

**STATE BOARD OF EQUALIZATION**

1020 N STREET, SACRAMENTO, CALIFORNIA  
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December 11, 1991

Mr. J--- W--- R---  
L--- of A---, Inc.  
XXXX --- --- Drive  
--- ---, California XXXXX

Re: Measure of Sales Tax  
On Merchandise Redeemed with L--- Dollars  
SR -- XX-XXXXXX

Dear Mr. R---:

By letter dated August 30, 1991, you requested an opinion from the Board concerning the measure of sales tax for L--- merchandise purchased with "L--- Dollars" under the frequent buyer's program. According to your letter and the information you enclosed, the facts are as follows:

L--- sells large scale model trains and equipment to authorized L--- wholesalers and retailers. As an incentive to retail customers to purchase certain slow moving merchandise, L--- initiated the frequent buyer's program. Under this program, persons who have previously purchased L--- products may obtain a frequent buyer's card from L--- by filling out an application. The card is free to the applicant, but additional cards for family members of the applicant cost \$5.00 apiece.

In order to use the card, the cardholder must earn L--- dollars. Under the current promotion, a cardholder receives 500 L--- dollars just for applying. In addition, each time the cardholder purchases an L--- product, he or she is credited with at least one L--- dollar for each two dollars spent. (The ration varies sometimes during special promotions.) Credits are given on items purchased with cash only and on purchases made with cash and L--- dollars. For the latter purchases, the credits are measured by the cash amount only. L--- credits must be used on future purchases, not on the purchase which earns the credits. To receive the credits, the cardholder presents at the time of purchase the frequent buyer's card which the retailer imprints on a triplicate form similar to those used for credit card purchases. The customer receives one copy, L--- another, and the retailer retains the third.

Only designated merchandise, generally the slower moving items, may be purchased by a customer with cash and L--- dollars. At present, the program is operated on the honor system. The customer must keep account of the total number of L--- dollars earned and may receive the lower price by presenting his or her card and representing that he or she has at least the number of credits necessary to obtain the item at the lower cost. For example, the customer may purchase a PRR Coach, Tuscan Red for \$50.00 cash and 100 L--- dollars. If L--- subsequently learns that a customer making a redemption purchase did not have sufficient L--- dollars, the customer will be rebilled at the manufacturer's suggested retail price. It appears that L--- will do the rebilling and will forward any funds collected in this manner to the retailer which made the transaction.

L--- plans to sell the products in the program to its retailers at a price below that initially offered for those products. For example, a product for which L--- might have charged its retailers \$200 is now sold to the retailer for \$100. The retailer sells the item to the retail customer for \$110 cash if the customer redeems a certain number of L--- dollars. The cardholders may only redeem at authorized dealers, not through telephone orders. The program can terminate at any time after six months advance notice to the cardholders.

Your question is whether the measure of tax on items purchased with L--- dollars is the full price, including the amount of L--- dollars, or only the amount paid in cash.

Revenue and Taxation Code section 6051 imposes a sales tax on all retailers measured by their gross receipts from retail sales of tangible personal property. "Gross receipts" is defined in Revenue and Taxation Code section 6012(a) as the total amount of the sale price of the retail sales of retailers, valued in money, whether received in money or otherwise. The total amount of the sale price includes any amount for which credit is allowed by the seller to the purchaser. Rev. & Tax. Code § 6012(b)(3). See also Rev. & Tax Code § 6011(b)(2). A cash discount, however, is not included in the measure of tax. (Rev. & Tax. Code § 6012(c)(1).

The board's staff has issued and published an opinion on a question similar to yours in the Sales and Use Tax Annotations of the Business Taxes Law Guide. In Annotation 295.0920 a retailer had a Christmas Club Plan in which customers received a discount upon the purchase of merchandise between December 1 and December 24 in the amount of 2.5% of the aggregate sales slips presented by the customer for purchases between January 1 and November 30 of the current year. The staff determined that the discount should be treated as a trade discount.

L---'s frequent buyer's program is similar to the Christmas Club Plan described in Annotation 295.0920. Assuming that all prior purchases for which customers earned L--- dollars were taxable, we conclude that the L--- dollars should not be included in the measure of tax. However, for those sales in which a customer is rebilled because he or she did not have sufficient L--- dollars, the retailer must include the additional amount paid by the customer in the retailer's measure of tax as soon as the retailer receives cash or credit from L---.

If you have further questions regarding sales and use tax law, please do not hesitate to write again.

Sincerely,

Elizabeth Abreu  
Tax Counsel

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