

OKLAHOMA TAX COMMISSION

TAX POLICY AND RESEARCH DIVISION
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September 8, 2000

Re: Our file Number LR-00-096; Sales tax incidence on high volume copying establishments.

Dear

This is in response to your inquiry concerning the sales tax responsibilities of your client. I have scanned in your letter below. As I felt appropriate, I have added material labeled "Comments" to your scenario to be sure the parameters of the answers I have listed after each of your questions are understood.

Scenario: Manufacturing Equipment

Our client maintains production equipment in every store. All production equipment in the full-service area is used for high volume copying and manufacturing of an end product from beginning to end. This production equipment includes high to medium volume black & white and color copiers, oversized enlargers (creates large posters and banners), one hour photo processing machines, and ancillary equipment (binders, cutters, paper drills, and other miscellaneous equipment). The employees in the stores operate all of the production equipment in this area and no customers have access to this area. Our Client has analyzed sales of ancillary services and found that approximately 94% of the ancillary services are provided in conjunction with the use of the production equipment.

Our client also maintains a self-serve area. The production equipment in this area is operated by the customer and the employee. This equipment only includes black & white and color copiers.

Questions:

1. Is our client entitled to a manufacturing exemption for machinery and equipment used in the full-service area?

Answer: NO. Please see Oklahoma Tax Commission Rule 710:65-19-259.

Are there special exemptions that apply to new stores / locations?

Answer: NO.

If classified as exempt, what supporting documentation needs to be provided to vendors of the manufacturing equipment used in the full-service area?

Answer: NOT APPLICABLE.

2. Is our client entitled to the manufacturing exemption for copiers used in the self-serve area?

Answer: NO.

Are there special exemptions that apply to new stores / locations?

Answer: NO.

If classified as exempt, what supporting documentation needs to be provided to vendors of the manufacturing equipment used in the self-serve area?

Answer: NOT APPLICABLE.

3. If sales / use tax was paid directly to the vendor on qualifying manufacturing equipment, how does our client claim a refund of tax paid to your state?

Answer: Although not applicable to your client, for refunds on manufacturing equipment, credit requests are covered by Oklahoma Tax Commission Rule 710:65-11-1

4. Does the taxability change if the equipment is leased under a capital or operating lease? If the answer is yes, please explain and provide the corresponding law sections.

Answer: NO.

5. Are separately stated installation charges taxable? If the answer is yes, please provide a detailed response with corresponding law sections.

Answer: NO.

6. What is the taxability of developer and fuser agent chemicals used in Xerox copy machines? Does it matter if the chemicals are used in the full-service equipment versus the self-serve equipment?

Answer: Taxable for both types of machines. Please see rule 710:65-19-259.

Scenario 2: Capital Versus Operating Leases

Our client leases machinery and equipment used in production and for their own use. The terms of the leases equal or exceed a 36 month period of time. Our client capitalizes capital leases, in accordance with GAAP. All operating leases are expensed.

Questions:

1. Is the lessor or lessee ultimately responsible for sales / use tax? Are there any exceptions to the law or internal guidelines that would hold the lessor ultimately liable for the tax?

Answer: The lessee is ultimately responsible for the tax, but the lessor is responsible for charging and remitting the tax. If the lessor fails to do so, it becomes responsible.

2. Does the taxability change if the lease is a capital lease versus an operating lease? Is sales / use tax due at lease inception or due based upon lease payments?

Answer: If the parties agree that the transaction is a lease, we will treat it as a lease for sales tax purposes and expect sales tax to be remitted on the total gross receipts of the lease as they become due. Please refer to Oklahoma Tax Commission Rule 710:65-1-11.

Scenario 3: Improvements to Real Property

Our client contracts with a number of in-state and out-of-state contractors to perform improvements to real property in their stores, including remodeling existing locations and

building out newly leased facilities. Below is a list of improvements that are physically attached to the real property.

- Carpet
- Cabinets
- Counter tops
- Signs attached outside the building
- Tables attached to real property
- Wiring for telephones and internet connections
- Lighting retrofits throughout the store (energy efficient lighting)
- Parking lot / sidewalk repairs
- Heating and air conditioning
- Roof repair
- Drywall repair
- Fabrication of interior walls Plumbing for restrooms
- Window tinting (film), not removed
- Window treatment (blinds, shades)
- Electrical outlets for production equipment

General Comments: Generally, carpet, cabinets, signs, and window treatments will be considered to be trade fixtures and as such will retain their identity as tangible personal property and will be subject to sales tax when sold.

Questions:

I . Who is ultimately responsible for the sales / use tax?

Answer: For items that retain their identity as tangible personal property, please see our response to question 1 of scenario two above. For the other items, which are improvements to real property, the contractor is required to pay sales tax when they are purchased and no further incidence of tax occurs.

3. Does the taxability change if the contract is lump sum or time and materials? If the answer is yes, please provide a detailed response with corresponding law sections.

Answer: The taxability does not change depending on whether the contract is a lump sum or time and materials contract. However, the manner of billing of progress payments may give rise to ambiguity as to what is occurring.

4. **For In-State Contractors:** If an in-state contractor is determined to be the retailer of materials used for improvements to real property, and does not separately charge sales tax on the sales invoices, is our client responsible for accruing the use tax?

Answer: If an in-state contractor is acting as a contractor, no tax should be shown on the billing documents since contractors are the taxable consumer users of goods used to complete contracts in Oklahoma. If an in-state vendor is remiss and does not charge sales tax on sales made, the purchaser would not report it on it's sales tax or use tax forms, rather it should advise the vendor and remit the tax to them.

5. **For out-of-state Contractors:** If an out-of-state contractor performs improvements to real property and does not separately state sales / use tax on the sales invoices, is our client responsible for accruing the use tax? If yes, what is the taxable measure? Does it matter if the contractor is or is not permatized (holding a seller's permit) or licensed in the state of Oklahoma?

Answer: As noted above, contractors will not hold sales tax permits nor charge sales tax on the gross receipts of their contracts. An out of state contractor is responsible for registering with the Oklahoma Tax Commission and is responsible for remitting use tax on the purchase price of goods purchased outside Oklahoma and brought into Oklahoma for its use in completing the contract.

6. Does the responsibility for sales / use tax change if a subcontractor bills our client directly? If the answer is yes, please provide a detailed response with corresponding law sections.

Answer: No, the sub-contractor has the same responsibilities as the general contractor for both registering and paying tax.

Scenario 4: Software

Our client purchases software and software licenses every year. The software is received outside of your state one of three ways:

- A) In the form of tangible personal property (diskette or CD).
- B) Electronically via the internet or modem.
- C) Received via a load and leave arrangement in which the vendor will travel to our client and load the software onto its computer system. (Our client does not obtain title or possession of tangible personal property at any time.)

Our client creates a master image CD of the software and then sends this software CD directly to the stores in your state or sends the software CD to a third party in Arizona to be loaded onto computer systems that will be sent directly to the store locations in your state.

Questions:

1. Are the software CDs or software licenses taxable in your state based upon the above facts? If the answer is yes, please provide a detailed response for each of the described methods of delivery.

Answer: The proportionate share of the purchase price of CD's brought into Oklahoma via methods "A" and "C" are subject to use tax. A credit may be taken for sales or use tax paid in another state. No tax is due on CD's brought into Oklahoma where the CD was downloaded via the internet or telephonically. Please refer to Oklahoma Tax Commission Rule 710:65-19-156.

2. Are software updates taxable if received and sent into your state in the same manner as discussed above? If the answer is yes, please provide a detailed response for each of the described methods of delivery.

Answer: Software updates are taxable in the same manner as discussed above. Just as in the last answer, the taxability depends on the receipt of tangible personal property by the purchaser.

3. Our client pays a non-refundable annual fee for "software insurance". This fee entitles our client to software updates if there are any within the year although our client may or may not choose to utilize the update. Is this software insurance fee taxable whether or not an update is received?

Answer: Charges for the right to receive software updates, whether the updates are received or not, are taxable in the same manner as discussed above. Just as in the

last answer, the taxability depends on the receipt, or the right to receive, tangible personal property by the purchaser.

Scenario 5: In Store Computer Rental Time

Our client maintains computers for customer in-store rental. The rental charge is based upon an hourly charge prorated by the actual number of minutes the customer uses the computers. The customer cannot add, delete, or modify any of the software applications on the computers. The computers can also be used to access the internet. No out of store rentals are allowed.

Questions:

1. Is sales tax due on the computer rental charge? If the answer is yes, please provide a detailed response with corresponding law sections.

Answer: Sales tax is due on the rental charge. Please see rule 710:65-1-11 cited above.

2. If the computer rentals are determined to be taxable, can the computer equipment be purchased for resale? Can our client file a claim for refund? What is the procedure to file a claim for refund?

Answer: Since rentals are defined as sales, a vendor who rents tangible personal property may make purchases of the item to be rented exempt from sales tax as a purchase for resale. Your client may make a refund request to its vendors. They in turn may make a request of the Oklahoma Tax Commission in accordance with rule 710:65-11-1.

Scenario 6: Document Creation Services

Our client offers document creation services to its customers. These services are separately stated on the sales invoice and include, but are not limited to, the following:

Resumes with or without graphics (one paper copy is given to the customer)
Resumes with or without graphics (electronic file on diskette is given to the customer)
Newsletter with or without graphics
Flyers with or without graphics
Company logos
Business cards

Questions:

1. Is sales tax due on any of the above document creation services? If the answer is yes, please provide a detailed response with corresponding law sections for each of the taxable document creation services.

Answer: For sales of resumes and company logos, if the sales are made in connection with the sale of printed material, then the services are taxable per rule 710:65-19-265. For the other types of transaction listed, since they are provided in connection with the sale of printed material to a consumer, they are taxable.

Scenario 7: Telecommunication Services & Equipment

Customers in the store can utilize the client's telecommunication equipment that includes fax machines and video conferencing equipment.

Questions

1. Are the charges for sending and receiving faxes subject to sales tax or telecommunications tax? Does the tax apply to faxes originating from out-of-state locations, or being sent to out-of-state destinations?

Answer: Sales tax applies to charges for faxes both originating or terminating in Oklahoma where the charge is at an Oklahoma location. Please see rule 710:65-19-330.

2. Are charges for intra-state and interstate video conferencing services subject to sales tax or telecommunications tax? If the answer is yes, please provide a detailed response with corresponding law sections.

Answer: Yes. Please see the rule cited immediately above.

3. Is there any exemption for telecommunication equipment? If the answer is yes, please provide a detailed response with corresponding law sections.

Answer: NO. Sales of telecommunications equipment to telecommunications providers for their use in providing the communications services are subject to sales tax.

Scenario 8: Internet Website

Our client offers an informational and on-line document creations website to its customers. A customer can create a document on-line or upload an electronic file directly to the website. The customer can specify the format, type and color of paper, the quantity of the order, any cutting and binding that needs to be done, and any other finishing process to complete the order. The finished order can be shipped anywhere in the United States or the customer can designate from one of our client's locations to pick up the finished product.

Questions:

1. Does the shipping or delivery point determine the tax rate? Does it matter if the shipping point originated from an out-of-state location?

Answer: For orders shipped from an Oklahoma location, the point of delivery will determine the tax rate, for both delivery points inside and outside Oklahoma.

Scenario 9: Resale /Exemption Supporting Documentation

Our client sells to a wide range of customers, including individual consumers, a variety of businesses and corporations, governmental agencies, and exempt nonprofit organizations. The printed material being sold can be used in a variety of ways depending on the customer. Therefore, it may not be clear if the printed material is being purchased for resale or for the customer's own use.

Our client's employees are instructed to **question good faith** by making sure an item purchased exempt from tax is either purchased for resale (not for the customer's own use) or sold to an exempt organization. At times a customer is persistent that the item being purchased is for resale or being used by an exempt entity. The employees will require the customer to complete an exemption or resale certificate in accordance with the regulation. As a retailer whose market depends on repeat business, our client cannot debate the taxability of a customer who is claiming exempt status and who has the proper documentation.

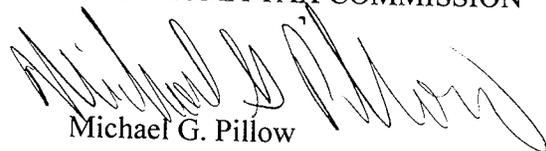
Comments: Answers to all of your questions listed under this scenario are answered in Oklahoma Tax Commission Rule 710:65-7-6.

Questions:

1. What documentation MUST be maintained by our client to relieve them of potential audit liabilities?
2. Do resale or exemption certificates have expiration dates? If the answer is yes, please provide a detailed response with corresponding law sections.
3. Can our client create it's own version of a resale / exemption certificate as long as it contains all of the required elements? What are the required elements?
4. In accepting resale / exemption certificates, what must our client do to establish good faith in order to relieve it of potential audit liability?
5. If our client later determines that a customer is taxable, can our client be held liable for previous transactions? Why?

This response applies only to the circumstances set out in your request of March 14, 2000 and may not be relied upon by any entity other than the addressee. In the event of any change in the facts surrounding the transaction described, this letter ruling would no longer be applicable. You are further advised that subsequent statutory or administrative rule changes or judicial construction of the statutes or rules upon which this advice is based may yield a different result from that which is expressed here.

Sincerely,
OKLAHOMA TAX COMMISSION


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