
State of South Carolina
Department of Revenue
301 Gervais Street, P. O. Box 125, Columbia, South Carolina 29214

SC Private Letter Ruling #97-4
(TAX)

TO: ABC, Inc.

SUBJECT: Security System
(Sales and Use Tax)

DATE: September 18, 1997

REFERENCE: S. C. Code Ann. Section 12-36-910 (Supp. 1996)
S. C. Code Ann. Section 12-36-1310 (Supp. 1996)
S. C. Code Ann. Section 12-36-60 (Supp. 1996)
S. C. Code Ann. Section 12-36-110 (Supp. 1996)
S. C. Code Ann. Section 12-36-100 (Supp. 1996)

AUTHORITY: S. C. Code Ann. Section 12-4-320 (Supp. 1996)
SC Revenue Procedure #94-1

SCOPE: A Private Letter Ruling is an official advisory opinion issued by the Department of Revenue to a specific person.

NOTE: A Private Letter Ruling may only be relied upon by the person to whom it is issued and only for the transaction or transactions to which it relates. A Private Letter Ruling has no precedential value.

Questions:

1. Are the periodic fees for the standard security package paid by a customer to ABC, Inc. ("ABC") for electronically monitoring a customer's home for the purpose of burglary and fire protection subject to the sales and use taxes?
2. Are charges by ABC to supply and install the add-on equipment subject to the sales and use taxes?
3. Are charges by ABC to repair the add-on equipment subject to the sales and use taxes?

Conclusions:

1. MONITORING AND EQUIPMENT FOR THE STANDARD SECURITY PACKAGE

The periodic charges by ABC are not for the access to, or use of, a communication system and are therefore not subject to the tax under Code Sections 12-36-910(B)(3) and 12-36-1310(B)(3). In addition, the periodic charges by ABC are not leases or rentals of the equipment in standard security packages; therefore, such charges are not subject to the sales or use tax under Code Sections 12-36-910(A) or 12-36-1310(A).

As such, ABC is using and consuming the equipment in providing a nontaxable monitoring service. ABC's purchase or use of the equipment used in the standard security package is subject to the sales or use tax at the time such equipment is sold to or purchased by ABC.

2. SALE AND INSTALLATION OF ADD-ON EQUIPMENT

Transfers of title and possession of add-on equipment to customers are sales of tangible personal property by ABC and are subject to the sales and use tax.

Charges by ABC to install the add-on equipment are subject to the sales and use taxes since such charges are not separately stated from the sales price of the add-on equipment on the bills to customers.

3. CHARGES TO REPAIR ADD-ON EQUIPMENT

Repair charges are addressed in Regulation 117-174.192. Based on this regulation, the following outlines the application of the tax to repairs made by ABC to add-on equipment:

1. If ABC charges customers for repair materials that pass to the customer, that do not lose their identity, and that are a substantial part of the repair job, then these charges are subject to the tax. However, installation charges by ABC with respect to these repair materials are not subject to the tax provided these charges are separately stated from the sales price of the property on billing to the customer and are reasonable.
2. If ABC never charges customers for repair materials that pass to the customer, that do not lose their identity, and that are a substantial part of the repair job, then the tax is due at the time these materials are sold to or purchased by ABC.

3. If ABC charges some customers for repair materials that pass to the customer, that do not lose their identity, and that are a substantial part of the repair job and does not charge other customers, then ABC may purchase all such material at wholesale and remit the tax at the time it charges the customer for the repair material or at the time it withdraws such material from inventory for the “no charge” repair. However, tax is not due on the withdrawal of the material for the “no charge” repair if ABC is replacing a defective part under a written warranty contract provided the warranty contract was (at the time of the original purchase of the defective property) given without charge, the tax was paid on the sale of the defective part or on the sale of the property of which the defective part was a component, and the warrantee is not charged for any labor or materials (See Code Section 12-36-110.).
4. If ABC uses repair materials that (a) do not pass to the customer or (b) that pass to the customer but lose their identity or are only incidental to the repair job, then the tax is due at the time these materials are sold to or purchased by ABC.

Facts:

ABC provides security services and monitoring services to residential customers. The security system generally consists of a standard package or a standard wireless package, both of which remain the property of ABC.

The standard package includes an electronic telephone dialer, door/window contacts, and a motion sensor. In addition to the above, the standard wireless package includes a receiver board and a key chain remote.

Monitoring services are provided from a communications center located outside of South Carolina. When a protected premises goes into a state of alarm, the system dials the communications center and transmits a digital message to the communications center. The operator in the communications center processes the message and takes appropriate action to resolve the situation. Additionally, patrol car services consisting of a ABC employee periodically patrolling the protected premises may be available sometime in the future.

ABC will provide residential customers with a security alarm system and monitoring services for a stated fee. The system (standard package) will be provided for a specified period of time (service contract). Under the terms of the service contract, title to the security system remains with ABC. Service contracts are anticipated to be for twenty-four months and the customer will have the option of renewing indefinitely. Customers will only obtain the right to use the system for the period during which the monitoring services are being provided. Service contract customers will be responsible to remit a

lump sum payment (monthly, quarterly, semi-annually, or annually) for use of the system and monitoring service.

In addition, customers may request additional protection over and above the standard package. The items providing this additional protection are known as “add-on protection items.” Add-on protection items will be sold to the customers (title will pass to the customers). Add-on pricing includes a lump sum charge for product, material, and labor. Charges for patrol car services, if instituted, will be separately stated.

ABC employees will assemble and install the equipment and perform service and training at the customer’s residence.

The question has arisen as to whether the fees charged by ABC are subject to the State sales and use taxes.

Discussion:

MONITORING AND EQUIPMENT FOR THE STANDARD SECURITY PACKAGE

With respect to the standard security package, ABC charges the customer one monthly fee. Separate charges are not assessed for use of the equipment and for monitoring.

The first question to arise is whether the monthly fee is subject to the tax as the sale or use of a communication service.

The sale or use of communications is subject to tax under Chapter 36 pursuant to Code Sections 12-36-910(B)(3) and 12-36-1310(B)(3), which impose the tax on the:

gross proceeds accruing or proceeding from the charges for the ways or means for the transmission of the voice or messages, including the charges for use of equipment furnished by the seller or supplier of the ways or means for the transmission of the voice or messages; . . .

In reviewing various communication issues in the past, the Department has concluded that charges for the ways or means of communication must be charges for access to, or use of, a communication system, whether this charge is based on a fee per a specific time period or per transmission.

Since the periodic charges by ABC are not for the access to, or use of, a communication system, such charges are not subject to the tax under Code Sections 12-36-910(B)(3) and 12-36-1310(B)(3)

Now it must be determined if such charges are subject to the sales and use tax as a "sale" of tangible personal property when ABC retains title to the equipment.

Code Section 12-36-910(A) imposes a sales tax and reads:

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) imposes a use tax and 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.

Therefore, for the 5% sales or use taxes to apply, there must be a retail sale or purchase of tangible personal property.

Code Section 12-36-110 defines the terms "sale at retail" and "retail sale", in part, as follows:

Sale at retail and retail sale mean all sales of tangible personal property except those defined as wholesale sales. The quantity or sales price of goods sold is immaterial in determining if a sale is at retail.

(1) The terms include:

* * * *

(c) the withdrawal, use, or consumption of tangible personal property by anyone who purchases it at wholesale,

In addressing withdrawals for use, SC Regulation 117-174.82 states that "[o]perators of businesses who are making both retail sales and withdrawing for use from the same stock of goods are to purchase at wholesale all of the goods so sold or used and report both retail sales and withdrawals for use under the sales tax law." In order for this regulation to apply, the business must have a substantial number of retail sales.

Therefore, a retailer is liable for the sales tax on sales made to the user or consumer and on withdrawals for use of items originally purchased at wholesale for resale but used or consumed by the retailer. In addition, a retailer is liable for the use tax on purchases of tangible personal property for the retailer's own use or consumption.

Now we must determine whether ABC is using and consuming its equipment in providing a nontaxable monitoring service or whether the transaction constitutes a sale under the law whereby the monthly monitoring fee is subject to the tax.

While it could be argued that the transaction constitutes a "sale" since it has transferred possession of its equipment for a consideration, one other factor first needs to be considered.

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 monthly fee is consideration paid for the sale of a monitoring service or the sale of tangible personal property (the equipment installed in the customer's home or business).

The "true object" test is best described in 9 Vanderbilt Law Review 231 (1956), wherein it is stated:

The true test then is one 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 needs - 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 a 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 inseparable part of the transfer to the purchaser of the article sold, then the vendor is engaged in the business of selling at retail ... 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 issues at hand.

As such, ABC is using and consuming the equipment in providing a nontaxable monitoring service. ABC's purchase or use of the equipment used in the standard package are subject to the sales or use tax at the time sold to or purchased by ABC. The periodic charges by ABC are not the lease or rental of the equipment in a standard security package; therefore, such charges are not subject to the sales or use tax under Code Sections 12-36-910(A) or 12-36-1310(A).

SALE AND INSTALLATION OF ADD-ON EQUIPMENT

With respect to the transfer of title or possession of the add-on equipment, Code Section 12-36-910(A) is applicable and reads:

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) imposes a use tax and 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, for the 5% sales or use taxes to apply, there must be a retail sale or purchase of tangible personal property.

Code Section 12-36-110 defines the terms "sale at retail" and "retail sale," in part, as follows:

Sale at retail and retail sale mean all sales of tangible personal property except those defined as wholesale sales. The quantity or sales price of goods sold is immaterial in determining if a sale is at retail.

Therefore, transfers of title and possession of add-on equipment to customers by ABC are sales subject to the sales and use tax.

Regulation 117-174.204 addresses the issue of installation charges for add-on equipment. The regulation states:

Not subject to the sales or use tax are charges for installation incident to the sale of tangible personal property when such charges are separately stated from the sales price of the property on billing to customers and provided the seller's books and records of account show the reasonableness of such labor in relation to the sales price of the property.

Based on the above, an installation charge by ABC for add-on equipment is subject to the tax with respect to add-on equipment sold (see Code Section 12-36-100) since the charge is not separately stated from the sales price of the property on the billing to the customer.

CHARGES TO REPAIR ADD-ON EQUIPMENT

Repair charges are addressed in Regulation 117-174.192 which reads:

Materials used in repairing, for tax purposes, fall into the following classes:

- (a) Materials which pass to the repairman's customers and which do not lose their identity when used by the repairman and which are a substantial part of their repair job (such as auto repair parts, radio tubes, and condensers) are sold at retail by the repairman. He must report sales tax on such sales, including tax on the service incidental thereto. He may, however, if making separate agreements to sell the repair parts and to perform labor and service required, remit tax only upon the price of the parts if his records and his invoices clearly show a separation of the amounts received from sales of parts and from the rendering of services.
- (b) Materials which pass to the repairman's customers but which lose their identity when used by the repairman or which are inconsequential in amount; such as paint, solder, and tack; are considered to have been used or consumed by the repairman and are taxable at the time of sale to him.
- (c) Materials which are used or consumed by the repairman and which do not pass on to his customers are supplies and taxable when sold to the repairman.
- (d) Materials which fall in class (b) or (c) are purchased at wholesale for use by a repairman who, in addition to using such materials as a repairman, sells the same kind of materials for use by others. These materials become subject to the sales tax upon their withdrawals for use by the repairman. Note, however, that a repairman is not considered a vendor unless he carries a stock of goods and sells outright therefrom a substantial amount. If the repairman makes only isolated sales or "accommodation" sales, he is not to be licensed as a seller under the sales tax law, in which case his supplier is liable for the tax.

In all instances materials are taxable when sold to repairmen for use in making repairs where such materials lose their identity as a result of such use. For instance, solder used in welding, paint used in automobile refinishing, thread used in mending clothes, cloth used in reupholstering. In all instances where the shape or composition of the repair material is materially changed, such altered or changed material is considered to have been used or consumed by the repairman, and, for that reason, subject to tax when sold to him. No tax on this material is to be collected by the repairman from his customer.

In instances where repair materials and repair parts are passed to the repairman's customers without charge, except necessary and customary minor adjustments, such parts or materials may be purchased at wholesale by the repairman licensed under the Sales Tax Law. The repairman is then liable for sales tax on such sales of materials and parts to his customers.

Based on this regulation, the application of the tax to repairs made by ABC to add-on equipment it has sold to the customer is as follows:

1. If ABC charges customers for repair materials that pass to the customer, that do not lose their identity, and that are a substantial part of the repair job, then these charges are subject to the tax. However, installation charges by ABC with respect to these repair materials are not subject to the tax provided these charges are separately stated from the sales price of the property on billing to the customer and are reasonable.
2. If ABC does not charge customers for repair materials that pass to the customer, that do not lose their identity, and that are a substantial part of the repair job, then the tax is due at the time these materials are sold to or purchased by ABC.
3. If ABC charges some customers for repair materials that pass to the customer, that do not lose their identity, and that are a substantial part of the repair job and does not charge other customers, then ABC may purchase all such material at wholesale and remit the tax at the time it charges the customer for the repair material or at the time it withdraws such material from inventory for the "no charge" repair. However, tax is not due on the withdrawal of the material for the "no charge" repair if ABC is replacing a defective part under a written warranty contract provided the warranty contract was (at the time of the original purchase of the defective property) given without charge, the tax was paid on the sale of the defective part or on the sale of the property of which the defective part was a component, and the warrantee is not charged for any labor or materials.
4. If ABC uses repair materials that (a) do not pass to the customer or (b) that pass to the customer but lose their identity or are only incidental to the repair job, then the tax is due at the time these materials are sold to or purchased by ABC.