COLORADO
Department of Revenue
Taxation Division

Office of Tax Policy
P.O. Box 17087
Denver, CO 80217-0087

DOR_TaxPolicy@state.co.us

GIL-09-019

June 30, 2009

XXXXXXXXXXXXXXXXX
Attn: XXXXXXXXXXXXXX
XXXXXXXXXXXXXXXXX
XXXXXXXXXXXXXXXXX

Re: use tax / display items

Dear XXXXXXXXXXXX,

This letter is in response to your inquiry regarding use tax. The Department issues general information letters and private letter rulings. A general information letter provides a general overview of the applicable tax law, does not provide a specific determination, and is not binding on the department. A private letter ruling is a determination of the applicability of tax to a specific set of circumstances and is binding in the department. A party requesting a private letter ruling must provide certain information and remit a fee. For more information about general information letters and private letter rulings, please refer to the Department's regulation 24-35-103.5, C.R.S., which is available on our web site at: www.colorado.gov/revenue/tax.

I will initially treat your request as one for a general information letter because the request does not contain the information or fee necessary for a private letter ruling. You may resubmit this request as a request for a private letter ruling.

Issue

1. Are your clients required to remit use tax upon withdrawal of products from inventory?

2. If they are required to remit use tax, are they allowed a credit for use tax paid when the product is ultimately sold?

3. Should the answers for questions one and two also apply to the Colorado cities that have use tax?

Background

You represent a client that will withdraw items from its inventory, assemble the product and displays it on the sales floor. After several weeks or longer of being on display, the client will sell the display product and replace it with another item.

Discussion

Colorado levies use tax on the use, storage, or consumption of tangible personal property sold at retail. §39-26-202, C.R.S. A retailer generally does not incur use tax on its inventory because it purchases the inventory at wholesale (purchase for resale), not retail. However, in order to come within this exemption, the retailer cannot make any use, other than incidental use, of the product prior to resale. If a retailer's use of goods from its inventory is more than incidental, then that use is a taxable transaction separate and distinct from the retailer's subsequent taxable retail sale of the goods to customers. See, e.g., *American Multi-Cinema, Inc. v. City of Westminster and Susan S. Stubbs, as Finance Director for the City of Westminster*., 910 P2d 64 (Colo.1995); *A.B. Hirschfeld Press, Inc. v. City and County of Denver*, et al, 806 P2d 917 (Colo. 1991). Thus, what was originally an exempt wholesale sale from the wholesale supplier to the retailer is recast as a retail sale to the retailer. See, *International Business Machines v. Charnes,* 601 P.2d 622 (Colo. 1979). Importantly, the use tax owed by the retailer is calculated on the full price the retailer paid the supplier (i.e., use tax is not calculated on a prorated schedule based on the retailer's partial use of the product prior to resale). For this reason, it does not matter that, at the time the retailer pulls goods from inventory its own use, the retailer intends to resell the used inventory to its customers at some future date. See, e.g., *A.B. Hirschfeld Press, Inc. v. The City and County of Denver;* 806 P2d 917 (Colo. 1991) (court rejected retailer's argument that it was not liable for use tax because it intended to resell goods that it used prior to resale). And because these are separate transactions, the retailer is not entitled to a credit for use tax it pays when the retailer sells the goods to a customer.

The principal issue presented in your letter is whether the use of inventory for a marketing display is more than an incidental use that would subject the retailer to use tax liability. In general, a retailer who places product on display while also holding the same out for sale has only incidentally used the product and is not liable for use tax. For example, a bookstore that withdraws a book from inventory for purposes of display and sale has not created a use tax obligation. The department generally views most retail display items as items held primarily for resale and not primarily for use by the retailer.

If, however, the "primary purpose" of the retailer is to put the goods to its own use rather than for sale, then the retailer owes use tax. *A.B. Hirschfeld Press*, supra. A common example of a retailer using inventory primarily for its own use and not for resale is the retailer's use of samples to market its goods. Similarly, products consumed to some significant degree in the course of a product demonstration are considered primarily used by the retailer and not primarily for resale. The department will consider a number of factors in applying this "primary purpose" test, including:

> (1) the nature of the retailer's contractual obligations, if any to use, alter or consume the property to produce goods or perform services;
> (2) the degree to which the items in question are essential to the retailer's performance of those obligations;
> (3) the degree to which the retailer controls the manner in which the items are used, altered or consumed prior to their transfer to third parties; and
> (4) the degree to which the form, character or composition of the items when transferred to third parties differs from the form, character or composition of those items at the time they were initially purchased.

Hirschfeld Press, 806 P.2d 921. See, also, *Kaiser Steel Corp. v. State Bd. of Equalization,* 24 Cal.3d 188 , 154 Cal.Rptr. 919 (1979); *Laux Advertising, Inc. v. Tully,* 67 A.D.2d 1066 , 414 N.Y.S.2d 53 (1979); *Baltimore Foundry & Mach. Corp. v. Comptroller of State,* 211 Md. 316 (1956).

We note that in circumstances similar in a number of respects to the circumstances presented by your clients, Maine found that a retailer primarily used display cabinetry for the benefit of the retailer. In *Mathews Bros. Co., v. Maine*, CV-93-001, 03/04/1994, the superior court of Maine considered whether a cabinet maker incurred use tax when it fully assembled and then displayed cabinets for customers to view. The display cabinets were periodically sold to retail customers. The retailer also depreciated the cabinets over the period they were displayed. Applying the "primary purpose" test, the court concluded that the primary purpose of the goods was for use by the retailer and, therefore, an assessment of use tax was appropriate. See, also, *Robert Philip Spudich, d/b/a Columbia Billiard Center, v. Director of Revenue, State of Missouri*, 745 SW2d 677, 02/17/1988 (pool tables used for display and demonstration and sold only when inventory depleted created use tax because products primarily used by retailer rather than for sale); *Foss Nirsystems, Inc. v. Comptroller, Md. Ct. of Special Appeals*, (2003) 151 Md App 44, 822 A2d 1297, Dkt. No. 1428, 5-6-2003, aff'g Tax Court, Dkt. No. 98-SU-OO-0272, 3-15-2001 (retailer's use of product for demonstration purposes was a use "primarily for the benefit of the retailer and not primarily used to sell the product). The department will also consider the length of time that the retailer holds goods on display as an indication of whether the primary purpose of the goods were for resale or primarily for use by the retailer. See, e.g., Washington Tax Decisions 90-305, 10 WTD 107, 08/06/1990 (goods on display for such long periods of time that they cannot be sold as new).

Although not a necessary basis for finding use tax liability, it is sufficient basis in most cases if the retailer treats the goods as other than inventory for tax purposes (e.g., capitalizing and depreciating a display item). Compare, *J.C. MConville v. SBE*, Calif. Ct. Appl. 3d Dist., (1978), 85 Cal App 3d 156, 149 Cal Rptr 194 (Inventory that is capitalized and depreciated will be treated as used for use tax purposes); Virginia Public Document Ruling No. 94-45, 03/09/1994.

As I noted above, a general information letter provides a general discussion of the tax issue and we do not make rulings regarding a specific factual setting in these general information letters. You may resubmit your request as one for a private letter ruling if you would like a determination on the specific facts you have described.

Miscellaneous

Please note that the department does not collect sales and use taxes for "home-rule" cities and counties. You can find a list of these jurisdictions by visiting our web site at:

www.taxcolorado.org (go to Tax Forms > DRP 1002)

Contact those governments for information about their taxes.

This general information letter represents the advice of experienced members of the Department's staff. However, it is not binding on the department. Enclosed is a redacted version of this ruling. Pursuant to statute and regulation, this redacted version of the ruling will be made public within 60 days of the date of this letter. Please let me know in writing within that 60 day period whether you have any suggestions or concerns about this redacted version of the ruling.

Sincerely,

Office of Tax Policy
Colorado Department of Revenue