
State of South Carolina
Department of Revenue
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SC PRIVATE LETTER RULING #06-2

SUBJECT: Early Termination Fee – Taxable Communication Services
(Sales and Use Tax)

REFERENCES: S. C. Code Ann. Section 12-36-910 (2000; Supp. 2005)
S. C. Code Ann. Section 12-36-1310 (2000, Supp. 2005)
S. C. Code Ann. Section 12-36-60 (2000)
S. C. Code Ann. Section 12-36-2645 (2000)
S. C. Code Ann. Section 12-36-90 (2000, Supp. 2005)
S. C. Code Ann. Section 12-36-130 (2000, Supp. 2005)

AUTHORITY: S. C. Code Ann. Section 12-4-320 (2000)
S. C. Code Ann. Section 1-23-10(4) (2005)
SC Revenue Procedure #05-2

SCOPE: A Private Letter Ruling is an advisory opinion issued to a specific taxpayer by the Department to apply principles of law to a specific set of facts or a particular tax situation. It is 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set forth, and is binding on agency personnel only with respect to the person to whom it was issued and only until superseded or modified by a change in statute, regulation, court decision, or another Departmental advisory opinion, providing the representations made in the request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:

Is an early termination charge imposed by ABC, Inc., as described in the facts, subject to the sales and use tax when billed in connection with a taxable communication service?

Conclusion:

An early termination charge imposed by ABC, Inc., as described in the facts, is subject to the sales and use tax when billed in connection with a taxable communication service since such a charge is a part of the "gross proceeds of sales" or "sales price" of the taxable communications service.

Facts:

ABC, Inc. ("ABC") provides telecommunication services and related services in South Carolina. There is a wide variety of telecommunication services available today from numerous providers, and the market for such services has become extremely competitive. As a result, ABC often implements special programs or promotions under which customers are offered a discount from the regular price of a service if they agree to comply with certain conditions, including the maintenance of the service for a specified period of time. A customer that desires to participate in such a program typically does so by completing and signing a form commonly referred to as a term agreement, program election, or similar name which sets forth the amount of the discount, the time period over which the service must be maintained, and any other terms and conditions of the program.

The term agreement generally provides that, if the customer terminates the agreement prior to the expiration of the elected term, the customer is required to pay an early termination charge. The early termination charge is expressed as a fixed dollar amount multiplied by the number of months remaining on the elected term. The fixed dollar amount varies depending on the program but in all cases is less than the monthly price of the service covered by the term agreement.

Discussion:

Code Section 12-36-910(A) 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. (Emphasis added.)

Code Section 12-36-1310(A) reads:

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. (Emphasis added.)

Code Section 12-36-60 defines the term "tangible personal property" to mean:

...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. ... (Emphasis added).

Therefore, the term tangible personal property includes the sale or use of intangibles, including communications, that are subject to South Carolina sales or use taxes under Chapter 36 of Title 12.

Communications are subject to sales and use taxes under Chapter 36 of Title 12 pursuant to Code Sections 12-36-910(B)(3) and 12-36-1310(B)(3) (“charges for the ways or means for the transmission of the voice or messages”), Code Sections 12-36-910(B)(5) and 12-36-1310(B)(5) (“the sale or recharge at retail for prepaid wireless calling arrangements”), and Code Section 12-36-2645 (900/976 telephone service). (For more detailed information as to the types of taxable and non-taxable communications services under these and other provisions of the sales and use tax, see SC Revenue Ruling #04-15.)

The sales tax is imposed upon a retailer's "gross proceeds of sales" which is defined at Code Section 12-36-90, in part, as:

...the value proceeding or accruing from the sale, lease, or rental of tangible personal property... without any deduction for... the cost of materials, labor, or service... [or] any other expenses....

The use tax is based upon the "sales price" of tangible personal property. The term "sales price" is defined at Code Section 12-36-130, in part, as:

...the total amount for which tangible personal property is sold, without any deduction for the cost of the property sold, the cost of the materials used, labor or service cost, interest paid, losses, or any other expenses.

In *Meyers Arnold, Inc. v. South Carolina Tax Commission*, 285 S.C. 303, 328 S.E.2d 920, 923 (1985), the Court of Appeals of South Carolina held the element of service involved in a lay away sale was subject to tax as being part of the sale of tangible personal property. The test used by the court was as follows:

...But for the lay away sales, Meyers Arnold would not receive the lay away fees. The fees are obviously charged for the service rendered in making lay away sales. For these reasons, this court holds the lay away fees are part of the gross proceeds and subject to the sales tax.

Accordingly, the total amount charged in conjunction with the sale or purchase of tangible personal property is subject to the tax.

Commission Decision S-D-92 was an analogous situation that dealt with the "inclusion in the taxable proceeds of sales of the face value on notes payable to the taxpayer and received by it in settlement of amounts due of lease agreements that were broken by the lessee." The Commission ruled that such notes payable a part of the proceeds subject to the sales or use tax.

In SC Private Letter Ruling #88-5, the Department held that the taxpayer's lease cancellation fee was a part of the "gross proceeds of sales" or "sales price" and therefore subject to the sales and use tax.

The Vermont Department of Taxes in Ruling 87-13, dated September 28, 1987, held that a "lease cancellation fee" was a receipt from the rental of tangible personal property. The Department stated:

...the cancellation fee you have described is a "receipt" from the rental of tangible personal property and is therefore subject to tax. In effect the Lessor has simply agreed to accept less than it is legally entitled to receive under the lease agreement. The amount that is paid, whether it is nominated rental payments or a "cancellation fee," is subject to tax as part of the consideration for the lease.

Based on the above, an early termination charge imposed by ABC, as described in the facts, is subject to the sales and use tax when billed in connection with a taxable communication service since such a charge is a part of the "gross proceeds of sales" or "sales price" of the taxable communication service.

CAVEAT: This advisory opinion is issued to the taxpayer requesting it on the assumption that the taxpayer's facts and circumstances, as stated, are correct. If the facts and circumstances given are not correct, or if they change, then the taxpayer requesting the advisory opinion may not rely on it. If the taxpayer relies on this advisory opinion, and the Department discovers, upon examination, that the facts and circumstances are different in any material respect from the facts and circumstances given in this advisory opinion, then the advisory opinion will not afford the taxpayer any protection. It should be noted that subsequent to the publication of this advisory opinion, changes in a statute, a regulation, or case law could void the advisory opinion.

SOUTH CAROLINA DEPARTMENT OF REVENUE

s/Ray N. Stevens
Ray N. Stevens, Director

November 7, 2006
Columbia, South Carolina