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

SC TECHNICAL ADVICE MEMORANDUM #95-01 (TAX)

TO: Marvin N. Davant, Director
Field Services Division

SUBJECT: Security System
(Sales and Use Tax)

DATE: May 23, 1995

SCOPE: This Technical Advice Memorandum is Policy's official advisory opinion of how laws administered by the Department of Revenue are to be applied to a specific issue or set of facts.

Question:

Is the monthly fee paid by a customer to XYZ for electronically monitoring the customer's home or business for the purpose of burglary and fire protection subject to the sales and use taxes?

Conclusions:

Communication Services: The monthly fee paid by a customer to XYZ for electronically monitoring the customer's home or business for the purpose of burglary and fire protection is not subject to the sales and use taxes under Code Sections 12-36-910(B)(3) or 12-36-1310(B)(3) since such charges are not for the access to, or use of, a communication system.

XYZ Retains Title to the Equipment: The monthly fee paid by a customer to XYZ for electronically monitoring the customer's home or business for the purpose of burglary and fire protection is not subject to the sales and use taxes under Code Sections 12-36-910(A) and 12-36-100 in cases where XYZ retains title to the equipment installed in the customer's home or business. XYZ is not selling the equipment but is using and consuming the equipment in providing a nontaxable monitoring service.

Customer Obtains Title to the Equipment: The monthly fee is not subject to the sales and use taxes in cases where title to the equipment rests with the customer as such fee is not considered a sale of tangible personal property under Code Sections 12-36-910(A) and 12-36-100. XYZ is merely providing a nontaxable monitoring service.

Facts:

XYZ is primarily engaged in the business of providing electronic security protection services to homes and businesses located in South Carolina and elsewhere. The business utilizes electronic

sensors that are installed into customers' premises to provide detection of events such as intrusion, fire, surveillance and control of access.

When an intrusion, fire or other event occurs, the applicable sensor sends a signal to a control unit, which in turn, places a telephone call to XYZ's Central Monitoring Station. A technician at this facility observes that an event has occurred and will then place telephone calls to the local police or fire department and the customer, as appropriate.

When the system is installed, the customer may choose to purchase¹ the electronic sensing equipment and either have XYZ monitor the system for a monthly fee or have another company monitor the system for a monthly fee.

If the customer does not choose to purchase the electronic sensing equipment, XYZ will retain title to the equipment and monitor the system for a monthly fee. XYZ has the right to the equipment upon written notice to the customer or may abandon the system in whole or part.

The monthly monitoring fee is the same for all customers with similar systems, regardless of whether or not the customer purchases the electronic sensing equipment from XYZ. In addition, if a person has purchased electronic sensing equipment from someone other than XYZ, that person will still pay the same monthly fee as persons with XYZ equipment in their homes if he chooses to have XYZ monitor his home or business.

The question has arisen as to whether the monthly fee charged by XYZ is subject to the State sales and use taxes.

Discussion:

Communications

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; . . .

¹In cases where the customer purchases the equipment that is installed in his or her home or business, all parties agree that the sale of the equipment is subject to the tax. The question in this document only concerns the taxability of the monthly fee.

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 monthly charges by XYZ 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)

XYZ Retains Title to the Equipment

Since the monthly charges by XYZ are not subject to the tax as a communication services, it must now be determined if they are subject to the sales and use tax as a "sale" of tangible personal property when XYZ 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. (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.

(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 XYZ is using and consuming its equipment in providing a nontaxable monitoring service or whether XYZ's contract constitutes a sale under the law whereby the monthly monitoring fee is subject to the tax.

While it could be argued that XYZ's contract constitutes a "sale" since it has transferred possession of its equipment for a consideration in those cases when XYZ retains title to the equipment, 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.

In light of the above it is important to note that the monthly monitoring fee is the same for all customers with similar systems, regardless of whether or not the customer obtains title to the electronic sensing equipment from XYZ. In addition, if a person has purchased electronic sensing equipment from someone other than XYZ, that person will still pay the same monthly fee as persons with XYZ equipment in their homes if he chooses to have XYZ monitor his home or business.

As such, if the customer does not choose to purchase the electronic sensing equipment and XYZ retains title to the equipment and monitors the system, the monthly fee is not subject to the tax. XYZ has not sold the equipment. XYZ is using and consuming the equipment in providing a nontaxable monitoring service² which is the nature of a personal service transaction.

²Since XYZ is providing a nontaxable monitoring service in the above transactions, it is the user or consumer of the electronic sensing equipment it installs in a customer's home or business. Therefore, XYZ, as both a retailer and user of electronic sensing equipment should purchase at wholesale all of the electronic sensing equipment so sold or used and report both retail sales and withdrawals for use under the sales tax law. (See SC Regulation 117-174.82.)

Customer Obtains Title to the Equipment

The final question concerns those instances where the customer obtains title to the equipment.

As stated above, in order for the 5% sales or use taxes to apply, there must be a retail sale or purchase of tangible personal property.

Code Section 12-36-100 defines the terms "sale" and "purchase" to mean "any transfer, exchange, or barter, conditional or otherwise, of tangible personal property for a consideration."

Therefore, if the customer chooses to purchase the electronic sensing equipment and thereby obtains title to the equipment³, the monthly fee is not subject to the tax. XYZ is not transferring title or possession of tangible personal property for payment of the monthly monitoring fee since the customer already has title and possession of the equipment. XYZ is merely providing a nontaxable monitoring service. (See footnote #1.)

³As stated in footnote #1, XYZ is liable for the sales tax on sales of the electronic sensing equipment when the customer obtains title to the equipment. XYZ will not be liable for the sales tax on charges for installation incident to the sale of the electronic sensing equipment when such charges are separately stated from the sales price of the equipment on the bill to the customer and provided XYZ's books and records show the reasonableness of such labor in relation to the sales price of the equipment. See SC Regulation 117-174.204.