Ohio Department of TAXATION

P.O. Box 530
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Opinion of the Tax Commissioner

Date Issued: December 24, 1992

Opinion No: 92-0014

Tax: Sales/Personal Property

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XXXX
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Subject: Sale or Lease

This request for an opinion of the Tax Commissioner was received on June 17, 1992. XXXX (the bank) is implementing a program to provide banking services to its customers through the use of an interactive telephone known as a "XXXX." The bank has entered into a contract to purchase these interactive telephones. The bank intends to furnish these phones to its banking customers to provide customer access to its banking services as well as information and other services of third parties who contract with the bank to have their services available over the bank's interactive telephone network. The interactive telephone can be used like a normal telephone to place and receive voice communication. It also has a visual monitor to display instructions and necessary information for accessing the available services, and a touch sensitive keyboard and other screen areas to allow the customer to communicate.

Upon entering a written agreement with the bank for interactive telephone services, the customer can either purchase an interactive telephone from a third party vendor or elect to lease an interactive telephone from the bank. In either event, there will be a one time set-up charge for each phone. The agreement will be on a month-to-month basis, and will have no minimum or maximum term of the services agreement. There will be no cancellation penalty, but the customer must return any leased interactive telephone when the service agreement is terminated. The customer will be subject to either actual or liquidated damages for failure to return the interactive telephone. Tax disclosures will be provided to the customer concerning the transaction in the initial services agreement. Sales tax will be charged, according to the customer's location, on the phone rental portion of the monthly bill for interactive telephone services. The bank will render monthly statements to its interactive telephone customers for the monthly fees and taxes. The statements will show a lump sum, designated as "INCLUDING APPLICABLE TAXES," and will not break down the separate costs itemized in the initial agreement.

The bank has requested the answer to seven questions which will be discussed individually below.

1) Whether or not the bank service fee portion of the interactive telephone charges is subject to sales tax?

> Answer: The bank service fee portion would not be subject to sales tax if the phone rental portion was based on a reasonable economic rental value for the equipment and the phone service fee portion was clearly stated separately as a charge for the interactive telephone banking system. Otherwise, the bank service fee portion would be taxable.

2) Whether or not the phone rental portion of the interactive telephone charges (applicable only if the customer leases an interactive telephone from the bank) is subject to sales tax?

Answer: The phone rental portion would be taxable.

3) Whether or not the one time set-up charge is subject to sales tax?

Answer: The one time set-up charge would not be subject to sales tax if it did not involve a fee for the installation, transfer, or use of tangible personal property but was merely for opening the customer's account and performing any related computer work to recognize the customer.

4) Are the interactive telephones returnable personal property of the bank, since the taxpayer is a financial institution utilizing the interactive telephone to provide a banking service?

Answer: The interactive telephones would be returnable personal property of the bank. The bank would not use the phones to provide a banking service. The service would be available to anyone who had an interactive phone, whether obtained from the bank or elsewhere. The bank would acquire the phones to lease to its customers, and the phones would be returnable as rental property of the bank.

5) If a "liquidated damages" clause is included in the agreement for failure to return the interactive telephone to the bank when banking services are terminated, whether or not such payment is subject to sales tax?

Answer: A "liquidated damages" clause would be subject to tax since it would be a payment for tangible personal property and R.C. 5739.01 (H)(1) includes termination charges in the definition of price.

6) If, instead of leasing the interactive telephone, the bank gives the phone to the customer at no charge at the time of contracting for interactive telephone banking services, and charges only a one-time set-up fee and monthly banking service fee and allows the customer to keep the interactive telephone at termination of the service, (i) is all or any portion of the set-up fee and monthly banking service fee subject to sales tax, and (ii) is the interactive telephone returnable personal property of the taxpayer?

Answer: (i) The economic reality of the stated fee breakdown would need to be examined. The consideration for the transfer of the interactive telephone would be included in one or both of the stated fees and, without convincing evidence to the contrary, both fees would be taxable.

(ii) The interactive telephone would not be returnable personal property of the bank unless the telephone is leased to the customer. If the contract clearly provides at the outset that the customer keeps the telephone, the telephone would not be considered as leased to the customer, but if the customer is merely given an option to keep the telephone for further consideration, even in a nominal amount, the telephone would be considered as leased to the customer and returnable by the bank.

7) What would be the answer to the question in number 6 if the bank charged a penalty to the customer for terminating the service during the first two years and allowed the customer to keep the interactive telephone? Additionally, would the penalty itself be subject to sales tax?

Answer: (i) Again, the economic reality of the stated fee breakdown would need to be examined. The penalty would imply that at least some of the consideration for the interactive telephone is included in the monthly banking service fee. The penalty charge would be subject to tax in the same manner as the "liquidated damages" in question 5. Without convincing evidence to the contrary, all fees would be taxable.

(ii) Again, the interactive telephone would not be returnable personal property of the bank unless the telephone is leased to the customer. If the contract clearly provides at the outset that the customer keeps the telephone, the telephone would not be considered as leased to the customer, but if the customer is merely given an option to keep the telephone for further consideration, even in a nominal amount, the telephone would be considered as leased to the customer and returnable by the bank. The penalty by itself merely shows that some additional consideration is due. Whether that consideration is for the previous transfer of ownership of the telephone or the transfer of ownership when the penalty is paid depends on whether the customer can avoid the penalty by returning the telephone to the bank.

This opinion applies to the bank and its property. It may not be transferred or assigned.

In addition, the tax consequences resulting from this opinion may be subject to change for any of the reasons stated in R.C. 5703.53(C). It is the duty of the bank to be aware of such changes. R.C. 5703.53(E).

Roger W. Tracy
Tax Commissioner