

Sales Tax Interpretation 20-04

Definition of the Term "Resale"

The Finance Director has made a sales tax interpretation by defining the context of the term "resale" as used in SGC 4.09.100 (P).

Facts:

1. SGC 4.09.100 (P) states that "A sale for resale of a product, service or rental to a consumer where the resale is subject to tax is exempt."
2. Confusion over the meaning of the term "resale", as used in SGC 4.09.100 (P), has been a long-standing aggravation, both to citizens and Municipal sales tax employees. Municipal sales tax employees consistently receive requests for interpretations as to whether or not certain transactions or situations constitute resales.
3. Many purchases made by businesses do not constitute a bona fide purchase of a product, service, or rental for resale. These purchases, instead, constitute the purchases of supplies or services, or rentals of equipment or real estate, necessary for business operations and are considered indirect business costs.
4. The nature and manner in which a business's accounting is conducted often gives insight into whether a business purchase is a sale for further resale, or, a business expense. For merchandising businesses, a purchase for eventual resale should be accounted for as resale inventory until it is sold, at which time it becomes a cost of goods sold. In a manufacturing business, a purchase of raw materials for conversion into a manufactured product should be accounted for as raw materials inventory, then work in process inventory, then finished goods inventory, then cost of goods sold.

Discussion:

1. SGC 4.09.420 does not define the term "resale". Accordingly, the meaning has been left open to interpretation.
2. Having a purchase qualify as a sale for resale is advantageous to businesses, especially those with slim profit margins. This is because such businesses must set their selling prices at the level dictated by the broad economy or competitors, and, any ability to lower their costs increases their profit margin. Elimination of sales tax adds 5%-6% to individual item profit margins.
3. As previously mentioned, Municipal sales tax employees consistently receive requests for interpretations as to whether or not certain transactions or situations constitute resales. Time spent parsing out these situational requests, without comprehensive guidelines to follow, frustrates business owners and takes the focus of supervisors away from other matters.
4. Logically, I look to accounting principles as the framework on which to define "resale, as it pertains to sales taxation. There are four subcategories of resale, and my definition for each and the logical foundation for the definition is as follows:
 - a. **Manufacturing.** In a manufacturing business, a purchase of raw materials for conversion into a manufactured product should be accounted for as raw materials inventory, then work in process inventory, then finished goods inventory, then cost of goods sold. If a product is purchased which is completely consumed in the manufacturing process, it is not normally accounted for as a raw material. Examples would be fuel and electricity. If a product is purchased which facilitates the manufacturing process or makes it more efficient but is not present in some tangible form in the finished product, it also not normally accounted for as a raw material. Examples are machinery, tools, solvents, abrasives, lubricants, and bits. For purposes of categorizing, construction contractors, restaurants and visual artists are considered manufacturing entities.

- b. **Retail Sales/Merchandising.** For merchandising businesses, a purchase for eventual resale should be accounted for as resale inventory until it is sold, at which time it becomes a cost of goods sold. If a product is purchased which facilitates retail sales, makes it more efficient, or is provided to customers as a service or convenience, it is not normally accounted for as resale inventory but, instead, as supplies or purchased services. Examples are office supplies, shopping bags, boxes, price tags, shelving and displays, and office or point of sales equipment. A markup is a rule of thumb is categorizing between inventory for resale and business expenses. If a good is purchased and then marked up for resale without modification, it is an indicator of a resale as opposed to an expense.
- c. **Service.** For service businesses, purchases for eventual resale are unusual and often are instantaneously passed through to cost of sales. If goods or secondary services are purchased for eventual resale, they should be accounted for as resale inventory until sold, at which time they become a cost of sales. If a product or secondary service is purchased which facilitates the primary service being sold, makes it more efficient, or is provided to customers convenience or on a complimentary basis, it is not normally accounted for as resale inventory. Examples are office supplies, shopping bags, boxes, price tags, shelving and displays, and office or point of sales equipment
- d. **Rentals.** Subletting is the normal and usual form of reselling a rental. In a subletting arrangement, the primary tenant enters into a lease for a large facility or piece of equipment, then subleases portions of the facility or equipment to sub-tenants. An example would be the primary lease of an entire office building wherein individual rooms or suites are sublet. In such instances, the primary leases are considered to be resold (sublet) and are tax exempt; the subleases to the ultimate end tenant are taxable. In the case of equipment, the equipment must be re-rented. An example would be an equipment leasing business. Its primary rentals of equipment would be tax exempt; its re-rentals of equipment would be taxable. The use of rented equipment conjunction with providing a service, retail sales, or manufacturing is not considered a resale. An example would be heavy equipment rented by a contractor to complete a job; such a rental is not considered a resale to the customer contracting for the job.

Interpretation

For the purpose of clarifying the meaning and intent of SGC 4.09.100 (P), the term “resale” is defined as:

“The sale of an end product which has passed through resale inventory, work in process inventory (in manufacturing), or construction in progress (in contracting) into cost of sales or cost of goods sold. Such passage can be instantaneous. Purchases of goods or secondary services which either facilitate or improve the efficiency of retail sales, manufacturing, or sales of primary services, or, are provided on a complimentary basis as a convenience to the customer are not considered to be for further resale.”

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To be submitted to the Assembly for ratification