Rule 68A”) address food that is given away on a complimentary basis. Rule 61E states:

E. Where a meal is given away on a complementary [sic] basis, the provider of the meal is considered to be the consumer of the items used in preparing the meal.

Rule 68A states:

A. Donors that give away items of tangible personal property as premiums or otherwise are regarded as the users or consumers of those items and the sale to the donor is a taxable sale. . . .

Utah Admin. Code R865-19S-68 B. (“Rule 68B”) and Utah Admin. Code R865-19S-68 F. (“Rule 68F”) address premiums or free items given away with the sale of taxable items. Rule 68B states:

B. When a retailer making a retail sale of tangible personal property that is subject to tax gives a premium together with the tangible personal property

Appeal No. 08-0117

sold, the transaction is regarded as a sale of both articles to the purchaser, provided the delivery of the premium is certain and does not depend upon chance.

Rule 68F states:

F. If a retailer agrees to furnish a free item in conjunction with the sale of an item, the sales tax applies only to the net amount due. If sales tax is computed on both items and only the sales value of the free item is deducted from the bill, excess collection of sales tax results. The vendor is then required to follow the procedure outlined in R865-19S-16 and remit any excess sales tax collected.

Utah Code Ann. § 59-12-102(83) defines sale, which term affects the meaning of transaction.

Section 59-12-102(83) states:

(83) (a) "Sale" means any transfer of title, exchange, or barter, conditional or otherwise, in any manner, of tangible personal property or any other taxable transaction under Subsection 59-12-103(1), for consideration.

(b) "Sale" includes:

(i) installment and credit sales;

(ii) any closed transaction constituting a sale;

(iii) any sale of electrical energy, gas, services, or entertainment taxable under this chapter;

(iv) any transaction if the possession of property is transferred but the seller retains the title as security for the payment of the price; and

(v) any transaction under which right to possession, operation, or use of any article of tangible personal property is granted under a lease or contract and the transfer of possession would be taxable if an outright sale were made.

#### DISCUSSION

The facts in this matter were not in dispute and the issue presented to the Commission is a question regarding the application of law. The relevant facts were that the Taxpayer offers its customers frequent diner cards at no charge. The customers may choose whether to participate in the program. A participant who buys ( # ) meals over an unspecified period of time, ( WORDS REMOVED ), may redeem the card for a "free" ( # ) meal by presenting the card at one of the Taxpayer's locations. A participant may redeem the card for the ( # ) free meal regardless of whether he or she makes another purchase at the time of the redemption.

Appeal No. 08-0117

The Taxpayer will not exchange cash for a participant's completed card and does not assign a dollar value to the cards. The Taxpayer redeems the cards directly, as there are no third parties involved and the Taxpayer is not reimbursed by a manufacturer, supplier, or any other party for the cost of the redeemed meals. The Taxpayer's cards have no expiration date so the ( # ) meal purchases may take place over an extended period of time. The Taxpayer's representatives claim that the Taxpayer would have charged all customers lower prices if it did not have its frequent diner card program. They also stated that reward programs such as the Taxpayer's are common in the restaurant industry.

The Division assessed use tax on the amount it estimated to be the Taxpayer's cost of the food items it purchases to prepare the ( # ) meal, but only when the participants redeemed their completed cards without making another purchase at the time of the redemption. For example, if the customer purchased both the ( # ) meal at the time they received the ( # ) complimentary meal, the Division did not assess use tax. The cards do not require an additional purchase at the time of redemption and sometimes there was a purchase with the free meal and sometimes there was not a purchase.

The Taxpayer tracks in its accounting records the sale prices of the ( # ) meals redeemed and can identify whether the participants redeemed their ( # ) meals while making another purchase at the same time. Further, the Taxpayer estimated their food costs associated with the ( # ) meals. The amount of the use tax deficiency in the Division's audit is based on the Taxpayer's food costs for the ( # ) meal and is approximately \$\$\$\$ for the audit period.

The issue in this case is whether the Taxpayer is subject to use tax on its costs to purchase the ingredients used for the "free" ( # ) meals if the meals were redeemed without the customer making other taxable purchases at the time of the redemption. Neither party was aware of a prior case at the Tax Commission or a Utah court decision on this issue. The Taxpayer's representatives had researched how these types of promotions were treated in other states, either in case law, publications or advisory rulings and did

Appeal No. 08-0117

argue that the decisions from the other states supported their position that no use tax should be charged on the ( # ) meal.

The Taxpayer argues that it does not owe use tax on the cost of the ( # ) meals because the ( # ) meals are paid by the customer as the customer is paying for meals one through ( # ) and the sales tax is collected on the sales of one through ( # ). It was their position that this was similar either to a buy one item, get the second item free promotion where the sales tax is limited to the amount charged for the first item, or to discount coupons for future purchases issued to a customer when they purchased a certain amount of merchandise.

Upon review of the applicable law and the parties' arguments in this matter, it is the Commission's conclusion that the ( # ) meals were provided in conjunction with the sale of the ( # ) meals, similar to a buy one get one free transaction. It is clear that had the sale of the first ( # ) meals and the ( # ) free meal been obtained in a single transaction, the Taxpayer would not owe tax on the ( # ) meal. Rule 68F states, "If a retailer agrees to furnish a free item in conjunction with the sale of an item, the sales tax applies only to the net amount due." In fact, the Division concluded that if at least one meal was purchased at the time the customer received the complimentary ( # ) meal, the transaction was not subject to tax.

The Division has indicated that the buy one get one free transaction must occur at the same time and argues that in this case, unless the ( # ) meal is redeemed with the ( # ), there are multiple transactions over an extended period as the customer purchases the ( # ) meals and then redeems the completed card later. The Division asserts that transactions occur each time a customer makes a purchase. The Division interprets "give[n] together with" or furnished "in conjunction with" for Rule 68B or Rule 68F to require that a customer make a taxable purchase at the same time as redeeming the completed PETITIONER card for a free ( # ) meal.

Rule 68F provides that in a buy one get one free transaction the sales tax applies only to the net

Appeal No. 08-0117

amount due. The Commission concludes, that this is, in fact, a buy one get one free transaction and it is a single transaction that occurs at one time, when the ( # ) meal is purchases and the customer ( WORDS REMOVED ). In this single transaction the customer has purchased meal ( # ) and the right to meal ( # ). Whether the customer exercises that right at the same time or months later is not determinative, because both meal ( # ) and the right to meal ( # ) were purchased together in the same transaction. Therefore, regardless of whether the customer redeemed the completed card for the ( # ) meal at the time he or she purchased the ( # ) meal, the Taxpayer is not liable for use tax on the ingredients of the meal.

DECISION AND ORDER

Based upon the foregoing, the Commission abates the portion of the audit deficiency relating to the use tax on the ingredients for the ( # ), complimentary meal. It is so ordered.

This decision does not limit a party's right to a Formal Hearing. However, this Decision and Order will become the Final Decision and Order of the Commission unless any party to this case files a written request within thirty (30) days of the date of this decision to proceed to a Formal Hearing. Such a request shall be mailed to the address listed below and must include the Petitioner's name, address, and appeal number:

Utah State Tax Commission  
Appeals Division  
210 North 1950 West  
Salt Lake City, Utah 84134

Failure to request a Formal Hearing will preclude any further appeal rights in this matter.

DATED this \_\_\_\_\_ day of \_\_\_\_\_, 2009.

\_\_\_\_\_  
Jane Phan, Administrative Law Judge

Appeal No. 08-0117

BY ORDER OF THE UTAH STATE TAX COMMISSION:

The Commission has reviewed this case and the undersigned agree with this decision.

DATED this \_\_\_\_\_ day of \_\_\_\_\_, 2009.

Pam Hendrickson  
Commission Chair

R. Bruce Johnson  
Commissioner

D'Arcy Dixon Pignanelli  
Commissioner

CONCURRENCE

I concur with my colleagues in their decision in this matter. I note, however, that this situation is not exactly the same as a buy one get one free purchase, and in fact, has some elements of a complimentary meal. However, it is clearly more closely related to the buy one get one free transaction. Therefore, I conclude that it is not subject to the use tax as determined by the Division.

Marc B. Johnson  
Commissioner

**Notice:** Unless a party requests a Formal Hearing, the balance of tax and interest resulting from this decision must be paid within thirty days from the date this decision is issued or an additional late payment penalty may be assessed.

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