

**TENNESSEE DEPARTMENT OF REVENUE
REVENUE RULING #95-29**

WARNING

Revenue rulings are not binding on the Department. This presentation of the ruling in a redacted form is information only. Rulings are made in response to particular facts presented and are not intended necessarily as statements of Departmental policy.

SUBJECT

Application of sales and use tax to cellular telephones sold at a reduced price or distributed at no charge when provided by a retailer in conjunction with a contract for telephone carrier services.

SCOPE

Revenue rulings are statements regarding the substantive application of law and statements of procedure that affect the rights and duties of taxpayers and other members of the public. Revenue rulings are advisory in nature and are not binding on the Department.

FACTS

XYZ, Inc. ("XYZ") is a retail establishment which sells electronic equipment, including cellular telephones. As a retailer, XYZ purchases the cellular telephones on a resale certificate and charges sales tax on the retail price of the cellular telephones sold to its customers.

Purchasers of cellular telephones must also contract for telephone service from a cellular telephone carrier. XYZ is an authorized agent of a telephone carrier and can offer service contracts to its customers.

Customers of XYZ have several purchasing options which include the following: the customer may purchase a telephone from XYZ; the customer may purchase a telephone from XYZ and contract for telephone service through XYZ in its capacity as an agent for the telephone carrier; and the customer may contract for telephone service through XYZ in its capacity as an agent for the telephone carrier, without the purchase of a telephone.

XYZ offers to its customers pricing programs for the retail purchase of telephones which may include a reduced price or no charge for the telephone if the customer also contracts for the telephone service through XYZ as an agent for the cellular telephone carrier. XYZ is compensated by the telephone carrier through a commission received upon activation

of the service contract. XYZ receives this commission regardless of the sales price XYZ charges its customer for the cellular telephone.

XYZ is able to sell telephones provided in conjunction with telephone service contracts at a reduced price or at no charge because XYZ also receives remuneration from both the commissions it receives from the telephone carrier and charges to its customers for installation and activation of the telephone service. The cost of the telephone, commissions earned, and installation and activation fees are viewed as a whole by XYZ in determining its pricing and retail strategy for cellular telephones.

QUESTIONS

1. Under the facts provided, when may XYZ purchase cellular telephones on a resale certificate?
2. What are the tax consequences if a cellular telephone is purchased on a resale certificate when the cellular telephone is in fact distributed at no charge rather than resold?
3. What is the correct tax base for the cellular telephones which are sold by XYZ to its customers at a reduced price or distributed at no charge in conjunction with a contract providing for telephone carrier services?
4. Is the commission received by XYZ from the telephone carrier for securing a telephone service contract with its customers subject to sales or use tax?
5. Are the telephone installation and activation fees charged to customers on behalf of a telephone carrier subject to sales or use tax?

RULINGS

1. XYZ may purchase on a resale certificate cellular telephones which it intends to resell. Cellular telephones which are intended to be distributed at no charge may not be purchased on a resale certificate.
2. XYZ will owe tax on the cost price of cellular telephones which are purchased on a resale certificate and subsequently distributed at no charge.
3. XYZ must collect and remit sales tax on the retail price it charges its customer for the sale of the cellular telephone. If the cellular telephone is distributed at no charge, no sales tax accrues at the retail level.
4. The commission is not subject to sales or use tax.
5. The installation and activation fees are subject to sales tax.

ANALYSIS

1. T.C.A. Section 67-6-102(23)(A) provides that retail sales are subject to sales tax when the sale is “for any purpose other than for resale.” It is further provided that

[a]ny sales for resale must, however, be in strict compliance with rules and regulations promulgated by the commissioner. Any dealer making a sale for resale which is not in strict compliance with rules and regulations shall be personally liable for and pay the tax.

Id. In order for XYZ to avail itself of the resale certificate, XYZ must purchase the cellular telephone for the purpose of reselling the cellular telephone to a customer. A “sale” is defined as any transfer of title or possession, or both, of tangible personal property for a consideration. T.C.A. Section 67-6-102(24)(A).

Consequently, where there is a charge for the distribution of the telephone from XYZ to its customer, it is a resale. Therefore, XYZ may purchase the cellular telephone on a resale certificate when the telephone is purchased for the purpose of reselling it to customers for a charge.

When XYZ distributes a cellular telephone to a customer for no charge, the transaction lacks the consideration necessary for this to be a resale. When XYZ distributes the cellular telephone without charge, XYZ is the user of the cellular telephone. T.C.A. Section 67-6-102(30)(A); *J. C. Penney Co., Inc. v. Olsen*, 796 S.W.2d 943, 947 (Tenn. 1990) (distribution of catalogs free of charge is a taxable use). Thus, if XYZ purchases a cellular telephone for the purpose of distributing it without charge, the purchase cannot be made with a resale certificate.

2. As discussed above, XYZ may purchase cellular telephones which it intends to resell on a resale certificate. Cellular telephones which are distributed at no charge are not resold and are considered for XYZ’s own use. Therefore, XYZ must pay sales tax at the time it purchases cellular telephones that it intends to distribute at no charge.

In some instances, XYZ may purchase the cellular telephone not knowing whether the telephone will be resold or distributed without charge. Sales and Use Tax Rule 1320-5-1-.95 specifies that when tangible personal property is purchased without payment of tax and the property is subsequently used or consumed, “such use must be reported and a tax paid thereon for the month in which the taxable use arose. It is the duty of the person to keep accurate records to show what determination is made of such property.”

T.C.A. Section 67-6-203(a) provides a tax on the cost price of each item of tangible personal property which is not sold but is distributed for use or consumption in this state. Consequently, when XYZ distributes cellular telephones to customers for no charge,

XYZ must pay tax on the cost of the telephone. If XYZ does not pay sales tax on the purchase of the cellular telephone and the telephone is subsequently distributed without charge, payment of the tax must be made at the time it is determined that the telephone will be distributed without charge rather than resold.

3. As discussed above, where there is no charge for the distribution of the cellular telephone, XYZ must pay tax on the cost of the telephone. No sales tax accrues at the retail level when there is no charge.

Where the customer is charged a price for the cellular telephone, XYZ must collect and remit sales tax on the actual sales price, even if it is a reduced price.

4. When articles of tangible personal property are sold at retail in this state, sales tax is “levied at the rate of six percent (6%) of the sales price of each item.” T.C.A. Section 67-6-202(a). “Sales price” is defined as “the total amount for which a taxable service or tangible personal property is sold, including any services that are a part of the sale of tangible personal property, valued in money, whether paid in money or otherwise.” T.C.A. Section 67-6-102(25).

Money XYZ receives from its customers in exchange for the sale of cellular telephones is clearly subject to tax under T.C.A. Section 67-6-202. Commissions which XYZ receives from the telephone carrier are not subject to sales tax under T.C.A. Section 67-6-202 because the commission is not received in exchange for tangible personal property. Since the commission is not made in exchange for tangible personal property, the commission can only be subject to sales tax if made in exchange for some taxable service. The commission is an incentive for XYZ to act as the telephone carrier’s agent in procuring service contracts. This is not a taxable service for purposes of sales and use tax.

5. Charges for installation and activation of telephone service are subject to sales tax. T.C.A. Section 67-6-102(23)(F) provides as taxable retail sales the following services:

(iii) The furnishing, for a consideration, of either intrastate or interstate telecommunication services. Only those charges for interstate telecommunication which are originated or received in this state and which are billed or charged to a service address in Tennessee shall be included in the tax base;

* * *

(vi) The installing of tangible personal property which remains tangible personal property after installation where a charge is made for such installation whether or not such installation is made as an incident to the sale thereof and whether or not

any tangible personal property is transferred in conjunction with such installation service.

The Code thus specifically provides that charges for installation services are subject to tax. Because cellular telephones are tangible personal property and remain tangible personal property after installation, the charges for installation services are subject to tax under T.C.A. Section 67-6-102(23)(F)(vi).

Charges for activation of the telephone services are subject to tax as part of the charge for the telecommunications services which are subject to tax under T.C.A. Section 67-6-102(23)(F)(iii).

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