

BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO

In the Matter of the Protest of)	
)	DOCKET NO. 15514
[Redacted])	
Petitioner)	DECISION
)	
)	
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On February 16, 2001, the Managed Audit Section of the Sales Tax Audit Bureau of the Idaho State Tax Commission (Tax Commission) issued a Notice of Deficiency Determination to [Redacted] (taxpayer), proposing additional use tax, and interest for the period of January 1, 1998 through December 31, 2000 in the total amount of \$2,515. The taxpayer filed a timely protest and petition for redetermination and requested an informal hearing before the Tax Commission. The hearing was held on June 26, 2001. The Tax Commission, having reviewed the file and the arguments presented by Mr. [Redacted], the owner of [Redacted], hereby issues its decision.

The taxpayer, [Redacted], is a video game arcade located in [Redacted], Idaho. The taxpayer operates several amusement devices and machines on its premises. The customers of the taxpayer purchase tokens that are deposited into the machines to play games. For some of the games, the customer is rewarded with tickets that may be redeemed for prizes. The skill of the player determines the number of tickets awarded. The number of tickets won per game played can vary from zero to over one hundred. The tickets may then be redeemed for prizes. The prizes range from pieces of candy to stereo equipment or bicycles. There is no dollar value assigned to or displayed with the prizes. Instead, each prize is assigned a specified number of tickets that are required to be redeemed for the prize.

The tax specialist performing the audit noted that the taxpayer purchased all of these prizes exempt from sales or use tax and determined that such purchases were taxable. The tax on

these purchases comprises all but \$167 of the tax imposed by the Notice of Deficiency Determination. The taxpayer does not contest the other items.

The taxpayer raises two arguments to support the contention that the purchases of the prizes should be exempt from sales and use tax. First, that the prizes were purchased for resale in the ordinary course of business, and second, that the Tax Commission is estopped from collecting the tax because Mr. [Redacted] was informed by members of the Tax Commission staff that he was not required to pay use tax on the purchase of the prizes.

A review of the applicable statutes is necessary to address the first argument. Idaho Code § 63-3612 defines the term “sale” for the purposes of the Idaho Sales Tax Act. This statute states the following in relevant part:

63-3612. Sale. (1) The term "sale" means any transfer of title, exchange or barter, conditional or otherwise, of tangible personal property for a consideration and shall include any similar transfer of possession found by the state tax commission to be in lieu of, or equivalent to, a transfer of title, exchange or barter.

(2) "Sale" shall also include the following transactions when a consideration is transferred, exchanged or bartered:

...

(f) The use of or the privilege of using tangible personal property or facilities for recreation.

Since fees paid for the use of pinball machines, video games, and similar devices are fees paid for the privilege of using tangible personal property for a recreational purpose, such fees fall within the definition of “sale.”

Idaho Code § 63-3609 provides the following definition of “retail sale;”

63-3609. Retail sale -- Sale at retail. The terms "retail sale" or "sale at retail" means a sale for any purpose other than resale in the regular course of business or lease or rental of property in the regular course of business where such rental or lease is taxable under section 63-3612(h), Idaho Code . . .

Thus if the sale is not for resale, i.e., the sale is to the ultimate consumer, the sale is a retail sale. Idaho Code § 63-3619 imposes the sales tax only on retail sales. Therefore,

purchases by the ultimate consumer are taxable, purchases of items for resale by a retailer are not taxable.

Idaho Code § 63-3621 imposes a use tax on the “storage, use, or other consumption of tangible personal property in this state.” The use tax is imposed on purchases of tangible personal property by a consumer which were not taxed by the seller at the time of sale. Every state that imposes a sales tax also imposes a complementary use tax. The use tax is imposed at the rate of five percent of the value of the property and a recent sales price is presumptive evidence of the value of the property. Thus the use tax rate is the same as the sales tax rate.

Idaho Code § 63-3615 includes within the definition of “use” the exercise of any right or power incident to ownership of tangible personal property, other than resale in the ordinary course of business.

In 1995, the Idaho Legislature enacted H.B. 340, which amended Idaho Code § 63-3623B, to provide that persons operating amusement devices pay a permit fee in lieu of sales tax on the fees paid for the use of the machine. This statute states:

63-3623B. Amusement devices. (a) For purposes of this section the term "amusement device" shall mean all coin, currency, or token operated machines and devices which are used for amusement including, but not limited to, game machines, pool tables, juke boxes, electronic games and similar devices.

(b) In lieu of the imposition of sales tax upon the use of the amusement device, the owner or lessee or person having the right to impose a charge for use of the amusement device must pay an annual permit fee of thirty-five dollars (\$35.00) for each such device.

(c) Upon payment of the permit fees, the state tax commission shall issue the permit(s) to the owner or lessee or person having the right to impose a charge for use of the amusement device. Such permit fee may be increased in a proportionate amount by the commission if the state sales tax rate increases.

(d) All applications for a permit renewal must be made to the state tax commission on or before July 1 of each year. Such application shall contain the same information required on an application to secure a seller's permit under this chapter and shall be accompanied by the annual permit fee due for each device.

(e) The state tax commission shall adopt a uniform system of providing, affixing and displaying official decals, labels or other official indicia evidencing

that the owner, lessee, or person having the right to impose a charge for the use of the amusement device has paid the annual permit fee for such amusement device. No person subject to a permit fee under this chapter may impose a charge or collect any consideration for use of such amusement device unless such official decal, label, or other official indicia, as required herein, is affixed to such amusement device.

(f) In addition to the penalties set forth above and in section 63-3634, Idaho Code, the state tax commission may assess the following penalties:

(1) If any owner, lessee, or person having the right to impose a charge for the use of any coin, currency or token operated amusement device in this state shall violate any provision of this section or any rule promulgated under this section, the commission may assess penalties, of fifty dollars (\$50.00) for each device for failure to pay timely permit sticker fees.

(2) A person who knowingly secures or attempts to secure an amusement device permit sticker under this section by fraud, misrepresentation, or subterfuge or uses any permit issued under this section in a fraudulent manner shall be subject to a penalty of up to twenty-five thousand dollars (\$25,000).

(g) The state tax commission shall impose the penalties provided in this section by a notice of deficiency determination in the manner provided in section 63-3629, Idaho Code, which shall be subject to review as provided in section 63-3631, Idaho Code.

(h) The commission may revoke all permits of any person who operates any amusement device without complying with the provisions of this section. Notice of revocation shall be given in the manner provided for deficiencies in taxes in section 63-3629, Idaho Code, which shall be subject to review as provided in section 63-3631, Idaho Code.

(i) Permits issued under this section are transferable to another person only after written notice of the transfer is given to the state tax commission.

Also, in 1995, the Tax Commission promulgated Idaho Sales Tax Administrative Rule 109 [IDAPA 35.01.02.109]. Subsection 109.01 states that the term "Amusement device" does not include vending machines that are used to sell tangible personal property.

The Commission notes that the taxpayer has purchased amusement device permits for all of its machines, including the machines that award tickets that may be redeemed for prizes. Thus, it would appear that the taxpayer considers these machines to be amusement devices.

In order to determine if the prizes in question were purchased for resale, therefore, one must determine if the customer is purchasing tangible personal property or paying for the use of the machines for a recreational purpose. The Idaho Supreme Court has imposed the "object of

the transaction” test to determine whether a sale consists of the transfer of tangible personal property or the purchase of an intangible service. *Consolidated Freightways Corp. v. Dept. of Revenue and Taxation*, 112 Idaho 652, 735 P.2d 963 (1987). If the object of the game player is the purchase of tangible personal property, then the purchase of the prizes would be exempt purchases for resale. Parenthetically, if the object of the transaction is the purchase of tangible personal property, then it would be incorrect to pay the permit fee in lieu of sales tax, and the sales price of the property would be the total amount of money taken in by each game.

If the object of the game player is entertainment, then Idaho Code § 63-3623B would apply. In this case, the taxpayer would have purchased the prizes to induce the customers to play the games and the purchase would not be for resale.

A review of the case law in other jurisdictions shows that there are only a few relevant decisions. In a New York case involving prizes awarded by carnival games (not coin operated games) the Supreme Court of Erie County noted that with regard to the use tax imposed on the purchases of prizes by the game operators:

[W]e believe it is obvious that the price charged for playing the ‘game’ is not contemplated as the market value selling price of the offered prize. Upon review we can only conclude that the prize is merely a further inducement beyond the entertainment value of participating in the carnival atmosphere, games and chances to entice, from a prospective customer, the price of having a try at the particular game being pressed by the booth’s operator or barker. It was, therefore, proper for the Tax Commissioner to assess a compensating use tax.

Outdoor Amusement Business Assoc. v. State Tax Commission, 420 N.Y.S. 2d 355 (1979).

The Appeals Court of New York ultimately held that the fee charged to play the game itself was not taxable under the New York sales tax laws. The imposition of use tax on the purchase of the prizes by the game operators, however, was upheld. *Outdoor Amusement Business Assoc. v. State Tax Commission*, 57 N.Y.2d 790, 441 N.E.2d 1104, (1982).

In another case, the Minnesota Supreme Court addressed the issue of novelty items (such as sunglasses, baseball caps, and duffel bags) given to persons attending Minnesota Twins baseball games. Although this case does not involve amusement devices, the Court's analysis is useful. The Court first noted that the sale of the admission tickets to the game were taxable. In holding that the purchases of prizes were subject to use tax, the Court stated,

The Twins' assertion that there was a resale of the novelty items and ticket stock falls short of the mark for two reasons. First, supplies purchased and used for the 'sole purpose of providing . . . services' are ultimately used by the service provider, and thus it is the service provider who is responsible for sales or use tax on the items. (Citation omitted.) Second, absent consideration, a transfer of property by a business to a consumer is not a sale, but is instead a gift of goodwill. (Citation omitted.) "Generally a person purchasing property to be given away in any manner is the user or consumer thereof and is liable for the sales tax thereon . . ."

Minnesota Twins Partnership v. Commissioner of Revenue, 587 N.W.2d 287 (1998).

There are two other points raised by the taxpayer in the protest letter. First, after describing the process of buying tokens, playing the games, winning tickets, and redeeming the tickets for prizes, the taxpayer asks, "what is the difference of that (redemption of tickets for prizes) and a restaurant customer that wishes to dine on beef either well done or rare, the only difference is in the process of preparing the item." The Tax Commission notes that there are substantial differences between the transactions. The restaurant customer selects specific items from a menu, pays a specified price, and the restaurant charges the customer tax on the entire sales price of the meal.

The other point was that Mr. [Redacted] feels that there is an issue of "double taxation," since he paid the \$35 fee per machine, and the fee was due before any sales were made. For this reason, if he has to pay tax on the purchase of the prizes, he would, in effect, be paying taxes twice.

As pointed out above, the \$35 permit fee is paid “in lieu of” sales tax and is not properly considered a tax at all. Putting aside this argument, however, the Idaho Supreme Court has addressed a similar issue in *Boise Bowling Center v. State*, 93 Idaho 367, 461 P.2d 262 (1969). In this case, several bowling alley proprietors had leased pinsetting equipment from AMF. The State Tax Collector determined that the equipment leases were taxable sales and imposed use tax on the rental payments. The bowling alleys argued that this would be double taxation because the bowling alleys were required to collect tax from their customers on fees charged for bowling. In rejecting this argument the Court stated:

It is evident that two transactions have occurred simultaneously. The first is the proprietor's rental of the pinsetting equipment from A.M.F. The second is the sale of bowling services by the proprietor of the bowling establishment to his customers. These are two entirely distinct transactions which are being subjected to taxation. The first relates to the privilege of renting tangible personal property within the state. The second relates to the privilege of using bowling facilities (a unique combination of property and services) for recreational purposes. There are two entirely different taxpayers in each transaction; the proprietors in the first, his customers in the second. A sales tax is not a tax on property but rather an excise tax—a levy on certain transactions designated by statute. Leonardson et al. v. Moon et al., 92 Idaho 796, 451 P.2d 542 (1969). *There is no double taxation when two separate and distinct privileges are being taxed even though the subject matter to which each separate transaction pertains may be identical.*

Boise Bowling Center, 93 Idaho 367 at 370 (emphasis added).

Applying the reasoning above, the Tax Commission finds that the object of the player when he deposits his token in the game machine is entertainment or recreation. At the time of the transaction, the player does not know how many tickets he will receive, or even if he will receive any tickets at all. Also, the player may not necessarily exchange the tickets at the time he wins them, but may, instead, accumulate them hoping to claim a bigger prize later. If the tickets are then lost or forgotten, no prize will, in fact, be awarded to the player. Furthermore, the tickets themselves have no intrinsic value to the winner but are used as an exchange medium. Thus, the taxpayer does not resell the prizes but gives them away as an inducement to encourage

customers to play the games. For this reason, the taxpayer is the consumer of the prizes and must pay sales or use tax on their purchase.

Next Mr. [Redacted] contends that he should not be required to pay use tax in this case because he was twice told by Tax Commission staff members that he was not required to pay use tax on the prizes. Mr. [Redacted] stated that he was told verbally that no use tax was due by a Tax Commission compliance officer at a small business fair held in [Redacted] in the fall of 1996. Also, on October 3, 2000, a staff member of the taxpayer's CPA firm called the Tax Commission Taxpayer Services Section and was told that, "if the machines have the amusement device decal attached to them then no sales tax are [sic] required for the operation of those machines, even if prizes are being awarded." Mr. [Redacted] did not receive any statements on this issue in writing from the Tax Commission.

In effect, the taxpayer is raising the doctrine of equitable estoppel. Webster's Ninth New Collegiate Dictionary, published by Merriam-Webster, Inc. defines "estoppel" as "a legal bar to alleging or denying a fact because of one's own previous actions or words to the contrary."

Because Mr. [Redacted] did not receive any statements in writing, it is not clear that the Tax Commission staff members understood the precise nature of Mr. [Redacted] question. Even so, the Idaho Supreme Court has ruled that "[t]he government is not estopped by previous acts or conduct of its agents with reference to the determination of tax liabilities or by failure to collect the tax, nor will the mistakes or misinformation of its officers estop it from collecting the tax." *State ex rel. Williams v. Adams*, 90 Idaho 195, 409 P.2d 415 (1965). For this reason, the State Tax Commission is not estopped from collecting use tax on the purchase of the prizes.

WHEREFORE, the Notice of Deficiency Determination dated February 16, 2001 is APPROVED, AFFIRMED, and MADE FINAL.

IT IS ORDERED and THIS DOES ORDER that the taxpayer pay the following tax, penalty, and interest (calculated through September 30, 2001):

<u>TAX</u>	<u>INTEREST</u>	<u>TOTAL</u>
\$2,203	\$403	\$2,606

DEMAND for immediate payment of the foregoing amount is hereby made and given.

An explanation of the taxpayer's rights to appeal this decision is enclosed with this decision.

DATED this ____ day of _____, 2001.

IDAHO STATE TAX COMMISSION

COMMISSIONER

CERTIFICATE OF SERVICE

I hereby certify that on this ____ day of _____, 2001, a copy of the within and foregoing DECISION was served by sending the same by United States mail, postage prepaid, in an envelope addressed to:

[Redacted] [Redacted]

ADMINISTRATIVE ASSISTANT 1