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California: Indoor Go-Kart Venue Assessed Tax on Lease of Tangible Personal Property

The California Office of Tax Appeals (OTA) recently concluded that a taxpayer furnishing go-karts to customers at its indoor racing venue was engaged in leasing tangible property and was required to collect sales tax on the rental receipts. The taxpayer offered various go-kart racing packages to customers, including a one-time "arrive and drive" option, as well as multi-race packages and group options. Before they could drive a go-kart, most customers were required to purchase a $5.95 driver's license, which provided for the use of a helmet, head sock and other items, and was valid for a year. The taxpayer purchased the go-karts from Italy and did not pay tax on the purchase. Following an audit, the California Department of Tax and Fee Administration (CDTFA) determined that the taxpayer was renting or leasing the go-karts to customers and was required to collect sales tax on the renal receipts. The CDTFA also determined that the $5.95 license fee was a taxable mandatory charge related to the rentals. The taxpayer made a few different arguments that the transactions were not taxable leases. The first was that certain go-kart rentals were excluded from the definition of the term "lease" under a California regulation because the charges were for less than $20, the go-karts were used for less than twenty-four hours at a time, and were used on the taxpayer's premises. The OTA rejected the taxpayer's position that the charges were for less than $20; even the least expensive option was over $20 because customers had to purchase the mandatory license. The taxpayer also asserted that the price per race in the multi-race packages was less than $20 and that these races must be evaluated separately because an individual could only possess and use one go-kart at a time. The OTA, relying on a California regulation providing that rental charges for separate items under a single rental agreement must be aggregated when evaluating whether a charge for a rental is less than $20, again rejected this argument.

The taxpayer next argued that under the true-object test, it was providing a non-taxable amusement service. The OTA noted at the outset that the rental of skis, surf boards, and other entertainment-related equipment could all constitute leases, and the fact that amusement was derived from using this equipment did not disqualify the equipment's rentals from being leases. Regardless, the test for whether something is a lease versus the provision of an amusement is whether possession and control of the property is transferred to the lessee, as distinguished from situations in which the lessor retains possession of and operates the property under a service agreement. In the OTA's view, the nature of go-kart racing was more akin to sporting activities in which participants exercised 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. The taxpayer's control over the go-karts was 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, racers generally controlled speed and direction of the go-karts. Accordingly, the OTA concluded that the taxpayer was not providing a nontaxable amusement service. The OTA determined that the mandatory annual license fee fell squarely within the term "payment required by the lease" and was therefore subject to sales tax along with the rental of go-karts. Please contact Jim Kuhl with questions on *In re K1 Speed, Inc.*