OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of:	) OTA Case No. 20015720) CDTFA Case ID 202-007
K1 SPEED, INC.	)
	)
	)
	)

OPINION

Representing the Parties:

For Appellant: Stan Pincura, CPA
Josh Boxer, CFO

For Respondent: Joseph Boniwell, Tax Counsel III
Scott Claremon, Tax Counsel IV
Jason Parker, Chief of Headquarters Ops.

A. WONG, Administrative Law Judge: Pursuant to California Revenue and Taxation Code (R&TC) section 6561, K1 Speed, Inc. (appellant) appeals a Decision issued by respondent California Department of Tax and Fee Administration (CDTFA)[1] partly denying a petition for redetermination of a Notice of Determination (NOD) dated October 6, 2014. The timely-issued NOD is for $2,521,276.46 in tax, and applicable interest, for the period of April 1, 2009, through March 31, 2012 (liability period).[2] In the Decision being appealed, CDTFA reduced the tax liability from $2,521,276.46 to $2,496,245.00, but otherwise denied appellant's petition.

Office of Tax Appeals (OTA) Administrative Law Judges Andrew Wong, Natasha Ralston, and Teresa A. Stanley held an oral hearing for this matter in Cerritos, California, on September 13, 2022. At the conclusion of the hearing, the record was closed, and this matter was submitted for an opinion.

[1] The State Board of Equalization (Board) formerly administered the sales and use taxes. On July 1, 2017, the Board's administrative functions relevant to this case transferred to CDTFA. (Gov. Code, § 15570.22.) For ease of reference, when this Opinion refers to acts or events that occurred before July 1, 2017, all references to "CDTFA" refer to the Board.

[2] CDTFA timely issued the October 6, 2014 NOD with respect to the period of April 1, 2009, through June 30, 2011, because, for that period, appellant waived the applicable three-year statute of limitations and consented to an extended deadline per R&TC section 6488.

ISSUE

Whether appellant's furnishing of go-karts to paying customers at its racing venues constitutes leases of tangible personal property such that appellant was required to collect and remit tax on the rental receipts.

FACTUAL FINDINGS

1. Appellant operates indoor go-kart racing venues in California and other states. Race participants drive electric go-karts on a rubberized track, usually in competition against other race participants.
2. Appellant purchased go-karts for use at its venues in California from a vendor in Italy without paying tax to California or tax reimbursement to its vendor.
3. During the liability period, appellant offered the following go-kart racing options:
   - Individual "arrive & drive" race, comprising 14 laps around the track, for $20 per person (non-transferable);
   - Discounted two-race package (plus one free race) for individuals, Mondays through Thursdays, for $40 per person (non-transferable);
   - Discounted three-race package for individuals, Fridays through Sundays, for $50 per person (non-transferable);
   - Discounted five-race package for individuals anytime for $75 per person (non-transferable);
   - Discounted eight-race package for individuals anytime for $100 per person (non-transferable);
   - Junior Mini Grand Prix group package of two races for $44 per person (eight person minimum);
   - Teen/Adult Mini Grand Prix group package of two races for $49 per person (eight person minimum);
   - Grand Prix group package of three races for $60 per person (eight person minimum); and
   - Le Mans Endurance group package of four races for $80 per person (eight person minimum).

4. Each individual race included a Race Result Sheet (RRS), which is a printout of the race results and rankings, along with information regarding the racing venue and a $5 off coupon.
5. All group packages included medals or trophies for the top three finishers, podium photos, and RRSs. Junior and Teen group packages also included T-shirts for participants.
6. For individual races, including those in the discounted multi-race packages, each participant required a $5.95 license, which was valid for one year at all of appellant's racing locations.[3] The license included the use of a helmet and a head sock during races, online access to race scores and racing history, and a monthly newsletter with special offers.
7. During the liability period, appellant did not report or remit to California any tax on its receipts from go-kart racing or the license fees.
8. CDTFA audited appellant for the liability period and determined that appellant failed to collect and remit tax for the following audit items: unreported taxable leases of go-karts for individual "arrive & drive" races measured by $4,780,797, for discounted multi-race packages for individuals measured by $15,373,977, and for group packages measured by $6,550,143; and unreported taxable mandatory license fees measured by $2,361,241.[4]
9. Following appellant's petition and a reaudit, CDTFA reduced the aggregate deficiency measure by $292,261.00 for tax-paid purchases resold, which in turn reduced the tax liability from $2,521,276.46 to $2,496,245.00, but otherwise denied appellant's petition.
10. Appellant timely appealed to OTA.

DISCUSSION

A "lease" includes rental, hire, and license. (Cal. Code Regs., tit. 18, § 1660(a)(1).) A "lease" also includes a contract under which a person secures for a consideration the temporary use of tangible personal property which, although not on his or her premises, is operated by, or under the direction and control of, that person. (*Ibid*.)

[3] By the end of the liability period, the $5.95 license fee eventually rose to $6.00.

[4] There were three other audit items totaling $251,719 in measure, but these are not in dispute.

Generally, a lease of tangible personal property in California is a continuing sale and a continuing purchase. (R&TC, §§ 6006.1, 6010(e); Cal. Code Regs., tit. 18, § 1660(b)(1) & (2).) However, a lease does not constitute a continuing sale and continuing purchase when the tangible personal property is leased in substantially the same form as acquired by the lessor, and the lessor made a timely election to pay tax or tax reimbursement on the purchase price of the property. (R&TC, §§ 6006(g)(5), 6010(e)(5); Cal. Code Regs., tit. 18, § 1660(b)(1)(E).)

Where a lease constitutes a continuing sale and continuing purchase, use tax generally applies to the leased property in California, measured by the rentals payable, which the lessor must collect from the lessee at the time rentals are paid and remit to the state. (Cal. Code Regs., tit. 18, § 1660(c)(1).) The "rentals" subject to the tax include any payments required by the lease with certain exceptions.[5] (*Ibid*.)

If CDTFA is not satisfied with the amount of tax reported by the taxpayer, CDTFA may compute and determine the amount required to be paid upon the basis of any information within its possession or that may come into its possession. (R&TC, § 6481.)

In the case of an appeal, CDTFA has a minimal, initial burden of showing that its determination was reasonable and rational. (*Appeal of Amaya*, 2021-OTA-328P.) If CDTFA carries its initial burden, the burden of proof shifts to the taxpayer to establish that a result differing from CDTFA's determination is warranted. (*Ibid*.) The applicable burden of proof is by a preponderance of the evidence. (Cal. Code Regs., tit. 18, § 30219(c).) That is, a party must establish by documentation or other evidence that the circumstances it asserts are more likely than not to be correct. (*Appeal of AMG Care Collective*, 2020-OTA-173P.) Unsupported assertions are not sufficient to satisfy a taxpayer's burden of proof. (*Appeal of Amaya*, *supra*.) To satisfy the burden of proof, a taxpayer must prove two things: (1) the tax assessment is incorrect; and (2) the proper amount of tax. (*Appeal of AMG Care Collective*, *supra*.)

[5] California Code of Regulations, title 18, section 1660(c)(1) excludes the following amounts from being taxable as payments required by the lease: (A) collection costs, attorney's fees, court costs, repossession charges, and storage fees (except delinquent rental payments); (B) costs relating to insuring, repairing, or refurbishing lease property following a default; (C) costs incurred in defending a court action or paying a tort judgment arising out of the lessee's operation of the leased property, or premiums paid on insurance policies covering such court actions or tort judgments; (D) costs incurred in disposing of leased property; (E) late charges and interest thereon for failing to timely pay rentals; (F) separately stated optional insurance charges, maintenance, or warranty contracts; (G) personal property taxes assessed against personal property where a bank or financial corporation is the lessor; and (H) "customer facility fees" collected pursuant to Civil Code section 1936 or any other law whereby a local agency operating an airport requires a rental car company to collect a facility financing fee.

Here, CDTFA determined that appellant did not elect to pay tax or tax reimbursement on the purchase price of the go-karts, which appellant furnished to its customers on a temporary basis for payment. CDTFA further determined that such furnishing constituted rental agreements, which are leases, so appellant's rental receipts were taxable. Specifically, CDTFA determined that appellant purchased the go-karts without having paid tax or tax reimbursement and rented them for a fee, and thus the rentals payable are subject to use tax, which appellant must collect from customers and remit to CDTFA. CDTFA also determined that the $5.95 license fee constituted a mandatory charge related to the rental of the go-karts for races, were part of the taxable leases, and therefore also taxable. Based on a review of the facts and record of this case, OTA concludes that CDTFA's determination is reasonable and rational, so the burden shifts to appellant to show otherwise.

Appellant challenges CDTFA's determination and argues that the transactions at issue were not leases based on three grounds: (1) the go-kart loans cost less than $20.00 and were used for less than a 24-hour period on appellant's premises; (2) go-kart racing is an amusement service not a lease because appellant maintained control of the go-kart; and (3) the $5.95 license fee is not for a loan of tangible personal property. OTA analyzes each of these grounds in turn.

Less than $20/less than 24 hours

Certain restricted grants of privilege to use property are excluded from the term "lease." (Cal. Code Regs., tit. 18, § 1660(e)(1); see also R&TC, § 6006.3.) To fall within this exclusion, the use of the property must be restricted to use on the premises or at a business location of the grantor of the privilege to use the property, the charge must be for less than $20, and the use must be for a period of less than one continuous 24-hour period. (*Ibid.*; see also Cal. Code Regs., tit. 18, § 1660(a)(1), (e)(1).) All three conditions – property used on grantor's premises, charge less than $20, and use less than one continuous 24-hour period – must exist to exclude a use from being categorized as a "lease."

Here, the go-karts' use undisputedly took place at appellant's racing venues. However, appellant contends that, for each go-kart racing option (single race, discounted multi-race package for individuals, group package), the per-race charge for the go-karts' use was less than $20 and their use lasted less than 24 hours. OTA examines whether each option qualifies for the lease exclusion.

Single Standard "Arrive & Drive" Race

Appellant contends that each $20.00 single standard "arrive & drive" race included an RRS worth an average of 5.5 cents, which, allocated as a "premium" under California Code of Regulations, title 18, (Regulation) section 1670(c), lowered the actual charge for a single race below $19.95, thereby disqualifying such grants of privilege from the definition of "lease."

However, the rental charge for this go-kart loan option was not less than $20.00 a race, even subtracting 5.5 cents for the RRS, because the rental charge must also include some portion of the mandatory $5.95 fee for the annual license a customer needed to participate in individual "arrive & drive" races. Per Regulation section 1660(c)(1), apart from certain exceptions not relevant here,[6] a rental charge includes *any payments* required by the lease contract/agreement. A single individual could purchase and participate in numerous "arrive & drive" races during the yearlong period a license is valid, and the $5.95 mandatory license fee would have to be apportioned among these races, but unless the total number of those races exceeds 108 ($5.95 license fee ÷ $0.055 alleged cost of RRS), then the rental charge for any individual "arrive & drive" race would not dip below $20.00. And there is no evidence in the record of any single individual customer purchasing more than 108 "arrive & drive" races during the yearlong period a license was valid. Because appellant has not shown that the rental charge for an individual "arrive & drive" race is less than $20.00, OTA concludes that the lease exclusion does not apply to such races.

Discounted Multi-Race Packages for Individuals

Appellant argues that the per-race charge for each race in every discounted multi-race package for individuals was less than $20.00, so these transactions are also excluded from the definition of "leases." For example, appellant contends that the per-race charge for the discounted package of two races (plus one free race) is $13.33 ($40.00 ÷ 3 races [2 paid + 1 free]), and, for the discounted package of three races, the per-race charge is $16.67 ($50.00 ÷ 3 races). Appellant asserts that races in discounted multi-race packages must be evaluated separately because an individual could only possess and use one go-kart at any time and purchased races are not transferable.

[6] See footnote 5, *ante*, page 4.

Regulation section 1660(e)(3)(C) provides an example illustrating the principle that the rental charges for separate items under a single rental agreement must be aggregated when evaluating whether a rental charge is less than $20. That specific example involves the rental of five separate tools whose individual rental charges totaled $21, which did not satisfy the exclusion's requirement that a rental charge be less than $20.[7] In this example, the total of all rental charges is evaluated at the time the rental agreement is made, not when the tools are used, and whether the lessee could simultaneously use all five tools does not appear to be a salient factor.

Considering Regulation section 1660(e)(3)(C), OTA finds no valid basis for breaking down the rental charges for discounted multi-race packages by the number of races therein. Although the per-race rental charge for most discounted multi-race packages would fall below $20.00 (e.g., the discounted eight-race package for $100.00 equals $12.50 per race), those packages are advertised, offered, and sold/purchased in a single transaction. There is no evidence, nor does appellant argue, that each individual race in the discounted multi-race packages could be separately purchased for the discounted per-race price. That would contradict the apparent purpose of a discounted multi-race package for individuals: bulk sales of individual races in exchange for reduced per-race prices. Because the races within discounted multi-race packages are sold and purchased together in a single transaction, the total rental charge of the discounted packages must be considered. And because these total rental charges range from $40.00 to $100.00 (i.e., they are not less than $20.00) even before factoring in the mandatory $5.95 license fee, OTA concludes that the discounted multi-race packages for individuals do not qualify for the exclusion in R&TC section 6006.3 and Regulation section 1660(e)(1).

[7] Specifically, Regulation section 1660(e)(3)(C) states, "Rental of tools to be used on the premises of the owner of the tools for a period of eight hours invoiced as follows:

1 Portable lamp	$4
1 Wheel pulley	$4
1 Portable hoist	$4
1 Sander	$4
1 Spray gun	$5
Total rental	$21

This situation does not qualify for the exclusion because the agreement for rental of the property is a single agreement involving rental charges of $21 and does not meet the requirement that the charge be less than $20."

Group Packages

For the group packages, appellant offers a combined contention: the total rental charges for each group package must be considered on both a per-person *and* a per-race basis, and then the per-person, per-race charges must be further reduced by the per-person cost of included premiums (i.e., medals, trophies, photos, and RRS in all group packages, as well as T-shirts in Junior and Teen group packages). According to appellant, this would reduce the per-race charge for each member of an eight-person group to less than $20, thus qualifying these group-package transactions for the lease exclusion.

In support of its argument that total rental charges must be evaluated on a per-person and per-race basis, appellant provided documentation from 2022 that members of a group purchasing a group package could split and individually pay for the per-person charges. Appellant also cites to Sales and Use Tax (SUT) Annotation 330.3078 in support of its argument that, even if only one person purchased a group package, that person would subsequently distribute the group-package races to individual group members who each had a separate contractual relationship with appellant, so total group package rental charges must be evaluated on a per-person basis.[8]

However, as with the discounted multi-race packages for individuals, the principle illustrated by Regulation section 1660(e)(3)(C) applies, so separate races under a single rental agreement, plus their associated rental charges, must be aggregated when evaluating whether a rental charge is less than $20. For group packages, the minimum number of participants is eight, and a single purchase transaction of the lowest-cost, two-race Junior group package of $44 per person totals $352 ($44 x 8 persons), far above the $20 threshold for the exclusion. Further, OTA is not persuaded by appellant's argument and evidence that each group member could pay for his/her own part of the group package because, regardless of the number of payors, the group package requires a minimum of eight persons and is sold in a single transaction.[9]

[8] SUT Annotations are digests of opinions written by CDTFA's legal staff and evidence administrative interpretations made by CDTFA in the normal course of its administration of the Sales and Use Tax Law. (*Yamaha Corp of America v. State Bd. of Equalization* (1998) 19 Cal.4th 1, 15.) Although SUT Annotations have substantial precedential effect within CDTFA, they are not binding upon taxpayers, OTA, or courts. (*Ibid.*)

[9] Even if each two-race segment is purchased separately by individual group members, appellant would still need to overcome the fact that the charge for each participant is at least $44 and that there is no evidence that the total per-person cost of all the items included in the package (medal, trophy, photos, RRS, and T-shirt) lowers the per-person rental charge to below $20.

Finally, OTA is not persuaded by appellant's attempt to analogize its group packages to the facts of SUT Annotation 330.3078, which involved coupons that entitled the holder to a free video cassette rental. There, the taxpayer sold 25,000 videotape rental coupons to a company, who distributed them for free to its customers. These coupons were essentially gift certificates, the purchase of which was not taxable but the redemption of which was taxable because they resulted in the rental of video cassettes. (See also SUT Annotation 280.0580.) Here, there is no evidence that appellant's group packages constituted aggregated individual gift certificates (i.e., vouchers for a set dollar amount not necessarily tied to the cost of a specific merchandise or service for which it is redeemed). Rather, the items in dispute are packaged races that simultaneously occur at a set date and time and involve participants who share some relationship racing together as a group. Accordingly, OTA concludes that SUT Annotation 330.3078 does not support appellant's assertion that total group package rental charges must be evaluated on a per-person and per-race basis.

Based on the above, OTA concludes that the group packages do not qualify for the lease exclusion.

Summary

Because the total rental charges for each type of transaction – single standard "arrive & drive" races, discounted multi-race packages for individuals, and group packages – was at least $20, the exclusion specified in R&TC section 6006.3 and Regulation section 1660 does not apply. Thus, no further analysis (i.e., whether the leases were over 24 hours) is necessary.

Amusement service

Appellant contends that in paying for the use of the go-karts, racers are seeking nontaxable amusement services rather than the possession and use of tangible personal property, per the true object test of Regulation section 1501. To that point, appellant also asserts that it maintains control over the go-karts.

As an initial matter, OTA notes that the language of Regulation section 1660 is broad and does not exclude from the definition of "lease" the temporary loan and use of tangible personal property for amusement or entertainment purposes (unless use of the property is restricted to the lessor's premises, the rental charge is less than $20, and the use is for less than one continuous 24-hour period).

In fact, the rental of skis, surf boards, and other entertainment-related equipment can all constitute leases, and, contrary to appellant's argument, the amusement derived from using this equipment does not disqualify the equipment's rentals from being leases. (See, e.g., SUT Annotation 330.2847 (ski equipment rentals were taxable leases).) Rather, the dispositive test here is whether possession and control of the property in question was transferred to the lessee, as distinguished from situations where the lessor retains possession of and operates the property under a service agreement. (See *Entremont v. Whitsell* (1939) 13 Cal.2d 290.)

Here, OTA finds the nature of go-kart racing is more akin to sporting activities in which participants exercise extensive control over the rented equipment, such as skiing or surfing, than activities involving property over which participants have little to no control, such as amusement park or carnival rides. Appellant's control over the go-karts is limited to the following: programming go-karts to a variety of pre-set speeds to accommodate various skill levels; automatically reducing the go-kart speed while in the pit area; and remotely turning off the go-karts in the case of emergencies. Otherwise, the speed and direction of the go-karts are primarily controlled by appellant's customer, the racer. While it may be true that the goal of each participant was amusement, the means of obtaining it was via go-kart racing and the go-karts themselves. Hence, OTA finds that appellant's argument that its customers primarily sought nontaxable amusement services unpersuasive.

License is not a lease of tangible personal property

Regarding whether the annual $5.95 license fee is subject to taxation, appellant offers three arguments. First, appellant contends that the annual $5.95 license fee required for the individual "arrive & drive" races is a separate membership fee excludible from tax under Regulation section 1584 because the amount is nominal. Second, appellant asserts that the annual $5.95 license fee is for the use of a helmet and a head sock and is excluded from the definition of a "lease" because the fee is less than $20.00, and the use is for less than 24 hours and restricted to appellant's premises. Third, appellant contends that because the go-kart rental is not taxable (because it is excluded from the definition of "lease"), the license fee is akin to a mandatory maintenance charge and is not taxable per Regulation section 1546(b)(3)(B).

OTA finds appellant's arguments unpersuasive. For reasons discussed above, the go-kart rentals constitute taxable leases, hence the mandatory annual license fee, as a condition to purchase an "arrive & drive" race, falls squarely within a "payment required by the lease," which

subjects it to tax as part of the lease. (Cal. Code Regs., tit. 18, § 1660(c)(1).) In other words, to purchase an "arrive & drive" race, a participant was required to pay, or must have paid within the past year, a $5.95 license fee. Since OTA found each go-kart rental to be a taxable lease, and the license is a mandatory fee tied to the rental, it follows that the license fee is a payment required by the lease and thus also taxable. It matters not whether the license consisted substantially of a loan of tangible personal property separate from the rental of the go-kart itself; it is still a mandatory charge required as part of an "arrive & drive" leases, hence taxable as part of a lease under Regulation section 1660(c)(1).

Incidentally, because OTA finds Regulation section 1660(c)(1) to be dispositive of the issue of the license fees, OTA need not reach a conclusion on appellant's claim that they constitute membership fees. That is, even if the $5.95 charge were properly characterized as a membership fee, it is still a mandatory payment required by the lease not specifically excluded by law,[10] hence taxable as part of the go-kart lease.

[10] See footnote 5, *ante*, page 4.

HOLDING

Appellant's furnishing of go-karts at its racing venues to paying customers constituted leases of tangible personal property such that appellant was required to collect and remit tax on its rental receipts.

DISPOSITION

CDTFA's decision to reduce the assessed tax liability from $2,521,276.46 to $2,496,245.00, but otherwise deny appellant's petition for redetermination, is sustained.

DocuSigned by:
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Andrew Wong
Administrative Law Judge

We concur:

DocuSigned by:
Natasha Ralston
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Natasha Ralston
Administrative Law Judge

DocuSigned by:
Teresa A. Stanley
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Teresa A. Stanley
Administrative Law Judge

Date Issued: 12/19/2022