201507559H [Tax Type: Sales] [Document Type: Hearing]

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Texas Comptroller of Public Accounts STAR System

201507559H

SOAH DOCKET NO. 304-14-4434.26
CPA HEARING NO. 109,007

RE: ***********
TAXPAYER NO: ***********
AUDIT OFFICE: ***********
AUDIT PERIOD: July 1, 2007 THROUGH April 30, 2011

Sales And Use Tax/RDT
BEFORE THE COMPTROLLER OF PUBLIC ACCOUNTS OF THE STATE OF TEXAS

GLENN HEGAR

ROBERT SCOTT
Representing Tax Division

****
Representing Petitioner

COMPTROLLER'S DECISION

THIS DECISION IS FINAL ON AUGUST 20, 2015, UNLESS A MOTION FOR REHEARING IS TIMELY FILED. SEE Administrative Procedure Act, Tex. Gov't Code SECTIONS 2001.142, .144, .146; 34 Tex. Admin. Code SECTIONS 1.29, .31, .32. A party that files a motion for rehearing must file it with the Deputy Comptroller through the Special Counsel for Tax Hearings at P.O. Box 13528, Austin, Texas 78711-3528 or by facsimile at 512-936-6190. A copy of the motion must be served on the opposing party. THE FAILURE TO TIMELY FILE A MOTION FOR REHEARING MAY RESULT IN ADVERSE LEGAL CONSEQUENCES.

Administrative Law Judge (ALJ) Victor John Simonds of the State Office of Administrative Hearings (SOAH) issued a Proposal for Decision (PFD) that includes Findings of Fact and Conclusions of Law. SOAH served the PFD on each

party and each party was given an opportunity to file exceptions and replies with SOAH in accordance with SOAH's rules of procedure. The ALJ recommended that the Comptroller adopt the PFD as written.

After review and consideration, IT IS ORDERED that the **PFD is adopted as changed** pursuant to Texas Government Code SECTION 2003.101(e) and (f).

The result from this Decision is Attachment A. The ALJ's recommendation letter is Attachment B. The PFD as changed is Attachment C. Attachments A, B and C are incorporated by reference.

Attachment A reflects a credit owed to Petitioner.

The credit will be processed after the date the order is final. The parties may waive the right to file a motion for rehearing to expedite the processing of the credit. A waiver of rehearing or motion for rehearing may be filed as described above.

SIGNED on this 28th day of July 2015.

GLENN HEGAR

by: Mike Reissig
Deputy Comptroller

Attachment A, Texas Notification of Hearing Results
Attachment B, ALJ's recommendation letter to the Comptroller
Attachment C, Proposal for Decision as changed

ATTACHMENT C

SOAH DOCKET NO. 304-14-4434.26
TCPA DOCKET NO. 109,007

****
Taxpayer No. ***********
v.

BEFORE THE STATE OFFICE OF ADMINISTRATIVE HEARINGS

PROPOSAL FOR DECISION

The Tax Division (Staff) of the
(Comptroller) audited *********** (Petitioner) for compliance with sales and use tax laws and made an assessment. Petitioner requested a redetermination hearing contending that the audit erroneously scheduled numerous sales and purchase transactions. Staff agreed to make adjustments to the Exam 4 purchase schedules after it reviewed the documentation that Petitioner provided with its Statement of Grounds. However, Staff contends no further adjustments are warranted. Petitioner disagrees and contends the audit erroneously assesses tax against nontaxable interior-design services. In this Proposal for Decision, the Administrative Law Judge (ALJ) finds that Petitioner's contracts involved two distinct elements, the sale of furnishings (I.E., tangible personal property) and the sale of nontaxable interior-design services.

Neither element of the mixed transaction was incident to the other and each element is readily separable. Therefore, the two elements are analyzed as distinct transactions. The ALJ recommends that Petitioner's contention be granted because charges for interior-design services are not taxable.

I. PROCEDURAL HISTORY, NOTICE, AND JURISDICTION

Staff referred the contested case to the State Office of Administrative Hearings and issued a Notice of Hearing. On November 18, 2014, ALJ Victor John Simonds convened a hearing on the merits. Petitioner was represented by COMPANY A. Staff was represented by Assistant General Counsel Robert E. Scott. The ALJ closed the contested case record at the conclusion of the hearing. There are no contested issues of notice or jurisdiction; therefore, those matters are set out in the Findings of Fact and Conclusions of Law without further discussion.

II. REASONS FOR DECISION

A. EVIDENCE

Staff presented the testimony of the auditor, Nunurai Karikoga, and offered the following exhibits into the record:

1. Sixty-day Notification Letter;
2. Texas Notification of Audit Results;
3. Penalty and Interest Waiver Worksheet;
4. Audit Report and Schedules;
5. Audit Documentation Report;
6. Schedule of Disputed and Agreed Transactions (known as AP 124 Schedule);
7. Petitioner's Production of Documents, June 15, 2013;
8. Petitioner's Production of Documents, October 15, 2013; and
9. Resale Certificates.

Petitioner presented the testimony of its owner, INDIVIDUAL, and offered the following exhibits into the record:

1. Schedule of Transactions at Issue;
2. Representative Contract;
3. Representative Contract Reconciliation, Invoices, and Vendor Payments; and
4. Additional Contracts and Purchase Authorizations.

Both party's exhibits were admitted to the record without objection.

B. STAFF AGREED ADJUSTMENTS

Staff reviewed the documentation Petitioner provided with its Statement of Grounds and agreed to make adjustments to the Exam 4 purchase schedules. Those recommendations are reflected within Staff's Exhibit No. 6.

C. FACTS ESTABLISHED BY THE EVIDENCE AND ISSUES PRESENTED

During the audit period July 1, 2007, through April 30, 2011, Petitioner operated a business that provided interior-design services for developers and owners of facilities that provide housing for senior adults. Some of the facilities are designed to be appropriate for active adults, others are considered assisted-living facilities, and still others provide skilled nursing care or hospice services. For example, on or about April 26, 2010, Petitioner entered into an agreement with COMPANY B, and that document contains terms that are generally representative of the sales contracts Petitioner entered into during the audit period.

Petitioner worked with COMPANY B to select furnishings (E.G., artwork, drapes, beds, chairs) that would meet the needs of COMPANY B's tenants. The two businesses entered into an agreement that required Petitioner to provide consulting services and serve as COMPANY B's agent to research, locate, and negotiate appropriate terms and conditions for receiving, warehousing, storing, and installing the selected items. [ENDNOTE 1] The contracting parties agreed that Petitioner would purchase and install the furnishings and provide related procurement services on behalf of COMPANY B. [ENDNOTE 2] By signing the purchase authorization, COMPANY B authorized Petitioner to purchase the furnishings, fixtures, and equipment. [ENDNOTE 3] The Purchase Authorization detailed charges for furnishings, freight, warehousing and installation, purchase consulting, and Texas sales tax. [ENDNOTE 4]

On June 13, 2011, Staff initiated a sales and use compliance audit. The auditor reviewed the records and determined certain adjustments were necessary. He generated several detailed audit schedules. Audit Exam 2 makes assessments for additional taxable sales, Exam 4 makes assessments for purchases of expense items, and Exam 5 makes adjustments for purchases of capital assets (Exams 1 and 6 are credit exams). On November 1, 2011, Staff issued a Texas Notification of Audit Results to Petitioner that made an assessment that included tax and interest accrued to the account (penalties were waived).

Petitioner requested a redetermination hearing contending that the audit erroneously duplicated certain invoices and misstated the purchase cost of certain purchases. In addition, Petitioner stated that the auditor erred when he scheduled nontaxable consulting and warehousing fees. Staff reviewed the documentation that Petitioner provided with its Statement of Grounds and agreed to make adjustments to the Exam 4 purchase schedules; however, Staff stated that Petitioner's contentions should otherwise be denied. Petitioner withdrew the contention related to the warehousing and installation fees, but it contends audit assessments against its consulting fees should be deleted. Staff argues that the consulting fees are taxable because they were included with the sale of taxable furnishings and accessories. Additionally, Staff contends no agency relationship exists to preclude the transfer of furnishings from being considered a sale. Petitioner contends the agency issue is not part of the taxability analysis.

D. ALJ'S ANALYSIS AND RECOMMENDATION

Interior-design services are not among the services for which tax is imposed. SEE Tex. Tax Code SECTION 151.0101. However, a charge for an interior-design service is taxable if it is included in a lump-sum billing for the sale of tangible personal property. SEE Tex. Tax Code SECTION 151.007(b), which provides that the sales price of an item includes a service that is part of the sale; SEE ALSO State Tax Automated Research (STAR) Document No. 200206210L (June 24, 2002). Additionally, the Tax Policy Division has stated that a purchasing fee that is a percentage of the taxable item (either tangible personal property or taxable service) is considered a mark-up and is also considered taxable. STAR Document No. 200206210L. But separately-stated fees for locating and purchasing furniture and accessories are not subject to tax if the decorator gets reimbursed by its customer for the exact price of the taxable item without adding a mark-up. ID.

Staff's taxability argument consists of two prongs. It first argues that the consulting fees at issue are taxable because Petitioner was not acting as an agent for its customers when it purchased the furnishings. There are two flaws with this argument. First, the ALJ could not locate any agency policy statements stating that the legal relationship between an interior designer and its customer is a material factor in determining the taxability of

interior-design consulting fees. SEE, E.G., STAR Document No. 200206210L; SEE ALSO Comptroller's Decision Nos. 42,165 (2003) and 19,107 (1987). Thus, the agency issues raised by Staff need not be addressed in order to reach the correct taxability determination in the contested case. Moreover, even if agency was a part of the analysis, the evidence does not support Staff's conclusion on the matter. Attachment A to the COMPANY B Purchase Authorization specifically states that Petitioner will serve as COMPANY B's agent to locate and negotiate terms. Additionally, by signing the Purchase Authorization, COMPANY B specifically authorized Petitioner to purchase the various furnishings on its behalf. Therefore, the agency prong of Staff's argument should be rejected.

The second prong of Staff's argument is that the consulting fees at issue are taxable because they were a percentage of the amount Petitioner charged its customers. For example, Staff calculated that the consulting fee Petitioner charged COMPANY B was 12.5% of the amount that was charged for furnishings, freight, and installation. Staff calculated the percentage relationship of the charges for other customers as well. For example, it calculated that Petitioner's fee represented the following percentages of furnishings sold: 15% (COMPANY C, March 13, 2009), 17.5% (COMPANY C, April 28, 2009), 19.98% (COMPANY C, June 11, 2009). Staff contends the fees are taxable because they can be expressed as a percentage of the amount Petitioner charged for consulting fees. The ALJ disagrees.

The source of Staff's confusion is the imprecise language in STAR Document No. 200206210L. The taxability letter states that a purchasing fee that "is a percentage of the taxable item" is considered a mark-up of the tangible personal property and is taxable. But a review of relevant Comptroller's Decisions demonstrates that the letter should have stated that a purchasing fee is taxable if it is **based or predicated on** a percentage of the taxable item. SEE, E.G., Comptroller's Decision Nos. 42,165 (2003) and 19,107 (1987). For example, in Comptroller's Decision No. 42,165, the interior designer charged its customers a fee that was described as a commission that was separately stated. The fee was found to be taxable because it was based on 40% of the sales price of the tangible personal property that was sold. A fee that is based on the cost of furnishings is properly deemed to be a furniture mark-up for sales tax purposes because the fee is considered part of the price of the tangible personal property. SEE Tex. Tax Code SECTION 151.007. In this case, Staff was able to express the relationship between the charge for furnishings and the charge for consulting services in terms of a percentage. However, the fact that Staff was able to express the relationship between the two charges as a percentage is not determinative or material. That post-transaction calculation will always be possible. The taxability issue is whether the evidence demonstrates that the seller based or predicated its consulting service fees on a percentage of the charge for the tangible personal property furnishings.

Petitioner's owner testified that the fees at issue were based on the complexity of the job presented, E.G., the number of items that need to be purchased and the amount of time it would take to make the selections. There is no evidence in the record to support a finding that Petitioner's consulting fee was based or predicated on the charge for tangible personal property furnishings. In fact, the reverse is true. For example, Petitioner's owner testified that if the final cost of the selected furnishings was less than the parties anticipated initially, the customer received a refund. If the charge for the furnishings was more than anticipated, the customer paid more. However, the charge for consulting services did not change. Moreover, Staff's own calculations show that there was no consistent relationship between the cost of the furniture and the charge for the consulting fee. Therefore, it is clear that Petitioner's consulting fee was not based on the cost of the furnishings.

Historically, anytime a nontaxable service was sold in connection with the sale of tangible personal property under the same contract, Staff treated the service as part of the sale of tangible personal property. SEE STAR Document No. 200107013L (July 23, 2001). However, in ~~August~~ February 2000, the Third Court of Appeals issued a decision holding that, when a transaction involved the bundled sale of a nontaxable service and a taxable item, Staff must apply the "essence of the transaction" test to determine the ultimate object of the sale. RYLANDER V. SAN ANTONIO SMSA, 11 S.W.3d 484 (Tex. App.—Austin 2000, no pet.). That analysis creates three possibilities: (1) the nontaxable service is the main item of the sale and the taxable property is incidental, in which case the entire transaction is nontaxable; (2) the taxable property is the main item purchased and the nontaxable service is incidental, in which case the entire transaction is taxable; or (3) there is a fixed and ascertainable relationship between the value of the tangible personal property and the value of the nontaxable service rendered, and each is a significant element capable of a separate and distinct transaction, in which case the elements are analyzed as separate transactions. SEE STAR Document No. 200107013L.

In the instant matter, the charges for the furnishings and consulting services were separately stated. Neither the furnishings nor the consulting services were incidental; there was a need for both elements of the transaction. Additionally, the charges for the tangible personal property and consulting are readily identifiable, and as has been explained, the charges for consulting were not based on the cost of the furnishings. Therefore, the consulting fees were not a mark-up or part of the sale of the furnishings. Petitioner was reimbursed by its customers for the exact price of the furnishings without adding a mark-up. Thus, the two transaction elements should be examined as distinct transactions.

The separately-stated fees for locating and purchasing furniture and accessories are not subject to tax because interior-design services are not taxable. SEE Tex. Tax Code SECTION 151.0101. Therefore, the ALJ recommends that Petitioner's contention be granted. Audit Exam 2 should be amended to delete the assessments associated with Petitioner's purchase consulting fees. Except as specifically stated by the ALJ or agreed to by Staff, the audit assessment should be affirmed.

III. FINDINGS OF FACT

1. During the audit period July 1, 2007, through April 30, 2011, *********** (Petitioner) operated a business that provided interior-design services for developers and owners of facilities that provide housing for senior adults. Some facilities are characterized as appropriate for active adults, others are considered assisted living facilities, and still others provide skilled nursing care or hospice services.

2. On or about April 26, 2010, Petitioner entered into an agreement with COMPANY B that contains terms that are generally representative of the contracts Petitioner entered into during the audit period.

3. Petitioner worked with COMPANY B to select interior-design items that would meet the needs of COMPANY B's tenants. Specifically, Petitioner provided purchase consulting services and served as COMPANY B's agent to research, locate, and negotiate appropriate terms and conditions for receiving, warehousing, storing, and installing the selected items.

4. The contracting parties agreed that Petitioner would "purchase and install the furnishings" and "provide related procurement services on behalf of" COMPANY B.

5. By signing the purchase authorization, COMPANY B specifically authorized

Petitioner to “purchase the furnishings, fixtures, and equipment.”

6. The Purchase Authorization detailed charges for furnishings, freight, warehousing and installation, a purchase consulting fee, and (in some cases) Texas sales tax.

7. On June 13, 2011, the Tax Division (Staff) of the Texas Comptroller of Public Accounts (Comptroller) initiated a sales and use compliance audit.

8. The auditor reviewed the records and determined certain adjustments were necessary. He generated several detailed audit schedules.

9. Audit Exam 2 makes assessments for additional taxable sales; Exam 4 makes assessments for purchases of expense items; Exam 5 makes adjustments for purchases of capital assets, and Exams 1 and 6 are credit exams.

10. On November 1, 2011, Staff issued a Texas Notification of Audit Results to Petitioner assessing a liability that included an assessment for tax and interest accrued to the account.

11. Petitioner requested redetermination.

12. Staff referred the case to the State Office of Administrative Hearings (SOAH).

13. Staff issued a Notice of Hearing to Petitioner. The notice contained the date, time, and location of the hearing; a statement of the nature of the hearing; a statement of the legal authority and jurisdiction under which the hearing was to be held; a reference to the particular sections of the statutes and rules involved; and a short, plain statement of the matters asserted.

14. On November 18, 2014, the Administrative Law Judge (ALJ) convened a hearing on the merits.

15. The ALJ closed the contested case record at the conclusion of the hearing.

16. The sole disputed issue relates to the taxability of Petitioner’s consulting fees.

17. The cost of the tangible personal property furnishings were stated separately from the charge for Petitioner’s consulting fees.

18. Petitioner did not add a mark-up to the furnishings it sold to its customers.

19. The fees at issue were based on the complexity of the job presented, E.G., the number of items that needed to be purchased, the amount of time it would take to make the selections, etc.

20. There is no evidence in the record to support a finding that Petitioner’s consulting fee was based or predicated on the charges for the tangible personal property furnishings.

21. If, when the project was completed, the cost of the furnishings was less than anticipated, the customer received a refund for the reduced cost of the items. But the consulting charges stayed the same, no matter what.

22. Staff’s calculations demonstrate that Petitioner’s consulting fees were not based on a percentage of the cost of the furniture Petitioner sold.

IV. CONCLUSIONS OF LAW

1. The Comptroller has jurisdiction over this matter pursuant to Texas Tax Code ch. 111.

2. SOAH has jurisdiction over matters related to the hearing in this matter, including the authority to issue a proposal for decision with findings of fact and conclusions of law pursuant to Texas Government Code ch. 2003.

3. ~~The Comptroller~~Staff provided proper and timely notice of the hearing pursuant to Texas Government Code ch. 2001.

Source: See Finding of Fact No. 13; 34 Tex. Admin. Code SECTION 1.42(10) (defines "party").

4. A separately stated charge for interior-design services is not taxable. SEE State Tax Automated Research (STAR) Document No. 200206210L (June 24, 2002); SEE ALSO Tex. Tax Code SECTION 151.0101, which does not include interior-design services among the services for which tax is imposed.

5. A charge for interior-design services is taxable if it is included in a lump-sum billing for the sale of tangible personal property. STAR Document No. 200206210L; SEE ALSO Tex. Tax Code SECTION 151.007(b), which provides that the sales price of an item includes a service that is part of the sale.

6. A purchasing fee that is based on a percentage of the taxable item (either tangible personal property or taxable service) is considered a mark-up and is taxable. STAR Document No. 200206210L; SEE ALSO Comptroller's Decision Nos. 42,165 (2003) and 19,107 (1987).

7. A separately-stated fee for locating and purchasing furniture and accessories is not subject to tax if the decorator gets reimbursed by its customer for the exact price of the taxable item without adding a mark-up. STAR Document No. 200206210L.

8. The matter of whether an agency relationship existed between Petitioner and its customers is not relevant to the taxability analysis of the consulting fees at issue.

9. Prior to 2000, if a nontaxable service was sold in connection with the sale of tangible personal property under the same contract, Staff treated the service as part of the sale of tangible personal property. SEE STAR Document No. 200107013L (July 23, 2001).

10. In ~~August~~ February 2000, the Third Court of Appeals issued a decision holding that, when a nontaxable service was bundled with a taxable item, Staff must apply the "essence of the transaction" test to determine the ultimate object of the sale. RYLANDER V. SAN ANTONIO SMSA, 11 S.W.3d 484 (Tex. App.—Austin 2000, no pet.).

11. When considering the taxability of a mixed transaction, there are three possibilities: (1) a nontaxable service is the main item of the sale and the property is incidental, in which case the entire transaction is nontaxable; (2) the property is the main item purchased and the nontaxable service is incidental, in which case the entire transaction is taxable; or (3) there is a fixed and ascertainable relationship between the value of the tangible personal property and the value of the services rendered, and each is a significant element capable of a separate and distinct transaction, in which case the elements are analyzed as separate transactions. SEE STAR Document No. 200107013L.

12. The consulting fees at issue were not a mark-up or part of the sale of the furnishings.

13. Because fees associated with interior-design services (such as are at issue in this matter) are not taxable, Petitioner's contention should be granted and audit Exam 2 should be amended to delete the assessments associated with

Petitioner's purchase consulting fees.

14. Except as specifically stated in Conclusion of Law No. 13 and as agreed to by Staff, the audit assessment should be affirmed.

SIGNED NOVEMBER 25, 2014.

VICTOR JOHN SIMONDS
ADMINISTRATIVE LAW JUDGE
STATE OFFICE OF ADMINISTRATIVE HEARINGS

ENDNOTES:
1. SEE Petitioner's Exhibit No. 2, Purchase Authorization, Attachment A.

2. SEE Petitioner's Exhibit No. 2, Purchase Authorization, paragraphs 1 and 2.

3. SEE Petitioner's Exhibit No. 2, Purchase Authorization, paragraph 3.

4. Staff and Petitioner agree that the terms of the COMPANY B agreement are representative of Petitioner's business practice, but not all of the agreements in evidence show Petitioner collecting sales tax.

ACCESSION NUMBER: 201507559H
SUPERSEDED: N
DOCUMENT TYPE: H
DATE: 2015-07-28
TAX TYPE: SALES