Ruling 96-12

Vermont Department of Taxes

Date: July 15, 1996

Written By: Gloria Hobson, Business Taxes Policy Analyst

Approved By: Edward W. Haase, Commissioner of Taxes

You requested a formal ruling on the applicability of Vermont's sales and use tax on the products your company sells. The advice in the ruling is based on the facts contained in your letter of April 26, 1996, my telephone conversation on May 8, 1996 with [Taxpayer's] office manager, [Name], and my telephone conversation with you on May 9, 1996.

Facts: [Taxpayer] designs and creates interactive, multimedia information presentations for clients. The presentations are operable on personal computers, laptop computers, and electronic kiosks. The presentations prepared by [Taxpayer] are primarily for marketing, sales and advertising, education, human resources purposes as well as custom designed applications by clients. The majority of its presentations are for marketing or promotion of retailers' products. [Taxpayer] believes it derived more than 80% of its 1995 gross receipts from retail advertising and anticipates 80% or more of its 1996 gross receipts also to be from retail advertising sources.

The presentation product is provided primarily though [Taxpayer's] proprietary software and computer application services. [Taxpayer] may assist clients in custom designing their presentation. The materials are assembled and converted into digitized format which creates the computer screen, sound, and video files. The digitized format is then integrated into [Taxpayer's] software. The presentation provides access to information in multimedia format which uses [Taxpayer's] graphical user interface software. [Taxpayer] also may purchase computer hardware to integrate its product into a kiosk or other system. The product is transferred for the client's use via CD-ROM, disk, or floppy disk, or it may be placed on an electronic kiosk system owned and operated by [Taxpayer]. Clients may also purchase [Taxpayer] software to create their own presentations.

Issue 1: Is [Taxpayer] an advertising agency as defined by 32 V.S.A. §9701(16)?

Ruling: To be an advertising agency, a business must meet the requirements of 32 V.S.A. §9701(16). As defined by this law, an advertising agency means a business that receives 80% or more of its gross receipts from sales of advertising services. The law further defines gross receipts as not including specifically reimbursed charges to customers for printing, reproduction or publishing and photography provided these activities are contracted out to another business. For example, a business has gross receipts of $100,000. Of this amount, $40,000 are from the specified reimbursed costs

and $10,000 represents non-advertising services such as employee training films. The gross receipts to test for the 80% threshold would be $60,000 and receipts from advertising services would be $50,000. This business derives 83% of its receipts ($50,000 advertising services receipts divided by $60,000 defined gross receipts) from sales of advertising services.

[Taxpayer] indicated gross receipts from advertising services made up 80% or more of [Taxpayer's] income in 1995 and anticipated 1996 gross receipts of the company will be 80% or more from advertising services. The majority of its products market or promote retailers' products. If its ratio of sales from advertising services to the defined gross receipts meets the 80% test, [Taxpayer] would qualify as an advertising agency.

Issue 2: Are the sales of interactive multimedia CD-ROM to clients for advertising, marketing, promotion, training or general information purposes customized by client's materials and information subject to sales and use tax under 32 V.S.A. §9771 or exempt as advertising under 32 V.S.A. §§9701(16) - (18) and 32 V.S.A. §9741(36)?

Ruling: The original, prototype CD-ROM for advertising, marketing or promotional purposes is exempt as an advertising product. Under 32 V.S.A. §9741(36), an advertising product is exempt when the charge made to a client by an advertising agency for the transfer of title or possession, or right to use of tangible personal property is in conjunction with delivery of the advertising services. This exemption reaches only the original advertising product delivered as tangible personal property. If the client requests copies of the original advertising product, this transaction is a sale of tangible personal property subject to sales tax upon the price charged the client. For example, the original CD-ROM created by the advertising agency is exempt; however, any additional copies of the CD-ROM are subject to sales tax under 32 V.S.A. §9771(1).

The purchase by [Taxpayer] of computer hardware or software and any other materials used by [Taxpayer] to create the original CD-ROM are subject to sales tax. 32 V.S.A. §9701(5). The materials purchased by [Taxpayer] and used to reproduce additional CD-ROM's or the costs to the advertising agency to have additional CD-ROM's produced are tax exempt as a sale for resale. 32 V.S.A. §9701(5).

The exemption for original advertising materials applies only to a product that promotes a product, service, idea, concept, issue or image of a person. 32 V.S.A. §9701(17). Training materials or other human resources materials are not advertising. To be advertising, the focus must be aimed at selling a product or company services to customers. The training and human resources materials, while potentially promoting the companies image, are not intended to sell a product to customers but rather to enhance employee relations or productivity.

Non-advertising products, such as training and human resources audio or video tapes or manuals, are subject to tax on the price charged to the client, including charges for services to produce the tape or manual. If the tape or manuals are contracted out, [Taxpayer] will purchase these items tax exempt as a sale for resale. 32 V.S.A. §9701(5). Purchases by [Taxpayer] of property or taxable services used by [Taxpayer] to make these items qualify for tax exemption as manufacturing. In order for the

machinery or equipment used to produce non-advertising tapes or manuals to be exempt, 96% of the machinery or equipment operating time must spent in manufacturing these items. Thus, recording equipment or a computer used to manufacture non-advertising materials must be dedicated 96% to this purpose and no more than 4% of the time used to produce advertising materials. 32 V.S.A. §9741(14).

Issue 3: Is [Taxpayer's] creation of client presentations for placement on a multimedia information kiosk system owned by [Taxpayer] where the client pays a monthly fee to [Taxpayer] to cover the cost of creating the client's kiosk presentation, space on the kiosk and updates to the client's information subject to sales and use tax under 32 V.S.A. §9771(1)?

Ruling: The monthly fee and the creation of the kiosk presentation are advertising services and [Taxpayer] does not collect sales tax on these charges to the client. 32 V.S.A. §9741(36). However, the materials used by [Taxpayer] to create the presentation are taxable. 32 V.S.A. §9701(5). [Taxpayer] owns the kiosk system and retains control of the kiosk system. The kiosk and any other computer hardware or software purchased for the kiosk system is tangible personal property used by [Taxpayer] to deliver its advertising services and [Taxpayer] pays sales or use tax on their purchase. 32 V.S.A. §9701(5).

Issue 4: Is [Taxpayer's] preparation of client presentations on [Taxpayer's] proprietary software where the presentation is transferred to the client via CD-ROM, disk, or floppy disk and installed on the client's computer taxable under 32 V.S.A. §9771(1)?

Ruling: The charges for the CD-ROM, disk or floppy disk and installation are not subject to tax. The CD-ROM is one of [Taxpayer's] formats to deliver the advertising services. The CD-ROM, disk or floppy disk is transferred to the client in conjunction with the delivery of advertising services and exempt. 32 V.S.A. §9741(36).

Issue 5: Are the sales of a software package created by [Taxpayer] that allows the user to create his/her own presentations taxable under 32 V.S.A. §9771(1)?

Ruling: The charge for [Taxpayer's] software is subject to sales and use tax. The sale of canned software is the sale of tangible personal property. See Chittenden Trust Co. v. King, 143 Vt. 271, 465 A.2d 1100 (1983).

This ruling is issued solely to your business and is limited to the facts presented as affected by current statutes and regulations. Other taxpayers may refer to this ruling to determine the Department's general approach, but the Department will not be bound by this ruling in the case of any other taxpayer or in the case of any change in the relevant statute or regulations.