


STATE BOARD OF EQUALIZATION

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October 25, 1996

Mr. R--- M. L---
 M--- A--- C--- Inc.
 XXX --- ---
 ---, --- XXXXXX

**Re: M--- A--- C--- Inc. [M---]
 S- -- XX-XXXXXX**

Dear Mr. L---:

Your undated letter to Tax Representative C.C. Harris has been referred to the Board's legal staff for response. On [M---]'s sales and use tax return, [M---] included an amount on line 10(f) which was deducted from [M---]'s taxable receipts. [M---] labeled the deduction "service & bac to [M---]" and our Return Analysis Unit wrote [M---] a letter asking for an explanation. In a letter dated March 12, 1996, [M---]'s Assistant Controller, M--- M---, indicated that the description "Back to [M---]" referred to a promotional campaign in which [M---] accepts empty makeup containers in return for a free lipstick. Mr. M--- explained that the retail value of the lipstick was included in the reported gross sales and therefore [M---] reduced this figure by the total of all lipsticks distributed at no charge for the period.

Mr. Harris wrote [M---] a letter dated April 24, 1996 requesting clarification on the deduction labeled "Back to [M---]." The letter explained that if [M---] had paid tax or tax reimbursement with respect to the free items, no further tax was due, but that if not, [M---] would owe use tax on its cost of the free items. In either event, no deduction was allowable. In your latest letter, you state:

"A description of the promotion which supports its non-taxable nature follows.

"In order to induce purchases of additional product, the Company will offer a customer one new lipstick in exchange for six empty make-up containers. Thus, a (prior) purchase of make-up by a customer carries a 16.6% discount toward a (future) lipstick purchase. The entire discount (100%) is redeemable by the customer upon the return of the sixth empty make-up container.

“Reg. 1670(c) suggests that the term ‘premium’ connotes a reward or some other inducement offered to encourage a particular transaction (in the immediate sense, the sale of make-up). The promotion can thus be appropriately classified as a premium. The regulation goes on to state that ‘when a person delivers tangible personal property as a premium together with other merchandise sold and the obtaining of the premium by the purchaser is not dependent upon chance or skill, the transaction is a sale of both articles.’ The six containers are simply a convenient way of proving that the customer made the purchases to justify receipt of the premium. The empty containers are not ‘trade-ins’ with any value; they are disposed of by the company. Thus, no additional sales or use tax is due since sales tax was charged and collected at the point of sale of the make-up (and lipstick).”

Sales tax applies to retail sales of tangible personal property, measured by the gross receipts, unless the sale is specifically exempt from taxation by statute. (Rev. & Tax. Code § 6051.) A “retail sale” or “sale at retail” means a sale for any purpose other than resale in the regular course of business in the form of tangible personal property. (Rev. & Tax. Code § 6007.) If a purchaser intends to resell tangible personal property in the regular course of business, he or she may purchase the property ex tax by giving the seller a timely and complete resale certificate. (See Rev. & Tax. Code § 6091.) We assume that [M---] purchased all lipstick in question ex tax for resale. As such, if [M---] makes any use of the property other than retention, demonstration, or display while holding it for sale in the regular course of business, [M---] must report and pay use tax on the cost of the property. (Rev. & Tax. Code §§ 6094, 6244.)

Our understanding is that a customer does not have a contract right to the free promotional lipstick, and that [M---] may, at any time, cancel the promotion and thereby cease distribution of the free lipstick even if a customer returns six empty make-up containers. Therefore, the promotional lipstick is a gift of tangible personal property to the customer. Since a gift of tangible personal property is not a sale, [M---] did not purchase the promotional lipstick for resale. [M---] must report and pay use tax, measured by the cost of the promotional lipstick, on line 2 of the sales and use tax return. No deduction is allowable.

The facts that you present do not fall within Regulation 1670(c). If [M---] provided the promotional lipstick upon the purchase of six make-up items, the lipstick would be considered a premium sold along with the others. Tax would apply to the gross receipts from that sale of seven make-up items for the price of six. However, our understanding is that the purchaser has no contract right to the free lipstick. The free lipstick is not a premium. No deduction is allowable, and [M---] owes use tax on the cost of the lipstick. Indeed, even if the free lipstick was considered a premium, there is no deduction. The transaction would be regarded as the sale of the lipstick (i.e. the premium) along with the six make-up items. [M---] would owe sales tax on its gross receipts from that sale, with no deduction.

We note that in 1994 [M---] claimed a deduction on line 10(e) for “service & consciousness (Donation to charitable org.),” which was explained in a June 7, 1994 letter from [M---]’s Controller, M--- L---, as “Services and Sale of Gift Certificates” and “Sale of --- --- Lipstick.” [M---] apparently believes that these transactions are entirely exempt from tax. The sale of the gift certificates itself is not subject to tax; however, when the gift certificate is redeemed, the value of the gift certificates and any other consideration provided is subject to tax. (See BTLG Annot. 280.0350 (12/19/78).) Thus, if [M---] had sold a \$20 gift certificate in the first quarter 1996 and it were redeemed in the second quarter 1996, [M---] would be required to report the \$20 on line 1 of its second quarter return and report tax on that \$20. You also claimed an exemption from gross receipts for the sale of “--- --- Lipstick,” the proceeds from the sales of which were donated to [M---] --- Foundation. There is no exemption for these sales simply because the proceeds are donated. (Cf. Rev. & Tax. Code § 6403; BTLG Annot. 165.0005 (9/9/93).) Rather, you must report the proceeds on line 1 of your return and report tax on such amounts.

This opinion is specifically based on the facts stated in your undated letter, [M---]’s March 12, 1996 letter, and the assumptions made above. If our assumptions are incorrect and you wish an opinion applicable to the actual facts of the transaction, please write and describe with specificity the nature of the promotion, and the manner of [M---]’s sales and use tax reporting.

Very truly yours,

Charlotte Chyr
Tax Counsel

CC:cl

cc: Out-of-State District Administrator
Mr. Chuck Harris -- Return Analysis (MIC: 35)