

**First Quarter
April 2009**

Sales Tax Update

a quarterly online newsletter about Texas
Sales and Use Tax

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Clarification - Home Stagers

In the 4th Quarter 2008 issue of *Sales Tax Update*, we presented an article entitled "Home Stagers" which set out the tax treatment of various home stager activities.

Regrettably, we incorrectly stated that a home stager could issue a resale certificate for furniture or accessories that she purchased for use (not for sale) in her client's home. A home stager must pay tax up front for furniture and accessories she uses to stage a client's home. The client does not owe tax to the home stager for furniture or accessories that the client does not purchase.

Interest Rate Change

Delinquent taxes accrue interest beginning on the 61st day after the due date until paid. This year, the interest rate is 4.25 percent, or 0.01164 percent per day.

Refund claims filed with the Comptroller's office accrue credit interest at either Treasury Pool rate or Prime +1, whichever is less. The Treasury (Pool) interest rate this year is 2.511 percent or 0.00688 percent per day.

For more information about how the interest rate is applied plus the interest rates for this year and previous years, please see Interest on Credits and Refunds and on Tax Due on our Web site.

Energy Star Sales Tax Holiday

In addition to the annual August clothing sales tax holiday, Texas shoppers get a break from state and local sales and use taxes during Memorial Day weekend every year on purchases of certain energy-efficient products.

This year, the Energy Star Sales Tax Holiday begins Memorial Day weekend at 12:01 a.m. on Saturday, May 23 and ends at 11:59 p.m. on Monday, May 25.

Energy Star is a joint program of the U.S. Environmental Protection Agency (EPA) and the U.S. Department of Energy (DOE). Earning the Energy Star means a product meets strict energy efficiency guidelines set by the EPA and the DOE.

The products qualifying for the exemption are:

- air conditioners priced under \$6000 (room and central units)
- clothes washers (but not clothes dryers)
- ceiling fans
- dehumidifiers
- dishwashers
- light bulbs (incandescent and fluorescent)
- programmable thermostats
- refrigerators priced under \$2000

Qualifying products display the Energy Star logo on the appliance, the packaging or the Energy Guide label. Clothes dryers are not included in the items qualifying for exemption during the Energy Star holiday because they use similar amounts of energy; therefore, the Energy Star program does not label clothes dryers.

There are no limits on the number of items that may be purchased during the Energy Star Sales Tax Holiday, and an exemption certificate is not required.

This tax-free holiday also applies to some Internet and catalog sales of eligible products. Layaway plans can also be used to take advantage of the sales tax holiday, within certain parameters.

To learn more about cutting energy costs, contact the State Energy Conservation Office (a division of the Comptroller's office) at (800) 531-5441, ext. 3-1931, or visit www.seco.cpa.state.tx.us.

Digital TV Transition and the Taxability of Converter Box Coupons

Beginning June 12, 2009, television stations will broadcast in digital only. This means customers with an analog television will need to purchase a converter box in order to view television programs.

Coupons worth \$40 are available to eligible U.S. households from the National Telecommunications and Information Administration's TV Converter Box Coupon Program to reduce the cost of the converter box. When a coupon is presented by the purchaser to the seller at the time of sale, it reduces the sales price of the converter box by \$40. As a result, the taxable amount is reduced by \$40. For example, if the price of a converter box is \$49.99, the \$40 coupon will reduce the taxable amount to \$9.99.

For more information about the program, see www.ntiadtv.gov.

Discounts, Coupons, "Free" Meals and Rebates

Retailers should remember to charge tax only on the final sales price of a taxable item. The final sales

price is the total after all discounts, coupons, "free" offers and all other price reductions have been subtracted. Tax is due only on the amount actually charged to the customer.

Discounts

Cash discounts are offers to customers that reduce an item's sales price. For example, a retailer may offer a customer a 10 percent discount on all purchases. If the customer buys a dress marked at \$150, the discounted price becomes \$135. Tax is due on the final discounted sales price of \$135.

Coupons

There are two types of coupons that are equivalents of a cash discount: manufacturer's coupons, which reimburse the retailer the coupon's face value plus a handling fee, and in-store coupons, for which there is no retailer reimbursement.

Both types of coupons are handled the same. Because the coupons reduce the price charged to the customer, the retailer should collect tax on the net price, after subtracting the value of the coupon.

Some retailers offer to double or triple the face value of manufacturers' coupons. In these cases, tax is due on the final reduced sales price, after subtracting the doubled or tripled face value of the coupon.

"Free" Meals and "Buy One, Get One Free" Offers

A restaurant that sells two meals for the price of one should collect sales tax only on the amount charged the customer. The customer pays no tax on the free meal. For more information on charging sales tax in restaurants, see *Restaurants and the Texas Sales Tax*.

Rebates

A mail-in manufacturer's rebate that is given after the sale does not reduce the sales price a retailer charges the customer. For example, a \$250 camera comes with a \$50 manufacturer's rebate offer. A customer buys the camera for \$250 then mails in proof of purchase and other documentation to receive the \$50 rebate. The retailer must collect tax on the \$250 sales price of the camera, the amount charged the customer.

A manufacturer's rebate that is deducted at checkout is treated as a cash discount. If a \$250 camera has a \$50 rebate taken at the time of sale, tax is due on the final selling price of \$200.

A mail-in rebate from the seller may be used to reduce the taxable sales price of the item. The seller should refund the sales tax that was collected on the part of the sales price that was rebated back to the customer. For example, a consumer buys software for \$150 with an available mail-in rebate of \$25. When the customer returns the rebate to the store and the retailer rebates the \$25, it should also rebate tax on the \$25. In this case, the tax would equal \$2.06 ($\$25 \times .0825$ state, city and transit tax), for a total rebate of \$27.06. Or, the seller's rebate can specifically state that it is a tax-included rebate. By doing so, the seller can rebate a total of \$25 to the customer ($\$25 / 1.0825 = \23.09 rebate + $\$1.91 = \25).

Skin Care Products Sold in a Doctor's Office

At times, physicians sell skin care products in their medical practice office. There have been questions whether such products are taxable, or qualify for exemption as drugs or medicines.

The question is addressed in STAR letter 200807135L. Rule 3.284 - *Drugs, Medicines*, states that sales or use tax is not due on the sale of drugs or medicines that are prescribed or dispensed on the oral or written prescription of licensed practitioners of the healing arts. The rule also defines a drug or medicine as something that is:

- applied to the human body and
- intended for use in the diagnosis, cure, mitigation, treatment, or prevention of disease, illness, injury, or pain.

Products that meet the definition of drug or medicine

For these products to qualify for exemption, a doctor must demonstrate the product sold is intended for use in the diagnosis, cure, mitigation, treatment or prevention of a disease, illness, injury or pain, and is being prescribed or dispensed by the physician.

"Prescribing" means that the physician would either have to give the patient a written prescription to purchase the items elsewhere or sell the item to the patient under a written or oral prescription.

An "oral prescription" means that the course of treatment is noted on a patient's medical records and that the qualifying drug or medicine is applied during the course of treating the medical condition presented by the patient.

To "dispense the product" means to apply the product to the patient during the course of treating the medical condition presented by the patient or to give the product to the patient during the course of treating the medical condition presented by the patient.

Products that do NOT meet the definition of drug or medicine

Sales of items that merely treat an aesthetic issue, such as wrinkles, do not meet the definition of a drug or medicine and are not exempt even if prescribed or dispensed by a physician during a course of treatment. Instead, they are considered a supply item provided as part of the medical service performed by the physician. Rule 3.284(d)(11)(C) states the following:

"Health care providers, such as doctors, clinics, hospitals, nursing homes, or other institutions providing health care or medical services to individuals owe tax on therapeutic appliances, devices, and related supplies they use in providing nontaxable health care and medical services. Unless the health care provider qualifies as an exempt organization under Tax Code, Section 151.309 or Section 151.310, sales or use tax must be paid by the health care provider on the purchase, lease, or rental of all therapeutic appliances, devices, and related supplies."

Therefore, tax is due on the initial purchase of these products that are dispensed by a physician for aesthetic purposes that are not **required** to be labeled with a "Drug Facts" panel. A health care provider is not reselling the item even if a separate line item appears on the bill for medical treatment for the item. The physician is not required to collect tax on the separated charge for the supply item that appears on the bill covering medical treatment. The physician is required to pay sales tax to the vendor on taxable items at the time of purchase or accrue and report the tax on purchases made from out-of-state

vendors.

When is a sales tax permit required?

A licensed practitioner of the healing arts is not required to hold a sales tax permit or to collect tax from patients on items prescribed or dispensed as part of a medical procedure. It is important to note that this provision applies only to sales of products made through medical practices and does not extend to any other businesses a physician may own or operate, such as a spa, fitness club or retail outlet. A spa, fitness club or retail outlet is required to have a sales tax permit, if it sells taxable items. Moreover, a physician is required to hold a sales tax permit if he maintains separate books and records or has established a separate profit center for any line of business that is separate and apart from the medical practice.

Over-the-counter drug or medicine required by the Food and Drug Administration (FDA) to have a "Drug Facts" panel

Rule 3.284 also exempts an over-the-counter drug or medicine (such as one that is not prescribed or dispensed by a physician) when it is labeled or required to be labeled with a "Drug Facts" panel in accordance with regulations of the federal Food and Drug Administration (FDA). However, legislation passed during the 80th Legislative Session in 2007 revised that provision. Tax Code Section 151.313 (a) (3) was amended effective September 1, 2007, to limit the exemption to only over-the-counter medications that are **required** by the FDA to be labeled with a "Drug Facts" panel. A product, such as sunscreen, that is not **required** by the FDA to have a Drug Facts panel no longer qualifies for the exemption - even if the product is so labeled.

In summary, any product that is **required** by the FDA to be labeled with a "Drug Facts" panel is exempt from sales tax without a prescription. A product that is not required by the FDA to be labeled with a "Drug Facts" panel is taxable when sold to a person without a prescription or when not dispensed by a physician.

Off-Road Use of Propane

Two chapters of the Texas Tax Code address the taxation of motor fuel: Chapter 162 Motor Fuel Taxes and Chapter 151 Limited Sales, Excise and Use Tax.

Tax Code Section 162.301(a) imposes a motor fuels tax on the use of liquefied gas (including propane) for the propulsion of motor vehicles on the public highways of this state. The tax is either prepaid by the operators of motor vehicles licensed in Texas or paid to the seller when delivered into a motor vehicle registered in another state, licensed under the International Fuel Tax Agreement (IFTA) or displaying a motor vehicle dealer's liquefied gas tax decal. Before a seller can make a taxable sale described above and collect the motor fuels tax on liquefied gas, the seller must hold a liquefied gas dealer's license.

Liquefied gas delivered into off-road equipment, such as a forklift, is exempt from the state motor fuels tax. Likewise, under Tax Code Section 151.308(a)(3), it is exempt from the limited sales, excise and use tax. An exemption certificate is not required for exemption from either tax.

There's No (Tax) Free Lunch for Employees of Exempt

Organizations

Under Rule 3.322(g)(5), "An employee of an exempt organization cannot claim an exemption from tax when the employee purchases taxable items of a personal nature even though the employee receives an allowance or reimbursement from the organization." Under Rule 3.322(g)(6), "A person who travels on official business for an exempt organization must pay sales tax on taxable purchases whether reimbursed on a per diem basis or reimbursed for actual expenses incurred."

Texas state and local governments and universities are among the numerous types of exempt organizations covered by Rule 3.322(g)(5) and (6). Only the exempt organization or its authorized agent may purchase items tax-free by issuing an exemption certificate in lieu of paying tax. Employees may not purchase meals tax-free with an exemption certificate, even when on official business. More information is available in our publication *Exempt Organizations: Sales and Purchases* (PDF, 11KB) .

Internet Sales are Subject to Sales Tax - Buying and Selling Online

Internet sales are subject to Texas sales and use tax in the same manner as sales made by any other business. Texas sales tax applies to taxable items on orders taken over the Internet when shipped or delivered to a purchaser in Texas. Taxable items include tangible personal property and taxable services.

An online seller engaged in business in Texas must obtain a Texas Sales and Use Tax Permit and collect and remit tax on the sale of taxable items shipped or delivered into Texas.

Texas buyer, Texas seller

When a purchaser in Texas buys a taxable item from a Texas online seller for use in Texas, the seller charges sales taxes based on the seller's place of business (which could be the seller's home) from which the item is shipped or delivered. If an order is placed with a seller in Texas, but the item is drop-shipped to the purchaser by an out-of-state third party supplier, local tax is due based on the location of the seller's place of business where the order was received. A seller may also be required to collect local use taxes for local taxing jurisdictions in effect at the point of delivery if the seller is engaged in business in those jurisdictions.

When a seller receives an order at a place of business in Texas and the taxable items sold are shipped or delivered to Texas customers from the seller's out-of-state location (either a place of business or a warehouse, etc.) then local use taxes are due based on the point of delivery. The seller is required to collect those local use taxes if engaged in business in those jurisdictions. See *Guidelines for Collecting Local Sales and Use Tax* (PDF, 827KB) for more information.

A seller is engaged in business in Texas if the seller has business locations or salespersons in Texas, or solicits sales, performs services or makes deliveries in Texas. A seller is not required to collect local use taxes for jurisdictions in which he is not engaged in business; however, the local use taxes are still due and the seller may choose to voluntarily collect and remit the taxes as a service to the customer. If the seller does not collect the local use taxes, the purchaser is responsible for remitting those taxes directly to the Comptroller's office.

Delivery charges

Fees for shipping and handling charged by the seller of a taxable item are considered part of the sales price of the item. Charges for transportation or delivery to a Texas location are considered to be services or expenses connected to the sale of a taxable item. If the item is taxable, charges for shipping and handling, transportation or delivery are also taxable. The taxability of the shipping or handling charges does not change even if these items are separately stated on the invoice. Likewise, if the item purchased is not taxable, then the shipping and handling, transportation or delivery charges are also not subject to tax. See Rule 3.303 - *Transportation and Delivery Charges*.

Texas buyer, out-of-state seller

When a purchaser buys a taxable item from an out-of-state seller for use in Texas, and the seller is engaged in business in Texas, the seller must collect Texas use tax. If the seller is engaged in business at the point of delivery, the seller must also collect any local use tax due.

If the seller is not engaged in business in Texas or otherwise does not collect the Texas tax due, the customer owes Texas use tax. The customer should use the tax rate in effect at the location where the goods were received to calculate the amount of tax due. Tax is due on the entire amount charged by the seller, including shipping and handling, even if separately stated.

A purchaser who holds a Texas sales tax permit may report the transaction as a "Taxable Purchase" on their sales and use tax return. If the purchaser does not have a sales tax permit, the purchaser should file a Texas Occasional Use Tax Return (Form 01-156). (PDF, 54KB)

Tax paid to another state

The purchaser can take a credit against the amount of Texas use tax due for legally imposed sales taxes the purchaser paid to another state or any subdivision of another state. A purchaser cannot take a credit for taxes paid to another country.

Texas seller, out-of-state buyer

A Texas seller who sells a taxable item and ships or delivers it to an out-of-state location does not have to collect Texas state or local sales tax on the sale, even if the billing address is in Texas. To document such a sale, the seller's records must include proof of delivery out-of-state, such as a bill of lading, a shipping invoice or a postal receipt. A Texas seller engaged in business in another state may have to collect tax in that state. The Multistate Tax Commission has a useful Web site with links to the tax Web sites of other states.

Occasional Sales

There is an exemption for tangible personal property sold online when the property was originally purchased for personal use by a person who does not hold a sales tax permit or a similar license or permit in another state.

To qualify for the exemption, the person must not be in the business of selling taxable items, and the receipts from these sales must not exceed \$3,000 in a calendar year.

There is also an exemption for the sale of up to two taxable items (other than an amusement service) in a

12-month period by a person who does not hold a sales tax permit or a similar license or permit in another state and who is not in the business of selling taxable items.

Sellers who have sales tax permits in Texas or similar licenses or permits in any other state may not sell items tax free claiming the occasional sale exemption. See Rule 3.316(b) related to occasional sales.

Purchasers are not responsible for accruing use tax on purchases made under the occasional sale exemption, except for one important exception. A purchaser who holds a sales tax permit must accrue use tax on a taxable item purchased from a person who does not hold a sales tax permit and who has sold two or fewer taxable items (other than an amusement service) during the 12-month period immediately prior to the sale. See Texas Tax Code § 151.304(g).

Although not required by law, we recommend that a purchaser ask the seller to provide a signed statement that the transaction qualifies for the occasional sale exemption in order to document the exemption. The purchaser should retain the statement in his records for four years following the date of the purchase.