

**M e m o r a n d u m****550.0826** □

To: Mr. Glenn Bystrom

Date: October 4, 1983

From: Donald J. Hennessy

Subject: [S]

S- -- XX-XXXXXX

This is in reply to your memorandum of September 6, 1983 asking our opinion on whether sales tax applies to the amounts received by [S] from the [C] Office of the [A]. [S] provides food service at the [A] cafeteria. The current audit of [S] established that customers are not charged for the items they purchase in the [A] cafeteria. Instead, all of the consideration received by [S] for sales at the [A] cafeteria comes directly from the [A] as payment of [S]'s billing for the cost of operating the cafeteria plus management fees. [S] has been paying no sales tax on its receipts from the [A]. [S] considers the entire amounts it receives from the [A] as a nontaxable "subsidy" within Szabo Food Service Inc. v. State Board of Equalization, 46 Cal.App.3d 268.

Your auditor believes that the entire receipts from the [A] are taxable. However, he hesitates to determine the tax, particularly on a retroactive basis because, knowingly or not, we included the tax on sales to the [A] in the amount that was refunded to [S] when we lost the Szabo case.

We agree that the amounts received by [S] from the [A] are taxable gross receipts. We also agree that given the circumstance of the Szabo decision the tax should be determined only a prospective basis.

We have purged our litigation files on the Szabo litigation but we consider it likely that the receipts from the [A] were included in the measure of the refund only because we did not realize that all of the consideration received by [S] for sales at the [A] cafeteria were paid by the [A]. This is exactly the type of factual situation we could have made much of at the trial. Such facts raise precisely the troublesome issues we are left with by the court's decision, i.e., at what point do the amounts seen by the courts as nontaxable subsidies shade over into taxable gross receipts from sales. As you point out, the court in Szabo stated that "In no case did an employer subsidy exceed 30% of sales." Does this imply that the court would have reached a different result if the subsidy was 50% of sales; 70% of sales; or as here 100%? This type of numbers game points out precisely the type of weakness we see in the court's rationale.

Even if we were to grant the correctness of the Szabo decision, we do not believe it would apply here. The very word "subsidy" implies a subsidiary payment in support of a primary payment. Here, there is no primary payment. The subsidy is the only payment and we believe is gross receipts.

We recommend tax be applies prospectively. [S] should be told that we now well realize that the [A]'s contract, while factually different from other contracts before the court, was presented to the court and included the decision without the factual differences being pointed out. The Board did not realize the different factual situation with the [A] contract or we would have raised the issue and that, if necessary, we will now raise the issue if [S] wishes to bring this variety of "subsidy" before the court. We note that it was probably easy to miss this variation on "subsidy" the first time around, since we still see nothing in writing between [S] and the [A] establishing that no charge will be made to the actual customers in the cafeteria but that instead all consideration will fall into the "deficit" language of paragraph 7 of the original Management Operating Agreement of November 4, 1964.

DJH:rar

cc: Mr. Gary J. Jugum