PRIVATE TAXPAYER RULING LR95-005

September 20, 1995

The following private taxpayer ruling is in response to your letter dated May 5, 1995, but not received by the department until May 26, 1995 and the receipt of the requested additional information dated August 8, 1995.

The following is a restatement of the facts in your letters.

Statement of facts:

The income derived by the track consists of admissions from paying customers and the sale of food and drink.

In addition, the race car drivers pay an entry fee. This is often called a "backgate fee" since a separate entrance is provided for the drivers and race cars. There are presently three race divisions that cars compete in at this track. The entry fee per driver for each race is $20.00. This money is put into a bank account. The entry fee becomes the purse. In general, the total entry fees will equal "the purse" to be paid to drivers in each race based on how the driver finished. Often the entry fees do not cover the purse. Rarely do the entry fees exceed the purse.

If a driver desires, he may purchase a track membership and receive $5.00 off of each entry fee. The membership money goes toward prize money paid by the company. Each year's points are totaled by the track, a banquet is held and prizes awarded based on racing performance. At the end of the season the track pays out prizes and purse money exceeding the entry fees and track memberships for drivers.

Money received for memberships is currently needed to help make up weekly events as the amount of money collected is never enough to cover the payoffs. While the membership fees are currently being used to make up the weekly purse, they are also to be used to pay prizes based on accumulated points at the end of the season.

Other than purse money or prizes, membership fees are not used to pay other track expenses and the track is currently having to supplement the purse and prize monies.

Track memberships are not available for spectators; however season tickets will be made available if requested and a tax on admissions would be charged.

Your position:

The Arizona statutes do not provide for a transaction privilege tax on entry fees or on membership fees received by drivers used for prize money or purse money.

The amusement classification includes "the business of operations on conducting ... races, contests ...". There is a distinction between admission fees and entry fees. Admission fees include the right to special seating arrangements or entertainment. The entry fee is for the right to provide the entertainment regardless of whether or not for pleasure or business purpose by the drivers.

Accordingly, there is a distinction between receiving the entertainment by spectators or by providing the entertainment either as a business or for sport by the drivers. The membership fees paid by the drivers have the same characteristics. The fee is provided as prize money at the end of the year. Both the entry fee and membership fees are returned to successful drivers and no net cash benefit is received by the owners of the track.

In addition, the track has a fiduciary obligation to hold the purse money and pay out the money according to track rules and common practice. The same applies to membership fees by drivers since the proceeds are returned to successful drivers either by track rule or common practice.

If the legislature had intended to tax entry fees then the receipt of such fee should have been more specifically defined.

The company does not receive a percentage of the entry fees and membership fees, as compensation and accordingly, is not subject to Arizona Administrative Code (A.A.C.) R15-5-404.

In addition to the non-taxability of entry fees under entertainment, the company does not believe that such an entry fee or membership fee can be classified as rent of facilities by the drivers. First, the entry or membership fee is in the nature of a deposit and may be returned to the person who made the deposit if he wins either a weekly purse or overall prize money. The renting of real and personal property must be rented for consideration. In this case, the track owner derives no consideration for the entry fees or membership fees, except the benefit of being able to provide entertainment, and food and drink which is already taxed. The company is not in the business of leasing property but is engaged in the business of entertainment on which they already pay a tax.

Issues:

1. Are entry fees (backgate fees) of drivers subject to a tax under the entertainment classification (A.R.S. § 42-1310.13)?

2. Are membership fees by drivers subject to a tax under the entertainment classification (A.R. S. § 42-1310.13)?

3. Are entry fees or membership fees by drivers subject to any tax under the rental classifications (A.R.S. § 42-1310.09 or A.R.S. § 42-1310.11)?

Applicable statutory provisions:

Arizona Revised Statutes (A.R.S.) § 42-1310.13 levies the transaction privilege tax on the business of operating or conducting ... races, contests ... or any other business charging admission or user fees for exhibition, amusement or entertainment.

A.R.S. § 42-1301.4 defines "gross income" as the gross receipts of a taxpayer derived from trade, business, commerce or sales and the value proceeding or accruing from the sale of tangible personal property or service, or both, and without any deduction on account of losses.

A.R.S. § 42-1310.09 levies the transaction privilege tax on the business of leasing for a consideration the use or occupancy of real property.

A.R.S. § 42-1310.11 levies the transaction privilege tax on the business of leasing or renting tangible personal property for a consideration.

Discussion:

Arizona imposes a transaction privilege tax which differs from the sales tax imposed by most states. The Arizona transaction privilege (sales) tax is a tax imposed on the privilege of conducting business in the State of Arizona. This tax is levied on the vendor, not the purchaser. The vendor may pass the burden of the tax on to the purchaser; however, the vendor is ultimately liable to Arizona for the tax.

A.R.S. § 42-1310.13 levies the transaction privilege tax on the business of operating or conducting ... races, contests ... or any other business charging admission or user fees for exhibition, amusement or entertainment. The tax base for the amusement classification is the gross proceeds of sales or the gross income derived from the business.

"Gross income" is defined as the gross receipts of a taxpayer derived from trade, business, commerce or sales and the value proceeding or accruing from the sale of tangible personal property or service, or both, and without any deduction on account of losses. (A.R.S. § 42-1301.4)

Gross receipts from entry fees to participate in competitions, such as car races, are not

included in gross income if the fees are returned to the participants in the form of awards or prizes and the fees are kept in a separate account. If however, an admission fee is charged to watch the competitions, income from the admission fee is subject to tax under the amusement classification.

With respect to "membership fees", a deduction is provided under the amusement classification for income derived from memberships which provide for the right to use a private recreational establishment, or any portion of an establishment, for participatory purposes for 28 days or more and fees charged for use of the private recreational establishment by bona fide accompanied guests of members. "Private recreational establishment" is defined as a facility whose primary purpose is to provide recreational facilities for its members and where at least 80 percent of the monthly gross revenue of the facility is received through accounts of memberships and accompanied guest use fees which provide for the right to use the facility or any portion of the facility, for participatory purposes for 28 days or more.

If a facility meets the definition of "private recreational establishment" and the membership fee provides for the right to use the facility or any portion of the facility for participatory purposes for 28 days or more and 80 percent of the facility's revenue is derived from membership accounts and accompanied guest fees, the membership fees charged are not subject to tax. However, it does not appear that the membership fees paid to ... by the drivers fall within the meaning of "memberships" as used in the amusement statute. (A.R.S. § 42-1310.13) The membership fees paid by the drivers appear to be more akin to pre-paid entry fees. Therefore, the transaction privilege tax treatment of the income from the membership fees would be similar to the treatment of entry fees.

Therefore, gross receipts from entry fees paid to participate in racing events are not subject to tax if the fees are returned to the participants in the form of awards or prizes and the fees are kept in a separate account. In addition, membership fees paid by, and returned to, the drivers in a manner similar to entry fees are also exempt from tax if kept in a separate account. If however, an admission fee is charged to watch the racing events, income from the admission fee is subject to tax under the amusement classification.

The lease of tangible personal property and the lease of real property are subject to transaction privilege tax. (A.R.S. §42-1310.11 and 42-1310.09, respectively.) However, the elements of a lease must exist. Elements of a lease include, but are not limited to, the granting to the lessee of the following rights: to use and operate the property, control of the property, access to the property during the lease period and possession of the property. The use of the track by the race car drivers during a race does not meet the requirements of a lease. Therefore, the entry fees and membership fees paid by the drivers do not constitute lease income subject to tax under the either of the rental classifications.

Conclusion and ruling:

The following ruling is given based on the facts presented in your request.

The department rules that entry fees which are placed in a separate account and paid out only as prize money or awards are not subject to tax under the amusement classification. (A.R.S. § 42-1310.13)

The department also rules that membership fees paid by drivers which are kept separate and are returned to drivers only in the form of prizes and awards are not subject to tax under the amusement classification.

In addition, the department rules that the entry fees and membership fees paid by drivers are not subject to tax under the rental classifications, A.R.S. § 42-1310.09 or 42-1310.11.

The conclusions in this private taxpayer ruling do not extend beyond the facts as presented in your letters of May 5, 1995 and August 8, 1995 in this request for a private taxpayer ruling.

This response is a private taxpayer ruling and the determination herein is based solely on the facts provided in your request. The determination in this taxpayer ruling is the present position of the department and is valid for a period of four years from the date of issuance except as set out herein. This determination is subject to change should the facts prove to be different on audit. If it is determined that undisclosed facts were substantial or material to the department's making of an accurate determination, this taxpayer ruling shall be null and void. Further, the determination is subject to future change depending on changes in statutes, administrative rules, case law or notification of a different department position.