

STATE OF CALIFORNIA
BOARD OF EQUALIZATION
APPEALS UNIT

In the Matter of the Petition)	HEARING
for Redetermination Under the)	DECISION AND RECOMMENDATION
Sales and Use Tax Law of:)	
)	
REDACTED TEXT)	No. REDACTED TEXT
)	
)	
<u>Petitioner</u>)	

The above-referenced matter came on regularly for hearing before Hearing Officer W. E. Burkett on November 6, 1989, in Sacramento, California.

Appearing for Petitioner: REDACTED TEXT

Appearing for the
Department of Business Taxes: REDACTED TEXT

Protested Items

The protested tax liability for the period July 1, 1984 through June 30, 1987 is measured by:

<u>Item</u>	<u>State, Local and County</u>
A. Taxable sales of instructional material not reported	\$REDACTED TEXT
B. Taxable sales of diet supplements claimed as exempt license fees	\$REDACTED TEXT

Contentions of Petitioner

- A. 1. Petitioner is not subject to tax on these items because they were not consumed by it.
- 2. The tax should not apply because use tax was applied to a portion of the daily license fee.
- B. 1. Continuing license fees are not subject to the tax
- 2. The amount allocated to the purchase price of the diet supplement is excessive.
- 3. Petitioner is not the consumer of the diet supplement.

Summary

The petitioner is a corporation that operates a diet counseling service. A prior audit has not been conducted of this corporation.

The first protested item consists of manuals, video instructional programs and business cards purchased and rebilled to counselors or other diet center operators.

Petitioner contends that tax should not be charged on these amounts in view of the fact that use taxes have been applied to a portion of the daily license fee discussed below. It also contends that the tax is not applicable because petitioner is not the consumer of the property.

The petitioner is a licensed franchisee of the REDACTED TEXT. The Department of Business Taxes (Department) has determined the petitioner was the purchaser and consumer of a daily packet of eight supplement capsules (the daily packet) provided to the customer as part of its diet counseling service.

The purchase price of the daily packet was computed at 45¢ a unit based on information that the cost price to REDACTED TEXT was approximately 05.6¢ per unit (disputed by petitioner). REDACTED TEXT charged petitioner a gross daily license fee of \$1.42 per customer during the period here considered. The price has been raised to \$1.71 in January of 1989. On this same date, petitioner raised the price paid by certain sub-franchisees from \$1.71 to \$2.25. During the period here considered, the sub-franchisee paid petitioner a daily gross license fee of \$1.71.

Petitioner contends that the computed purchase price does not have any commercial relationship to the manufactured cost of the daily packet. Further, that if a tax is due, it should not be placed on petitioner because it was not the consumer of the daily packet. This is apparently premised on the claim that at least some packets are shipped directly to customers by REDACTED TEXT.

Petitioner was requested to provide us with a copy of its franchise agreement. A copy of the agreement has not been received to this date.

Other Information

In two related cases involving franchises of REDACTED TEXT, the Board heard and considered the issue of the price of the daily packet. In these cases it concluded that an appropriate purchase of the packet was 30¢. In each case the gross license fee was \$1.21 per day.

Analysis & Conclusions

It is our conclusion that petitioner was properly classified as the seller and retailer of the manuals, video tapes and business cards. The fact that petitioner otherwise pays tax on a portion of the gross license fee does not provide a basis for exemption of property separately sold to the counselors and diet center operators.

It is our conclusion that the petitioner was properly classified as the consumer and user liable for use tax on the purchase price of the daily packet. The diet center customers who contract with petitioner do not seek or specifically order the daily packets. The daily packets are only provided as part of the diet counseling service which is provided for a lump sum. Since the daily packets were only incidentally provided as part of the service and not as an item sought as a "true object" of the contract, the petitioner was properly classified as the consumer of the property. (See Regulation 1501.) On the other hand, the petitioner is properly regarded as the seller and retailer of the daily packets provided to the sub-franchisees for distribution to their customers. In this latter instance the petitioner is not provided the service per se, but merely providing the elements to provide the service one of which is tangible personal property of substantial value (the daily packet).

It is immaterial that the charge for the daily packet was included as part of the daily license fee.

The remaining question is whether the Department has computed an appropriate price for the daily packets. In the two prior cases the Board determined a price of 30¢ per daily packet. This was not based upon a percentage formula, but was set in light of the gross daily charge which, in each case, was \$1.21 per customer.

It is our conclusion that the percentage of taxable purchases in the prior Board decisions of 24.79% (i.e., 30 divided by 1.21 = 24.79%) would be an appropriate percentage to apply in computing the price of the daily packet for this petitioner. ($24.79\% \times \$1.42 = 35¢$) While the price may not be related to the manufactured cost, it is nevertheless reasonable to conclude that any rise in the gross license fee, whether by reason of inflation or otherwise, should be accompanied by a corresponding rise in the price of the daily packet. We conclude that this same percentage figure, 24.79%, should be used to compute the sales price of the sale to sub-franchisees ($24.79\% \times \$1.71 = 42¢$).

Recommendation

It is recommended that a reaudit be completed to recompute the measure of tax as outlined herein.

W. E. BURKETT, HEARING OFFICER

3-22-90
DATE