STATE OF MINNESOTA
DEPARTMENT OF REVENUE

In the Matter of the Proposed Adoption of a New Rule Relating to Sales and Use Taxation of Advertising and Promotional Material (Minnesota Rules Part 8130.9250)

STATEMENT OF NEED AND REASONABLENESS

This document has been prepared as a verbatim affirmative presentation of the facts necessary to establish the statutory authority, need for, and reasonableness of the proposed new rule. It is submitted pursuant to Minnesota Statutes Section 14.23 and Minnesota Rules Part 1400.0500 requiring a Statement of Need and Reasonableness.

A Notice of Intent to Solicit Outside Opinion regarding sales and use taxations of advertising agencies was published in the State Register on June 19, 1989. The notice specifically mentioned this rule and invited interested persons to submit comments or suggestions in writing to the Department by June 30, 1989. No one submitted written comments.

IMPACT ON SMALL BUSINESS

The impact of this rule on small business has been considered. The proposed rule does not impose a new filing, or payment requirement on small businesses and therefore is not expected to

place any additional financial or administrative burden on small businesses. Small businesses are accorded relief in filing elsewhere in the rules, in Rule 8130.7300.

AUTHORITY TO ADOPT RULES

Minnesota Statutes section 297A.29 grants the Commissioner of Revenue authority to promulgate rules concerning the sale and use tax laws.

PART 8130.9250 ADVERTISING AND PROMOTIONAL MATERIAL

A starting point for understanding the necessity of the proposed rule and the reasonableness of its content and structure is a basic understanding that the sales and use tax is a transactional tax. The taxable transaction under Minnesota's sales and use tax law is the sale at retail as defined in the statute. Exemptions from taxation for the most part are based either on the transaction itself (isolated and occasional sales, sales for out-of-state delivery, purchases for resale at retail, amongst others) or the nature of tangible personal property sold (food products, medicine, clothing, materials consumed in production, caskets, amongst others). A narrow line of statutory exemptions is based on the status of the purchaser, which includes sales to certain governmental agencies, sales to nonprofit groups in the performance of their nonprofit functions

and sales to disabled veterans purchasing either automobiles or building materials used in a residence.

Rule 8130.9200, as is presently in effect and proposed to be repealed, first divides advertising agencies into two categories for sales and use tax purposes. Advertising agencies may act as "independent service businesses" or as "agents." The rule does not define advertising agency, independent service business, or agent. This division of sales and use tax consequences by the status of the seller, the advertising agency, has no basis in the Minnesota sales and use tax statute. The present rule uses terms which are not used in the statute, which leads to confusion over definitions and tax consequences.

Under the present rule, it appears that an "independent service business" is a synonym for "retailer" as defined in Minnesota Statutes, section 297A.01, subdivision 10. In the rule, an independent service business may either sell tangible personal property or a service. In the sales and use tax statute, the sale of tangible personal property is generally taxable, the sales of a service is generally not, so the use of the term independent service business is imprecise when applied to a seller of tangible personal property as it is in this rule. A service business, under the present rule, may sell tangible personal property at retail, which is a taxable transaction.

Subpart 3 of the present rule creates the classification of agent. This classification applies to any advertising agency with a written agency agreement. Advertising agencies classified as agents are permitted to pay sales and use tax on the purchases they make to the same degree as the client would have paid. The rule is silent on the treatment of service or labor cost which is included by statute in the sales price, and does not address the concept of fabrication labor as set forth in the statutory definition of a sale and purchase. The present rule's reliance on the status of a seller to determine tax consequences of a retail sale and its failure to incorporate important statutory concepts regarding the sales price and sale have led to confusion in calculating taxes due from advertising agencies.

The proposed rule 8130.9250 would tax the sales of advertising and promotional material in a fashion more consistent with the statute, chapter 297A. It would not be necessary to ascertain the status of the person selling advertising and promotional materials because status of the seller would not determine tax consequences. Rather, because the sales and use tax is a transactional tax, the nature of the transaction is the determinant of whether a tax is imposed or not. The primary criteria for determining whether a sale at retail is taxable or nontaxable is whether there is a sale of tangible personal property, or a sale of services.

Subparts 2 and 3 define service transactions which are not

taxable as sales at retail. Subpart 4 defines the sale of tangible personal property which are sales at retail. Subpart 5 sets forth the rule for separating the value of the service and tangible personal property sold when a single contract covers both and the contract does not specify the value of the service or value of the property sold. Subpart 7 covers taxation of two distinct situations which are related because both are purchases by persons who make advertising and promotional material. The first is where tangible personal property is purchased which can be used repeatedly but not consumed, the second is where tangible personal property is consumed in the performance of a service and in the production of tangible personal property. Subpart 8 refers a seller to the general rule of sales and use taxation when that seller is producing something other than advertising and promotional material regardless of what the business of the seller is held out to be. Subpart 9 is an exception to the general rule set forth in subparts 2, 3, and 4, because the status of the purchaser determines the tax consequences of the transaction. The exception is necessary because the statute makes an exception based on the status of the purchaser at Minnesota Statutes, section 297A.25, subd. 16 for nonprofit groups if the property is purchased for the performance of the charitable, religious, or education functions.

Subpart 1.

This subpart defines terms used in the rule. The definitions

are necessary to inform affected persons of what is meant, for the purposes of this rule, by the terms advertiser, advertising agency, collateral advertising and mass media.

Item A. This item defines "mass media" as television, radio, newspapers, magazines, and billboards to the extent not governed by Rule 8130.9400. It is reasonable to use this definition of mass media, because it is in accordance with the ordinary meaning given to the words.

Item B. This item defines the term advertising agency as used for taxation of mass media placed and mass media prepared advertising. An advertising agency is a person with a contractual obligation to prepare advertising material for mass media placement. The advertising material may be placed in mass media by the advertising agency or delivered to the advertiser by the advertising agency. The term advertising agency is not applicable to, nor does it limit application of, this rule to collateral advertising and persons selling collateral advertising. This definition of an advertising agency is reasonable, although it is limited in application to those persons who produce mass media placed or mass media prepared advertising. Persons engaging in the activities described in subparts 2 and 3 of the rule will be treated as advertising agencies. Subparts 2 and 3 of the rule are the only subparts which treat sales of advertising and promotional material as a service. The definition of advertising agency is reasonable

because it is directly related to the activities taxed as services.

Item C. This item defines an advertiser as one who contracts to have prepared advertising material regardless of whether it is mass media placed, mass media prepared or collateral. Further, it is not material to this definition whether an advertiser receives the advertising it has placed in mass media or it has delivered to third parties. The definition of advertiser is reasonable because it is defined in accordance with the ordinary meaning of the word.

Item D. This item defines collateral advertising as generally all advertising or promotional material which is not mass media placed or mass media prepared advertising. It is reasonable to define collateral advertising as all advertising which is not mass media placed or mass media prepared advertising because collateral advertising is an expanding form of advertising. The list in this rule is not all inclusive because creative and technological innovations in advertising continue, such as delivering computer discs which are advertisements. Collateral advertising can not include items exempt from taxation, most notably clothing. The list of collateral advertising and promotional materials which is in the rule included brochures, direct mail advertising, coupons, tear-off pads, in-store promotional display kits, point-of-sale materials, calendars, pencils, pens, and ash trays.

Subpart 2.

This subpart is a substantive section which governs the taxation of mass media placed advertising. An advertising agency placing advertising in a mass medium is performing a service. The taxable incident, as with all services is the purchase of tangible personal property and taxable services which are used or consumed in providing the service. Sales and use taxation is not laid on nontaxable services used in creating a service, nor does this rule exempt persons who create mass media placed advertising from paying tax on services which are included in the terms "tangible personal property" and "sale at retail" in Minnesota Statutes chapter 297A. Tax is not laid on the sales price of the service that the advertising agency creating and placing the advertising charges the advertiser. This rule is reasonable because it follows the statutory structure in taxing sales of advertising and promotional material, and it makes a necessary distinction between sales of advertising and promotional material which is a service under the statute and that which is the sale of tangible personal property under the statute. This subpart makes certain the taxable transaction and the incidence of taxation.

Subpart 3.

This subpart is a substantive section which governs the taxation of advertising prepared for placement in mass media. An advertising agency preparing advertising for placement in mass

media is performing a service. The taxable incident, as with all services, is the purchase of tangible personal property and taxable services which are used or consumed in providing the service. While the sales and use tax is not imposed on nontaxable services used in creating a service, neither does this rule exempt person who create mass media advertising for placement by others from paying tax on taxable services which are included in the terms "tangible personal property" and "sale at retail." Taxable services included, for example, the furnishing of lodging, parking services, laundry and dry cleaning, motor vehicles washing, waxing and cleaning, building and residential cleaning, detective agency services, pet grooming, lawn care, electricity, gas water or steam use,local telephone exchange service, intrastate toll service, and interstate toll service. A complete listing of taxable services is set forth in Minnesota Statutes chapter 297A. Tax is not imposed on the sales price of the service, creating advertising and promotional material for placement in the mass media by the advertiser or another, which is charged by the advertising agency to the advertiser. This rule is reasonable because it follows the statutory structure in taxing sales of advertising and promotional material, and it makes a necessary distinction between sales of advertising and promotional material which is a service under the statute and that which is the sale of tangible personal property under the statute.

Subpart 4.

This subpart is a restatement, particularized for advertising and promotional materials, of the general sales and use tax rule that any sale of tangible personal property is a sale at retail unless the sale is made to purchasers who intended to resell the property to others in the regular course of business. This subpart is necessary to distinguish mass media placed and mass media prepared advertising, which are services, from all other sales of advertising and promotional material. This subpart further clarifies the subject sales and use tax rule by stating that it applies to any person making such sales, regardless of what business the person holds itself out as engaged in. It neither exempts nor includes persons not otherwise subject to taxation. This rule is reasonable because it follows the statutory structure in taxing sales of advertising and promotional material, and it makes a necessary distinction between sales of advertising and promotional material which is a service under the statute and that which is the sale of tangible personal property under the statute.

Subpart 5.

This subpart governs the taxation of advertising and promotional materials when an advertiser contracts for both the performance of a service and the creation of tangible personal property.

When such a contract does not separately state the cost of the collateral advertising, the collateral advertising is required to be assigned a fair market value when transferred to a purchaser or third party. The seller of collateral advertising must collect and remit tax at the time tangible personal property is transferred to the purchaser. Similar treatment of sales, where a portion of the sale is tangible personal property and a portion of the sale is a nontaxable service, is set forth at Rule 8130.0400, subp. 5. The subpart is necessary to afford the seller of advertising and promotional material certainty in determining what portion of an undifferentiated sales price, which includes both the sale of a service and the sale of tangible personal property is taxable, as the sale of tangible personal property. The nonexempt sale must be taxed according to the statute, so the apportionment of the total sales price is a reasonable method of determining the taxable portion of the total sales price. It is reasonable that the retailer has the burden of proof to apportion the sales price because the sales and use tax statute includes the presumptions that a sale is a retail sale and a retail sale is taxable. Moreover, as a practical matter, experience and expertise of the seller of advertising and promotional material makes the seller more able to make this apportionment of sales price, subject of course to audit by the Department of Revenue.

Subpart 6.

This subpart is a restatement of the general rule, set forth in Rule 8130.0110, subpart 2 and 3, as it applies to advertising agencies and others creating mass media placed or mass media prepared advertising or producing collateral advertising. The subpart is in accordance with the general rule that all sales are a sale at retail unless the purchaser intends to resell the property in the general course of business or is specifically excepted from taxation. This is necessary to clarify some confusion that had existed regarding the taxation of purchases which are used in rendering a service.

Subpart 7.

This subpart contains two applications of the sales and use tax laws, adapted to the particular circumstances of an advertising agency. The first is that a purchase by an advertising agency of material which may be reused and is used in both mass media placed and/or mass media prepared advertising and also collateral advertising is a purchase of materials at retail. Items which can be used but not consumed are graphics, artwork, and photographs. An instance of use without consumption is where a photograph is bought and used both in mass media advertising, such as magazine advertising, and is also used in the same advertising campaign as part of a point-of-sale display. Although the purchase of materials is taxed because

the purchase is not an exempt transaction, the sale of collateral advertising is also a taxable transaction. The sales and use tax is a tax which is levied by reviewing each transaction to ascertain whether an exemption from taxation applies.

The second application set forth in this subpart is more common, where material is used and consumed, not used repeatedly. The use anticipated is in both the production of tangible personal property for sale at retail or an other exempt fashion and in a nonexempt use. A much wider range of tangible personal property can be used and consumed in both a taxable and an exempt fashion. A single illustration is the purchase of paper, some of which is consumed in printing a brochure. The brochure is tangible personal property sold at retail, and the portion of the paper used in printing can be purchased exempt as material consumed in industrial production for sale at retail. The sale of brochures is a taxable event unless exempted by a different section of the statute and rules. Another portion of the paper is consumed in developing mass media placed advertising. A sales tax must be paid to the vendor, or a use tax paid by the advertising agency consuming this portion of the paper while rendering the service. The material used in a nonexempt fashion is subject to use tax if a sales tax was not previously paid on the material, as Rule 8130.1300 generally states.

This subpart is a reasonable application of the statute in its classification of transactions as taxable, exempt or able to be apportioned to arrive at a taxable portion. It is necessary because the sales and use tax rules adopted for general application do not address the peculiar situation when a purchased item can be used in both the production of tangible personal property and the rendering of a service, but consumed in neither.

Subpart 8.

This subpart is necessary in that it eliminates any confusion over what rules apply to advertising agencies when they are acting outside the scope of this rule. The general sales and use tax laws and rules apply, unless another specific rule is applicable to the purchases or sales in question. If, for example, a person selling advertising and promotional materials is also engaged in business as a veterinarian, sales and use tax Rule 8130.8700 "Veterinarians" will apply to the business activities of the person as a veterinarian. An advertising agency which is making taxable purchases or sales which are not to create, produce, or sell advertising or promotional material are not governed specifically by Rule 8130.9250 and Minnesota Statutes, chapter 297A and rules promulgated thereunder generally govern taxation.

Subpart 9.

This subpart applies the statutory exemption contained in Minnesota Statutes, section 297A.25, subd. 16, sales of tangible personal property to a nonprofit group if the property is to be used in the performance of their charitable, religious, or educational purpose to the advertising and promotional materials purchased on the nonprofit group's behalf. When an advertising agency or other person purchases components, tangible personal property, and taxable services which will be used in advertising and promotional material, it may purchase the component tangible personal property and taxable services as an agent of the nonprofit group. This exemption is not extended beyond its scope as applied to nonprofit groups. The purchases must be used in their performance of the charitable, religious, or educational functions, or by any senior citizen group or association of groups that in general limits membership to persons age 55 or older and is organized and operated exclusively for pleasure, recreation and other nonprofit purposes, no part of the net earnings of which inures to the benefit of any private shareholders, which are exempt. (See Rule 8130.6200, Charitable, Religious, and Educational Organizations for the general rule on the subject.) The last paragraph of the item sets forth the general rule that a sale is presumed to be a taxable sale at retail unless an exemption from taxation is shown by the purchaser or the tangible personal property sold is exempt from taxation.

A listing of the acts required by a nonprofit group to make a valid appointment of a purchasing agency is set forth in the rule. The nonprofit group principal must grant to the advertising agency the ability for the agent to bind the nonprofit group for payment of purchases made by the agent. The advertising purchasing agent is required to purchase materials in the name of the nonprofit principal, and to disclose the obligation of the principal to pay on all contracts, purchase orders or similar writings. The purpose of these two requirements is to clearly disclose to vendors that they are selling otherwise taxable purchases to a nonprofit group. The last requirement on a nonprofit group to make an effective grant of purchasing agent to an advertising agency is that the advertising agency may not make any use of such purchases for any use other than creation or production of advertising and promotional material for the nonprofit group.

This subpart is necessary to apply the statutory exemption set forth in Minnesota Statutes, section 297A.25, subd. 16 to the sales of advertising and promotional materials. It clarifies any ambiguity in the relation of the statutory section to transactions entered into in the sale of advertising and promotional material.