

SC PRIVATE LETTER RULING #05-5

SUBJECT: Supplies Purchased for Management of Real Estate
(Sales and Use Tax)

REFERENCES: S. C. Code Ann. Section 12-36-910 (2000; Supp. 2004)
S. C. Code Ann. Section 12-36-1310 (2000; Supp. 2004)
S. C. Code Ann. Section 12-36-60 (2000)
SC Regulation 117-308 (Supp. 2004)

AUTHORITY: S. C. Code Ann. Section 12-4-320 (2000)
S. C. Code Ann. Section 1-23-10(4) (Supp. 2004)
SC Revenue Procedure #03-1

SCOPE: A Private Letter Ruling is a written statement issued to a specific taxpayer by the Department to apply principles of law to a specific set of facts or a particular tax situation. A Private Letter Ruling is an advisory opinion; it does not have the force and effect of law and is not binding on the person who requested it or the public. It is, however, the Department's opinion limited to the specific facts set forth, and is binding on agency personnel only with respect to the person to whom it was issued and only until superseded or modified by a change in statute, regulation, court decision, or advisory opinion, providing the representations made in the request reflect an accurate statement of the material facts and the transaction was carried out as proposed.

Question:

What is the application of the sales and use tax to the purchase of tangible personal property from third-party vendors, as described in the facts, for use in the operation of commercial real estate being managed by 123, Inc. on behalf of the property owner?

Conclusion:

It is the opinion of the Department that 123, Inc. is providing property management services to the property owner under the agreements described in the facts and is not selling the property owner tangible personal property at retail. In addition, sales by third-party vendors as described in the facts, for use in the operation of commercial real estate being managed by 123, Inc. on behalf of the property owner, are retail sales to the property owner and are subject to the sales and use tax.

Therefore, the third-party vendors are liable for the sales tax, or are responsible for collecting and remitting the use tax, on retail sales of tangible personal property to the property owner. If the third-party vendor does not have nexus with South Carolina and is not otherwise licensed as a retailer with South Carolina for sales and use tax purposes, then the property owner is liable for the use tax on its purchases of tangible personal property from the third-party vendor.

Note: The property owner is liable for the use tax until the tax is paid to the State. However, if the purchaser has a receipt from a licensed retailer indicating the tax was paid, then the purchaser is relieved of the liability for the use tax.

Facts:

123, Inc. (“123”) is a foreign corporation with offices in South Carolina and throughout the country. 123 performs property management services for the owners (“clients” or “123’s clients”) of commercial real estate in South Carolina. For each client engagement, 123 operates under one of two types of arrangements, as determined by marketplace conditions:

IC Engagement: In an IC Engagement, 123 operates as an independent contractor under a Facilities Management Agreement. Unless specifically stated, 123 does not operate with express agency authority from the client.

Agency Engagement: In an Agency Engagement, 123 acts as an agent for the client under an express grant of authority given in the Property Management Agreement entered into between 123 and the client.

In the normal course of a property management engagement, whether an IC Engagement or an Agency Engagement, 123 procures from third-party vendors all goods and services necessary to operate the properties being managed for a particular client. Examples of such goods and services include landscaping services, washroom supplies, and elevator maintenance services. The goods and services acquired from third-party vendors are provided directly to a specific client’s property for immediate use on that property to satisfy an immediate need. The third-party provided goods are never held as inventory of 123 for use at a later date, or for performing property management services for any of its other clients. Although the Facilities Management Agreement between 123 and its client is silent as to whether 123 or the client holds title to the property, the intent of the parties is that the title to the property passes directly to the client at the time the property is acquired by 123. There is no provision in the agreement regarding passage of title; however, the agreement does provide that upon termination of the agreement, all property purchased by 123 for use of the client remains with the client.

123 issues purchase orders and receives invoices for these specific goods and services from the third-party vendors, and presents the invoices to the specific client for approval. The purchase order submitted by 123 to the third-party vendor states that the goods or services are being purchased on behalf of the specific client who owns the property where the third-party vendor will deliver such goods or perform such services. All invoices include the cost of the tangible personal property and applicable sales and use taxes. Once the invoice is approved, the client deposits funds into a segregated bank account from which 123 is authorized to withdraw funds to

pay the invoice. The third-party vendor and 123 agree that the vendor will only be paid from funds deposited by the client into the segregated bank account and 123 does not pay the vendors using its own funds. The third-party vendors and 123 further agree that 123 will have no liability in the event of non-payment by the client.

For both IC Engagements and Agency Engagements, the third-party vendor determines the applicable sales and use tax for each invoice and adds that tax to the invoice. The tax is paid when the full amount of the invoice is paid from the segregated bank account, and the vendor remits the tax to the state as part of its usual sales and tax filing procedures. 123's role is to oversee the payment of applicable sales and use taxes as part of the payment of vendor invoices from the segregated bank account. In instances where the third party vendor does not have nexus with South Carolina sufficient to require collection of applicable use taxes, the clients self-assess and remit the use tax directly to the State.

123 does not charge or receive any sort of mark-up on the goods and services procured on behalf of the client. 123 is compensated through a monthly management fee.

The only differentiating feature between IC Engagements and Agency Engagements is the way that a third-party vendor makes its contract. In an IC Engagement, the third-party vendor contracts directly with 123, notwithstanding that remittance for the tangible personal property used in the Engagement is made from segregated funds provided by the client. The third-party vendor is always aware that the client is the ultimate purchaser or user of the property. In an Agency Engagement, due to the express agency 123 obtains from its client, the third-party vendor makes its contract with 123 as agent for 123's client.

Discussion:

Code Section 12-36-910(A) imposes the sales tax and states:

A sales tax, equal to five percent of the gross proceeds of sales, is imposed upon every person engaged or continuing within this State in the business of selling tangible personal property at retail.

Code Section 12-36-1310(A) imposes the use tax and states:

A use tax is imposed on the storage, use, or other consumption in this State of tangible personal property purchased at retail for storage, use, or other consumption in this State, at the rate of five percent of the sales price of the property, regardless of whether the retailer is or is not engaged in business in this State.

Code Section 12-36-60 defines the term "tangible personal property" and states:

"Tangible personal property" means personal property which may be seen, weighed, measured, felt, touched, or which is in any other manner perceptible to the senses. It also includes services and intangibles, including communications, laundry and related services, furnishing of accommodations and sales of electricity, the sale or use of which

is subject to tax under this chapter and does not include stocks, notes, bonds, mortgages, or other evidences of debt. Tangible personal property does not include the transmission of computer database information by a cooperative service when the database information has been assembled by and for the exclusive use of the members of the cooperative service.

Based on the above, in order for the sales or use tax to apply, there must be a retail sale of tangible personal property.

SC Regulation 117-308, concerning professional, personal, and other services, states in part:

The receipts from services, when the services are the *true object* of the transaction, are not subject to the sales and use tax, unless the sales and use tax is specifically imposed by statute on such services (i.e. accommodation services, communication services). (Emphasis added.)

The so-called “true object” test is generally used to delineate sales of services from sales of tangible personal property. Applying this test to the matter at hand, it must be determined whether the owner of the property is seeking management services or tangible personal property from 123. In other words, what is the “true object” of the transaction between these two parties? The “true object” test is best described in 9 Vanderbilt Law Review 231 (1956), wherein it is stated:

The true test then is one of basic purpose of the buyer. When the product of the service is not of value to anyone other than the purchaser, either because of the confidential character of the product, or because it is prepared to fit the purchaser's special need — a contract or will prepared by a lawyer, or the accident investigation report prepared for an insurance company — this fact is evidence tending to show that the service is the real purpose of the contract. When the purpose of the contract is to produce an article which is the true object of the agreement, the final transfer of the product should be a sale, regardless of the fact that special skills and knowledge go into its production. Under this analysis, printing work, done on special order, and of significant value only to the particular customer, is still a sale. The purchaser is interested in the product of the services of the printer, not in the services per se. Similarly, it would seem that contracts for custom-produced articles, be they intrinsically valuable or not, should be classified as sales when the product of the contract is transferred.

The Vanderbilt Law Review article, in quoting *Snite v. Department of Revenue*, 398 Ill. 41 , 74 N.E. 2d. 877 (1947), also establishes the following general rule:

If the article sold has no value to the purchaser except as a result of services rendered by the vendor, and the transfer of the article to the purchaser is an actual and necessary part of the services rendered, then the vendor is engaged in the business of rendering service, and not in the business of selling at retail. If the article sold is the substance of the transaction and the service rendered is merely incidental to and an inseparable part of the transfer to the purchaser of the article sold, then the vendor is engaged in the business of

selling at retail, and the tax which he pays ... [is measured by the total cost of the article and services]. If the service rendered in connection with an article does not enhance its value and there is a fixed or ascertainable relation between the value of the article and the value of the service rendered in connection therewith, then the vendor is engaged in the business of selling at retail and also engaged in the business of furnishing service, and is subject to tax as to the one business and tax exempt as to the other.

While the above quotes do not establish rigid rules, they do provide general guidance in determining the purpose of a transaction, and are particularly helpful in addressing the issue at hand.

Based on the above and the facts set forth above, the property owner is seeking management services from 123.

Having determined that 123 is providing property management services to the property owner, and is not selling the property owner tangible personal property at retail, it is the opinion of the Department that sales by third-party vendors, as described in the facts, for use in the operation of commercial real estate being managed by 123 on behalf of the property owner, are retail sales to the property owner and are subject to the sales and use tax.

With respect to the sales tax, Code Section 12-36-910 imposes the liability for the sales tax on the retailer – the third party vendor.

With respect to the use tax, Code Sections 12-36-1310, 12-36-1330 and 12-36-1340 impose the use tax on the “the storage, use, or other consumption in this State of tangible personal property purchased at retail for storage, use, or other consumption in this State.” Under these sections, the person storing, using, or otherwise consuming in this State tangible personal property purchased at retail is liable for the use tax, until the tax is paid to the State. However, if the purchaser has a receipt from a licensed retailer indicating the tax was paid, then the purchaser is relieved of the liability for the use tax. In addition, a retailer is required to collect the use tax from the purchaser and remit it to the State if the retailer has nexus with South Carolina or has voluntarily registered to collect and remit the use tax.

SOUTH CAROLINA DEPARTMENT OF REVENUE

s/Burnet R. Maybank III
Burnet R. Maybank III, Director

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Columbia, South Carolina