

STATE OF COLORADO

DEPARTMENT OF REVENUE
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GIL-2008-11

Bill Ritter, Jr.
Governor

Roxy Huber
Executive Director

XXXXXXXXXXXX
Attn: XXXXXXXX
XXXXXXXXXXXX
XXXXXXXXXXXX

February 28, 2008

Re: hostess dollars

Dear XXXXXXX,

This letter is in response to two letters, both dated January 17, 2008, sent by you to the Colorado Department of Revenue.

Issue

1. Is a credit (hostess dollar) included in the purchase price when computing sales tax?
2. Is a transportation charge included in the purchase price when computing sales tax?

Background

The company is a direct sales company that markets goods exclusively through independent distributors. Distributors recruit hostesses to hold parties at her home and for the purpose of marketing and selling the company's product to prospective customers. Hostesses can earn "hostess dollars," the value of which is determined by the amount of sale order taken at the party. Hostess dollars are credited against the purchase price of product purchased by the hostess. Hostess dollars become worthless if not used, cannot be assigned to another person, and cannot be used to pay applicable sales taxes or shipping charges. The hostess orders may include one or more customers and contain promotional items for the hostess (these promotional items are the hostess dollars and/or hostess free gifts). Distributors submit to the company the sales tax for remittance to the state.

The company charges a fee for shipping goods. The fee is computed as a percentage of the total purchase price and there is a minimum shipping charge of [dollar value]. The shipping charge is separately stated on the customer's invoice. Goods are typically shipped by the company either to the distributor or to the hostess, who then delivers the goods to customers. Goods are shipped by common carrier and the sales contract does not specify where title to the goods passes. If goods are lost in transit, the company will replace the goods and seek reimbursement from the carrier.

Discussion

1. *Hostess dollars are included in the price upon which tax is computed.*

The purchase price upon which tax is computed includes amounts received in cash and credit and any consideration valued in money. Department Regulation (39-)26-102.7(a). For example, a consumer who pays for a \$5 item by paying \$2 in cash and applying a \$3 credit owed by the retailer to a consumer because of an overpayment by the consumer on a prior purchase, must pay sales tax on the \$5 purchase price, not the purchase price reduced by the \$3 credit.

A discount, however, is a reduction in the purchase price and tax is computed on the reduced purchase price. Grocery store coupons are typical of such discounts. In general, discounts are unilateral in the sense that there is not a *quid pro quo* exchange of consideration in order for the consumer to receive the discount. For example, a purchaser does not have to pay money or provide a service to the retailer in order to receive the discount.

Credits, on the other hand, reflect value received by the retailer, either in the form of money or performance by a purchaser or from third parties, or by some other valuable consideration received by the retailer. Credits are included in the purchase price. For example, if a retailer and buyer agree that the retailer will reduce the price of its goods in exchange for a buyer's agreement to provide the retailer some valuable service or goods, the credit is added to the reduced sales price in order to compute the sales tax.

In the case you describe, the hostess dollars are credits, not discounts. The company issues hostess dollars to the hostess in compensation for the hostess' agreement to open her home for the company as a forum to market its products and the hostess' efforts to generate sales for the company. The hostess is not entitled to the hostess dollars in the absence of her agreement to perform in the manner specified by the company. The fact that the company restricts the hostess's ability to assign the dollars or restrict when the dollars can be redeemed is not relevant. Clearly, such restrictions are likely matters taken into consideration by the hostess when evaluating her willingness to enter into an agreement with the company, but it remains the case that the hostess dollars are a *quid pro quo* exchange of consideration for the hostess' agreement to provide the company with valuable services. The retailer agrees to give a credit to the hostess goods in exchange for the hostess' successful efforts to garner sales for the company.

Other states that have considered similar circumstances have reached similar conclusions. See, e.g., Illinois Dept. of Rev. General Information Letter ST 97-0446-GIL, 08/15/1997; Illinois Dept. of Rev. General Information Letter ST 96-0061-GIL, 02/13/1996 (hostess dollars must be added to purchase price when computing tax); In the Matter of the Petition of POPULAR CLUB PLAN, INC. for Revision of a Determination or for Refund of Sales and Use Taxes under Articles 28 and 29 of the Tax Law for the Period July 15, 1988 through, 810667 ; 810668, 01/27/1994 (reward credits given to sales representatives were includable in purchase price). See, also, Texas Comptroller's Decision No. 18,266, 12/09/1986; Texas Comptroller's Decision No. 10,572, 06/18/1980; California Sales Tax Counsel Rulings Nos. 295.0940.175 and 280.0970; but, see, Cal. Code Regs. 1671.1(c)(A)(3). Not all states agree with this reasoning. See, e.g., *Columbus Southern Lumber Company v. Peck*, 113 NE2d 1 (Ohio 1953) (tax correctly computed on subsequent downward price adjustment which could only be determined after purchaser reached agreed-on sales volume).

Finally, you cite the New Jersey case of *Burger King v Director, Division of Taxation*, 9 N.J. Tax 251 (Tax Ct. 1987, aff'd 224 N.J. Super 628 (App. Div. 1988) in support of your position that the hostess dollars are not added to the purchase price when computing the sales tax. In that case, the retailer provided customers with two-for-one coupons. The coupons had no value other than as a discount for meals. The court held that the coupons represented a discount and that tax is computed on the discounted price.

The case is not dispositive. Unlike the present case, the two-for-one coupons were available to all consumers and customers were not required to provide the company with valuable consideration in exchange for the coupons. The discount was similar to the grocery store discount coupon which entitles the consumer to buy two apples for the price of one.

In contrast, the hostess dollars at issue here are available only when a person agrees to open their home to the company and consumers and give the company a forum in which to sell its product. Hostess dollars create an incentive for the hostess to actively (and successfully) engage in the promotion of the company's product. In many respects, the hostess dollars are similar to sales commissions, but are paid not in real dollars but as a credit toward the purchase price of goods sold by the company. Had the company paid the hostess real dollars instead of hostess dollars, but required the hostess' to use the money only for buying the company's goods, the sales tax would clearly be computed on the full purchase price. The company has simply made the transaction more efficient by issuing hostess dollars (which presumably are not issued as tangible medium at all, but, rather, as a credit memo against any purchase).

2. Transportation costs are includable in the calculation of the sales tax.

The purchase price on which sales tax is computed includes all costs incurred by the retailer in making a sale. Services that occur after the sale are generally not taxable. *A.D Stores v Department of Revenue*, 19 P3d 680 (Colo. 2001). The department has promulgated a regulation that governs the taxability of transportation charges (Department Special Regulation Sales 18), which provides as follows:

- 1) The transportation of tangible personal property between a retailer and purchaser is a service presumed to be not subject to sales or use tax. Transportation charges are not taxable if they are both (1) separable from the sales transaction, and (2) stated separately on a written invoice or contract.
 - a) "Transportation charges" include carrying, handling, delivery, mileage, freight, postage, shipping, trip charges, stand-by, and other similar charges or fees.
 - b) Separable charges. Transportation charges are separable from the sales transaction if they are performed after the taxable property or service is offered for sale and the seller allows the purchaser the option either to use the seller's transportation services or use alternative transportation services (including but not limited to the purchaser picking up the property at the seller's location). The fact that transportation charges are stated separately does not, in and of itself, mean the charges are a separable charge.
 - c) Stated Separately. Transportation charges will be regarded as "separately stated" only if they are set forth separately in a written sales contract, retailer's invoice, or other written document issued in connection with the sale.
 - d) Intermediate or "Freight in" charges. Transportation charges incurred in connection with transporting tangible personal property from the place of production or the manufacturer to the seller or to the seller's agent or representative, or to anyone else acting in the seller's behalf, either directly or through a chain of wholesalers or jobbers or other middlemen, are deemed "freight -in" charges and are not a transportation charge exempt from tax.
 - e) Overstated Transportation Charges. The amount of transportation charges excluded from the calculation of tax shall be the amount of transportation charges separately stated in accordance with subparagraph (c), provided that such separate statement is not to avoid the tax upon the actual sales price of tangible personal property.

From the information presented by you, it appears that the transportation charges must be included in the calculation of the sales tax. Goods are shipped from your warehouse which is located out-of-state to either the distributor or the hostess. Crucial to this determination is the assumption that the customer does not have any realistic alternative to the transportation services provided by the

company. That is, the customer does not have a realistic option to pick up the merchandise or to acquire other transportation service. If that assumption is incorrect, the transportation charges would not be taxable.

Finally, the Department makes a good faith effort to provide accurate and complete answers to questions posed to it by taxpayers. However, the information and answers provided here are not binding on the Colorado Department of Revenue, nor do they replace, alter, or supersede Colorado law and regulations. The Executive Director, who by statute is the only person having authority to bind the Department, has not formally reviewed and/or approved this response.

Respectfully,

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