

EXECUTIVE SUMMARY:

SALES TAX EXEMPTION FOR ADVERTISING

JUNE, 2015

JOINT SUBCOMMITTEE TO EVALUATE TAX PREFERENCES

- PREFERENCE:

Subsection 5 of § 58.1-609.6 exempts advertising from sales and use tax.

- SUMMARY:

Provides a sales and use tax exemption on the purchase of the creation and placement of advertisements in the media

- REVENUE IMPACT:

The exemption for advertising services accounts for approximately \$100.2 million in reduced sales and use tax revenue (FY 2015).

- JOINT SUBCOMMITTEE RECOMMENDATION:

The Joint Subcommittee did not make any formal recommendation regarding the preference.

PREFERENCE REPORT: SALES TAX EXEMPTION FOR ADVERTISING

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Preference Description

Subsection 5 of § 58.1-609.6 exempts "advertising as defined in § 58.1-602." Section 58.1-602 states that "advertising means the planning, creating, or placing of advertising¹ in newspapers, magazines, billboards, broadcasting and other media, including, without limitation, the providing of concept, writing, graphic design, mechanical art, photography and production supervision. Any person providing advertising as defined herein shall be deemed to be the user or consumer of all tangible personal property purchased for use in such advertising."

Under this exemption entities providing advertising are exempt from collecting sales tax on their sales of media advertising, but are responsible for paying sales tax on their purchases of tangible personal property. However, this exemption must be read in conjunction with subsection 4 of § 58.1-609.6,² which expands the exemption for sales as well as purchases. Regarding sales, subsection 4 exempts the sale by any entity of any printed materials, whether they constitute media advertising or not, if they are stored in the Commonwealth for 12 months or less and distributed outside the Commonwealth. Regarding purchases, subsection 4 exempts advertising agencies from paying sales tax to a printer for printing such materials.

¹ The cost of running the advertisement by the media is also exempt.

² Subsection 4 of § 58.1-9.6 states: "Catalogs, letters, brochures, reports, and similar printed materials, except administrative supplies, the envelopes, containers and labels used for packaging and mailing same, and paper furnished to a printer for fabrication into such printed materials, when stored for 12 months or less in the Commonwealth and distributed for use without the Commonwealth. As used in this subdivision, "administrative supplies" includes, but is not limited to, letterhead, envelopes, and other stationery; and invoices, billing forms, payroll forms, price lists, time cards, computer cards, and similar supplies. Notwithstanding the provisions of subdivision 5 or the definition of "advertising" contained in § 58.1-602, (i) any advertising business located outside the Commonwealth which purchases printing from a printer within the Commonwealth shall not be deemed the user or consumer of the printed materials when such purchases would have been exempt under this subdivision, and (ii) from July 1, 1995, through June 30, 2002, and beginning July 1, 2002, and ending July 1, 2017, any advertising business which purchases printing from a printer within the Commonwealth shall not be deemed the user or consumer of the printed materials when such purchases would have been exempt under subdivision 3 or this subdivision, provided that the advertising agency shall certify to the Tax Commissioner, upon request, that such printed material was distributed outside the Commonwealth and such certification shall be retained as a part of the transaction record and shall be subject to further review by the Tax Commissioner."

The exemption under subsection 5 of § 58.1-609.6 is only for advertisements placed in the media. The Department of Taxation has ruled that to qualify as media advertising, it must be directed to the general public. The exemption applies whether the creator of the advertisement that can be placed in the media, actually places it in the media, or transfers it directly to the customer.

Media advertising includes, for example, ads placed in magazines and newspapers (including advertising supplements), on billboards, in direct mailing, on television and radio, over the internet, and point-of-sale advertising devices including exhibit and display devices used in public retail establishments. Non-media advertising includes, for example, in-house training videos, media that are available only upon request by a particular customer, development of logos or other corporate identity programs which are not in connection with a media advertising campaign, fabrication of signs, and development of materials, kits, and similar things for salesmen. The sales tax on non-media advertising is based on the total sales price of the ad, including goods and services.

Preference Purpose

There is no official statement of the purpose for exempting the creation and placement of advertisements. The impetus may have been a reaction to the Supreme Court of Virginia in *WTAR Radio-TV Corporation v. Commonwealth*, 217 Va 877 (1977).

In that case a television station sought relief from the Tax Department's assessment of sales tax the station should have collected on its charges for creating and broadcasting advertisements. The station claimed that no tax should be imposed because (i) the charges were for services and (ii) there was no sale of property because there was not "transfer of title or possession" of the film as required in the statutory definition of "sale."

The Court disagreed based on its interpretation of the law governing taxation of a transaction involving a combination of tangible personal property and services found in subsection 1 of § 58.1-609.5 and the "true object test." Subsection 1 of § 58.1-609.5 exempts "professional, insurance, or personal service transactions which involve sales [of property] as inconsequential elements for which no separate charges are made. . . ."

The true object test (a version of which is used in most states) is a judicially created standard used in determining whether a transaction that involves a combination of services and tangible property should be taxed as personal property or be considered services and therefore exempt. The inquiry concerns the true object that the purchaser is mainly seeking. If his objective is mainly to obtain personal property, then the tax is applied to the total cost charged by the seller, including the cost of services. If the purchaser mainly wants services provided, the total cost is exempt from taxation, including the cost of incidental personal property.

The Court ruled that the finished product was tangible property that was not an inconsequential element of the transaction and was the true object for the purchaser (purchaser was "more interested in the final product than in the service that produced it"). Regarding whether the station had transferred title or possession of the film containing the advertisement, the Court said that (i) "showing the commercial on television was tantamount to a delivery of possession of the film to the buyer" and (ii) that the station furnished and transferred the film to the customer by putting electronic signals on the air which produced the customer's advertisement.³

Legislative History & Background

The exemption for advertising was enacted in 1985 and became effective July 1, 1986. Although the statutory exemption for advertising has not been amended, in 1994, the exemption available for printed material stored in the Commonwealth for 12 months or less and distributed outside the Commonwealth was expanded to include advertising businesses purchasing printing from a Virginia printer. The exemption was extended to all advertising businesses in 1995. It has not been amended.

Revenue Impact

The exemption for advertising services accounts for approximately \$100.2 million in reduced sales and use tax revenue (FY 2015).

Other States

Most states consider advertisements to be tangible property, the sale of which would be taxed without an exemption or, application of the "true object test."⁴ With perhaps a couple of exceptions, states

³ Courts in some states have reached a different conclusion as to whether title or possession of an advertisement has been transferred to the customer (e.g. *Federal Sign & Signal Corp. v. Bowers* 172 Ohio State 161 (1961) regarding billboard signs.

⁴ Obtaining information regarding states' taxation of advertising is challenging because many states' exemptions are not specifically set out in statute but rather are derived from application of the true object test which may or may not have been judicially determined. In addition, the most well-recognized source on states' taxation of services are charts from the Federation of Tax Administrators (set out in Appendix A) has limited value as explained in Appendix A.

uniformly exempt pure advertising services (i.e. when not even an inconsequential tangible product is involved), including the service provided by a media entity in running an advertisement.⁵ New Mexico taxes all services unless specifically exempted, and has no exemption for advertising services.

In addition, like Virginia, the vast majority of states that impose a sales tax, exempt the creation and placement of advertisements in the media, including North Carolina, Maryland, and the District of Columbia.

While there are exceptions, most states imposing sales tax on some form of advertisement, including Virginia on non-media advertising, base it on the total charge for the goods and services. Some states, like Ohio, base the tax only on the charge for the goods if the charge for services is separately stated. A few states limit the exemption to ads created by "advertising agencies" which are usually defined according to a threshold percentage of gross receipts from advertising services (e.g. Vermont, 80%).

Unlike Virginia, New York taxes advertisements sold directly to the customer if the transfer occurs prior to the ad being placed in the media. However, New York exempts sales of digital or electronic ads sold directly to the customer. New York's and Pennsylvania's exemption do not apply if the title to the advertisement is transferred to the customer.

Joint Subcommittee Recommendation

The Joint Subcommittee did not make any formal recommendation regarding the preference.

Preference Report Compiled by Staff from the
Virginia Division of Legislative Services and the
Virginia Department of Taxation

⁵ The information in Appendix A may be helpful regarding the taxation of pure advertising services.

The Federation of Tax Administrators' compilation of all states' taxation of services (set out below) is the most well-recognized source on the taxation of services, but it has several shortcomings, the first of which is evidenced by its disclaimer regarding the compilation. In essence, the disclaimer states that the survey was based on NACIS codes which classify types of businesses not types of goods or services. So, for example, a gas station is not the same as motor fuel. The compilation identifies categories of businesses that might provide one or more services that may be taxed, which may or may not involve tangible property. Another problem is that the information is based on responses by the states that are not uniform and subject to each state's interpretation of the survey questions.⁶ These things, plus the many footnotes for individual states, means, in the words of the disclaimer, one cannot simply count the number of "taxable" checkmarks under a state and develop an informed impression of a state's taxation of services. Finally, it is not clear how much of the information in the chart is relevant to one of the core issues in this report of Virginia's sales tax exemption which is placement of advertising.

Federation of Tax Administrators Services Taxation Survey

Sales of Advertising Time or Space:

- 1 - Billboards
- 2 - Radio & television, national advertising
- 3 - Radio & television, local advertising
- 4 - Newspaper
- 5 - Magazine
- 6 - Advertising agency fees (not ad placement)

	1		2		3		4		5		6	
Alabama	E		E		E		E		E		E	
Alaska												
Arizona	E	see note	E	see note	E		E		E	see note	E	see note
Arkansas	E		E		E		E		E		E	
California	E		E		E		E		E		E	see note
Colorado	E		E		E		E		E		E	
Connecticut	E		E		E		E		E		E	
Delaware	0.384		0.384		0.384		0.384		0.384	see note	0.384	see note
District of Columbia	E		E		E		E		E		E	
Florida	E	see note	E		E		E		E	see note	E	see note
Georgia	E		E		E		E		E		E	see note
Hawaii	4		4		4		4		4		4	
Idaho	E		E		E		E		E		E	
Illinois	E		E		E		E		E		E	
Indiana	E		E		E		E	see note	E	see note	E	
Iowa	E		E		E		E		E		E	
Kansas	E		E		E		E		E		E	
Kentucky	E		E		E		E		E		E	see note

⁶ For example it appears that some states are addressing a tax other than their sales tax such as a gross receipts tax.

	1	2	3	4	5	6	
Louisiana	E	E	E	E	E	E	E
Maine	E	E	E	E	E	E	5 see note
Maryland	E	E	E	E	E	E	E
Massachusetts	E	E	E	E	E	E	see note E
Michigan	E	E	E	E	E	E	6 see note
Minnesota	E	E	E	E	E	E	see note
Mississippi	E	E	E	E	E	E	E
Missouri	E	E	E	E	E	E	E
Montana							
Nebraska	E	E	E	E	E	E	see note
Nevada	E	E	E	E	E	E	E
New Hampshire							
New Jersey	E	E	E	E	E	E	see note
New Mexico	5	E	5	5	5	5	5
New York	E	E	E	E	E	E	E
North Carolina	E	E	E	E	E	E	E
North Dakota	E	E	E	E	E	E	E
Ohio	E	E	E	E	E	E	E
Oklahoma	E	E	E	E	E	E	E
Oregon							
Pennsylvania	E	E	E	E	E	E	see note
Rhode Island	E	E	E	E	E	E	E
South Carolina	E	E	E	E	E	E	E
South Dakota	E	see note	E	E	E	E	4
Tennessee	E	E	E	E	E	E	E
Texas	E	E	E	see note	E	E	see note
Utah	E	E	see note	see note	E	E	E
Vermont	E	see note	E	E	E	E	E
Virginia	E	E	E	E	E	E	E
Washington	1.5	see note	E	0.484	0.484	0.484	see note 1.5 see note
West Virginia	E	see note	E	E	E	E	6
Wisconsin	E	E	E	E	E	E	see note
Wyoming	E	E	E	E	E	E	E

Tax Rate: E - Exempt from Tax, T - taxable at various unspecified rates, or a number indicates percentage tax rate applicable.

Notes: Indicates a footnote clarifying the response is available. If note does not load, try reloading the page.

Source: Federation of Tax Administrators, 2007 Survey of Service Taxation.

Note:

This report was organized based on the best classification codes available for use at the time the survey was designed. There are shortcomings in using these NAICS codes, however. A solid understanding of how these codes work will help you get the clearest picture of what is -- and what is not -- taxed within a state.

NAICS codes classify types of businesses. They do not classify types of goods or services being sold. For example, gas stations are not the same as sales of motor fuel.

This survey therefore does not specifically identify the services that are taxed in the participating states. Rather, this survey identifies categories of businesses that might provide one or more services that are taxed.

Just because a business category is identified as taxable does not mean that every good or service related to that business is being taxed. Likewise, a single taxed good or service might be reflected under several business categories.

The footnotes are important and will enhance your understanding of what is, or is not, taxable. FTA is planning to re-craft this survey in ways that will allow us to present far more information.

In the meantime, however, we ask that you recognize that a researcher cannot simply count the number of "taxable" checkmarks under a state and develop an informed impression of a state's taxation of services. You will find that revenue earned by a particular business category is not equivalent to the revenue generated by the sale of any particular service. A state may tax a business category in a small, limited way (affecting one or two services), or in a large, broad way (affecting many services).

1

Arizona Exempt at the state level after December 31, 1985, but most cities levy privilege taxes on local advertising.

District of Columbia Payments for space are taxable as the rental of tangible personal property. TPP used in performing all these services taxable to service provider.

Florida TPP used in performing all these services taxable to service provider.

South Dakota Building of billboards is subject to contractor's excise tax of 2%.

Vermont Vermont law prohibits billboards

West Virginia Sales of outdoor advertising space, such as billboards, are exempt from sales tax.

Wyoming

2

Arizona Exempt at the state level after December 31, 1985, but most cities levy privilege taxes on local advertising.

Utah Video tapes for use by movie theater, drive-in, radio and TV broadcasting are exempt.

3

Texas Purchases of radio or TV time are exempt.

Utah Video tapes for use by movie theater, drive-in, radio and TV broadcasting are exempt.

4

Indiana Inserts to magazine and newspapers are taxable unless newspaper criteria are met.

Iowa Processing and agricultural production exempt.

5

Indiana Inserts to magazine and newspapers are taxable unless newspaper criteria are met.

6

Arizona Although such services are not generally taxable, certain "full-service" advertising agencies may provide services (e.g., photography, graphic design) that may render some or all of its gross receipts subject to tax under the retail or job printing classification.

California Tax applies to any sales of tangible personal property. If an advertising agency bills a lump-sum charge that includes both services and tangible personal property, a reasonable portion of the charge must be allocated to the sales price of the property and taxed.

Delaware Tax rate applies to gross receipts in excess of \$50,000 per month.

Florida Tax due on tangible personal property consumed, not on services performed.

Georgia Tax due on tangible personal property consumed, not on services performed.

Kentucky Taxable, copies sold after master ad created 103 KAR 26:120

Maine If transfer of tangible personal property.

Michigan Materials and supplies are taxable. See R 205.133.

Minnesota Nontaxable advertising is creative promotional services that meet three criteria: 1) the advertising has no functional use other than to carry the advertising message; 2) the advertising agency must be involved in the creation of the advertising, and; 3) the advertising agency must have a direct relationship with the advertiser. Other sales of advertising are taxable at 6.5%.

Nebraska See Reg. 1-056

New Jersey Exempt as of 11/1/1998.

Pennsylvania Transferring tangible personal property in conjunction with advertising services is subject to sales tax.

Texas Sales of tangible personal property are taxable unless ad agency paid tax on the property as agent of client.

Washington B&O tax paid by the firm.

Wisconsin Any charge related to finished art is taxable, unless an exemption applies.