STATE OF CALIFORNIA

550.1365

STATE BOARD OF EQUALIZATION
PO BOX 942879, SACRAMENTO, CALIFORNIA 94279-0001
TELEPHONE (916) 322-3684

April 3, 1992

P--- L---
Senior Manager of Taxes
P--- P--- Corporation
XXXXX --- Avenue
--- ---, CA XXXXX

Dear Mr. L---:

Re: SR – XX XXXXXX

Enclosed is a copy of the Decision and Recommendation pertaining to the above-referenced petition for redetermination and claim for refund. I have recommended that the petition and claim be denied.

Please read the Decision and Recommendation carefully. If you have new evidence or contentions not considered therein, you should file a Request for Reconsideration. Any such request must be sent to me within 30 days from the date of this letter, at the post office box listed above, with a copy to the Principal Tax Auditor at the same box number. No special form is required, but the request must clearly set forth any new contentions, and any new evidence must be attached.

If you have no basis for filing a Request for Reconsideration, but nevertheless desire an oral hearing before the Board, a written request must be filed within 30 days with Ms. Janice Masterton, Assistant to the Executive Director, at the above post office box.

If neither a request for Board hearing nor a Request for Reconsideration is received within thirty (30) days from the date of this letter, the Decision and Recommendation will be presented to the Board for final consideration and action. Official notice of the Board's action will then be mailed to you.

Very truly yours,

James E. Mahler
Senior Staff Counsel

JEM:ct
Enc.

cc: Janice Masterton
Assistant to the Executive Director (w/ enclosure)

Glenn Bystrom
Principal Tax Auditor (file attached)

--- – District Administrator (w/ enclosure)

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BUSINESS TAXES APPEAL REVIEW SECTION

In the Matter of the Petitions for Redetermination and Claim for Refund Under the Sales and Use Tax Law of:	)	DECISION AND RECOMMENDATION
P--- P--- CORPORATION dba P--- S--- COMMISSARY	)	No. SR -- XX XXXXXX-010, -001
Petitioner/Claimant	)	

The Appeals conference in the above-referenced matters was held by Senior Staff Counsel James E. Mahler on June 26, 19XX, in Hollywood, California.

Appearing for Petitioners/ Claimant:	P--- L--- Senior Manager of Taxes
Appearing for the Sales and Use Tax Department:	Joseph J. Cohen District Principal Auditor Forrest Paisley Supervising Tax Auditor

Protested Items

The protested tax liability for the period January 1, 1987, through June 30, 1989, is measured by:

	Item	State, Local County & District
A.	Unreported taxable sales	$260,921
B.	Overreported measure	(31,096)
		$229,825

Petitioner and claimant (hereinafter "petitioner") also seeks a refund in an unstated amount for tax paid on meals served to certain employees for the period January 1, 1986, through March 31, 1989.

Petitioner's Contention

1. Title to meals did not pass since the employees who ordered the meals were acting on behalf of the company while conducting company business.

2. No consideration was paid for the meals.

Summary

The petitioner corporation is a --- --- --- --- which holds separate seller's permits for several departments or locations. The permit involved in these matters was issued to petitioner's Commissary Department (the commissary) to report tax on food service operations at a cafeteria and dining room on petitioner's studio lot.

Reported sales from the dining room were 21.5 percent lower than recorded dining room sales for the periods in question. The difference represented a deduction for "intra-company sales" of the type described below. The 21.5 percent figure was an estimate which was apparently derived by the Board's auditors in a prior audit.

Sometime early in 1983, petitioner decided that the deduction should have been 36.53 percent of dining room sales and therefore filed a claim for refund. An audit was initiated to verify the amounts of the claim, but ultimately concluded that the "intra-company sales" were subject to tax. Therefore, the staff not only concluded that the claimed refund should be denied, but also issued a determination to disallow the netted deductions. (The refund claim and the determination are for different periods because of procedural problems such as the statute of limitations.)

The "intra-company sales" in the dining room were for luncheons at which petitioner's executives hosted business guests. Charges for such meals were rung up on the dining room cash register as sales, at the regular prices, and tax reimbursement was added to the bills. The host executives paid the bills by credit card. The commissary then billed the credit card company (usually American Express) in the normal fashion and ultimately received payment from the credit card company, less that company's fee.

Each host executive used his or her own personal credit card for these transactions. Each executive had applied for and received the card from the credit card company of his or her own choice. Petitioner encouraged senior executives who regularly incurred business expenses to obtain one credit card for use only on company business, and reimbursed the executive for the annual fee on such a card. Other executives used their cards for both personal and business expenses and paid any annual fees themselves. In either case, the credit card company billed the

executives for the "intra-company sales" on normal monthly statements and the executives paid those bills to the credit card company.

Each executive included the charges for "intra-company sales" on a weekly expense report to petitioner, attaching a copy of the credit card receipt received from the commissary. For income tax reasons, the expense report form also required the executive to verify the business purpose of the lunch and to list the names of the guests, among other particulars. Petitioner periodically reimbursed its executives for the claimed expenses. Naturally, any personal expenses which the executive may have charged to the credit card were to be excluded from the expense claims.

It has long been petitioner's policy that business lunches should be taken only in the commissary dining room, but the policy may not have been strictly enforced prior to the years in question. In July 1987, petitioner notified its executives that only the commissary dining room could be used for luncheon meetings, and advised them that the costs of business lunches eaten elsewhere would no longer be reimbursed.

The commissary operated a cafeteria in addition to the dining room. The cafeteria apparently catered meals at movie sets and provided coffee and doughnuts for business meetings. We understand that the commissary billed the ordering department directly in such cases, rather than billing any individual person, and that tax reimbursement was not added to the bills. These types of transactions are not at issue here.

The commissary also reported use tax on an estimated basis on its sales and use tax returns. The estimate was 75.93 percent of recorded costs and, again, that estimate was apparently developed in prior Board audits. The current audit revised the estimate and developed new, separate percentages for soft drinks, beer and wine, mineral water and paper goods, resulting in the adjustment reflected in Audit Item B. This adjustment is not directly at issue herein, but the staff advises us that any changes in the treatment of "intra-company sales" could affect the use tax adjustment.

Analysis and Conclusions

Subdivision (a) of Revenue and Taxation Code Section 6006 defines "sale" to include the "transfer of title or possession of tangible personal property … for a consideration." Subdivision (d) of that section further provides that "sale" includes the "furnishing, preparing, or serving for a consideration of food, meals, or drinks."

1. A transfer of property between departments or divisions of a single corporation is not a "sale" because there is no transfer of title or possession. The same legal entity, the corporation , has title and possession of the property both before and after the transaction. (See Sales and Use Tax Annotation 410.0020, ¶3 [9/14/51].) Relying on this rule, petitioner

contends that the "intra-company sales" were simply transfers from one department of petitioner (the commissary) to other departments of petitioner (the departments employing the executives who ordered the meals) and were therefore not sales at all.

We find guidance for resolving this issue in Automatic Canteen Co. v. State Board of Equalization, 238 Cal. App.2d 372. Plaintiff in that case contracted with its customers (the "employers") to provide food service for the customer's employees. Plaintiff conceded that the employees who paid for and consumed the food were buyers in retail sales transactions; the issue was whether plaintiff or its customers was the retail seller. (238 Cal.App.2d at 381.) Plaintiff contended that it had sold the meals to its customers for resale to the employees or, alternatively, that it was acting only as an agent of its customers in serving the meals.

The court stated that "the question in each instance is whether the transaction under scrutiny is in fact what it appears to be in form." (238 Cal.App.2d at 382.) With respect to the resale issue, the court found that the contracts "did not in reality deal with 'sales for resale,' but were merely an attempt to put form above substance …." (238 Cal.App.2d at 372.) On the agency issue, the court found:

> "… While it is true that the form of the contract between the parties and the labels used by them are not necessarily controlling and that a contract should be considered not only in view of the circumstances under which it was made, but also in the light of the conduct of the parties while the work is being performed, the form of the contract and the labels used are of some weight in determining the nature of the relationship since the relation is prima facie that expressed by the terms of the writing. In the present ease not only is the relationship of the parties expressed in terms indicating that [plaintiff] was an independent contractor, but there is nothing in the conduct or acts of the parties inconsistent therewith." (238 Cal.App.2d at 389; citations omitted.)

The transactions at issue here took the form of sales from petitioner to the executives. Petitioner argues, however, that the substance of each transaction was self-consumption by petitioner, since the executive was acting on company business and was reimbursed in full for the cost of the meals. Petitioner contends that its intent was simply to provide free meals to its executives and their business guests. Petitioner cites Sales and Use Tax Annotation 565.0180 (10/15/51) for the proposition that taxability depends on the intent of the parties.

We find that these transactions were sales from petitioner to the executives, not only in form, but also in substance. Each transaction was rung up on the dining room cash register at the regular price in the same manner as any other sale, with tax reimbursement added to the bill. When the executive paid by credit card, the executive incurred a legal responsibility to repay the credit card company for the entire charge, including tax reimbursement, regardless of whether the executive would or would not be reimbursed by petitioner. If an executive failed to file an expense claim with petitioner or filed a claim which petitioner rejected for some reason, the

executive was still obligated to pay the credit card company. Even if petitioner reimbursed the executive for the meals, the executive still could be liable for interest or late charges to the credit card company, none of which were reimbursed by petitioner.

Further, the executive's department had no obligation, either legally or as a matter of company policy, to reimburse the commissary for the costs of these meals. The transactions were treated on all company records as sales from the commissary to the executive, not as transfers from the commissary to the executive's department. The commissary looked solely to the credit card company for payment. It ultimately received payment from the credit card company for the billings, including tax reimbursement, less the fee charged by the credit company. Petitioner, the executives and the credit card all dealt at arms-length in these transactions in the same manner as in any other sale transaction.

At the appeals conference, petitioner's representative explained that the transaction were structured in this manner to maintain efficiency in the dining room. It would allegedly have been cumbersome to have the executives sign for the meals on behalf of their departments and then record the costs as intra-company transfers from the commissary to the executive's department. It was simpler to have the executive pay for all purchases, whether personal or on company business, so that the dining room did not have to set up special procedures to account for the business meals. Petitioner cites Sales and Use Tax Annotation 550.1380 (11/2/64) to argue that internal bookkeeping procedures do not control taxability.

We agree that bookkeeping entries do not control taxability, but the credit card company acted as a lender in these transactions, not as an internal bookkeeper. The credit card company advanced credit to the executives in exchange for the executives' promises to pay, irrespective of any plan or hope that the executive might be reimbursed by petitioner. The paperwork used to account for these transactions (credit card receipts, monthly statements and claim forms) was the same paperwork used for any other credit card transaction. In other words, the paperwork reflects the transactions as they actually occurred and was not a mere "bookkeeping entry" for internal accounting purposes.

Petitioner could of course have structured and accounted for these transactions as true intra-company transfers, perhaps avoiding the tax. Instead, petitioner chose to sell the meals to the executives in the same manner as it would sell meals to anyone else, and then reimburse the executives. Having made this decision for presumptively valid business reasons, petitioner is in no position to argue that the sales were in form only. While the tax agency has authority to look through the form of a transaction to its substances, taxpayers are normally bound by the form they have chosen. (See W.E. Hall Co. v. Franchise Tax Board, 260 Cal.App.2d at 179; and Moline Properties v. Commissioner, 319 U.S. 436.)

Sales and Use Tax Annotation 505.0030 (9/2/76), upon which petitioner also relies, is not to the contrary. The annotation states that car rentals to federal employees traveling on government business are not taxable "if the vehicle was rented under a General Services

Administration rental contract." On the other hand, several annotations hold that sales to a private vendee are taxable even if the Federal Government funds the purchase or reimburses the vendee. (See e.g., Sales and Use Tax Annotations 505.0640 [3/18/52]; 505.0800 [12/20/51]; and 505.0820 [8/22/66].) The rationale of these annotations is clear: If a sale contract is between a vendor and the United States directly, the sale is an exempt sale to the government; but if the sale contract is between a vendor and some other vendee, the sale is not to the Federal Government even if the government foots the bill. Here, the sale contracts were between petitioner and the individual executives, and the sales were therefore made by petitioner to the executives even if petitioner reimbursed the executives for the costs.

2. Subdivision (c) (1) of the Revenue and Taxation Code Section 6012 provides that the "gross receipts" from a sale of property do not include "cash discounts allowed and taken …" Section 0413.40 of the Board's Audit Manual further provides that when a customer is not satisfied with the merchandise and wishes to return it, but the seller prevails upon the customer to keep the merchandise at a reduced price, such "price adjustments will be deductible if the customer is actually given a refund in cash or credit …."

Petitioner contends that when it reimbursed the executives for the costs of these meals, it was in effect reducing the price to zero. Thus, there were no gross receipts from the sales and no tax is due.

We disagree. Petitioner's decision to reimburse its executives has nothing to do with price adjustments for defective merchandise which is the subject of Audit Manual Section 0413.40.

The California Supreme Court has held that the definition of "gross receipts" in Section 5012 refers to "to the price agreed upon at the initial sales transaction and not to the net amount which the buyer ultimately pays for the goods purchased … [nor] to that amount which the seller ultimately received on the sale …." (Southern California Edison Co. v. State Board of Equalization, 7 Cal.3d 652 at 661; emphasis in original.) Here, the amount charged for the meals and rung up on the dining room cash register was the regular menu price, plus tax reimbursement, and that price was never adjusted. The reimbursement which petitioner later paid to its executives therefore does not qualify as a "cash discount" under Section 6012.

Recommendation

Redetermine without adjustment to the tax.

3/17/92

James E. Mahler, Senior Tax Counselor Date