



Business Essentials for the Artist Entrepreneur: Understanding the Texas Sales Tax

2017

This outline provides information on general tax issues and is not intended to provide advice on any specific legal matter or factual situation. This information is not intended to create, and receipt of it does not constitute, a lawyer-client relationship. Readers should not act upon this information without seeking professional counsel.

Instructor



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1. What Is Subject to Tax in Texas?

- a. **Question:** Yellow Submarine, a concert venue, books a Beatles cover band to play three nights at the venue. Is Yellow Submarine required to charge sales tax on ticket sales?
 - i. **Answer:** Amusement services are subject to tax in Texas, so Yellow Submarine would be required to charge sales tax on the ticket sales. *See* 34 Tex. Admin. Code § 3.298.
- b. **Sales Tax:** Imposed on the sale, lease, or rental of tangible personal property (TPP) and on certain specified services. *See* Tex. Tax Code §§ 151.010 and 151.0101.
 - i. **TPP** – property that can be seen, weighed, measured, felt, touched, or that is perceptible to the senses in any other manner. *See* Tex. Tax Code § 151.009.
 - ii. **Services** - Texas Tax Code § 151.0101 includes a list of services that are taxable in Texas. These include (but are not limited to) amusement services, telecommunications services, information services, data processing services, and Internet access services.
 - iii. **Presumptions.** The tax law presumes that all retail sales or uses of tangible personal property are taxable.
 - iv. There no presumption that services are taxable. Instead, the State must present prima facie proof that a service is taxable.
 - v. The tax is not imposed when an *exemption* from the tax applies.
- c. **Use Tax:** Imposed on the storage, use, or other consumption in this state of a taxable item purchased from a retailer. *See* Tex. Tax Code § 151.101.
- d. Sales and use taxes are intended to be complementary – they ensure that transactions are taxed only once whether they take place inside or outside of Texas.

- e. **Exemptions & Sales for Resale:** Certain sales in Texas may be exempt from sales and use tax.
- i. Examples include:
 - 1. Purchases made by exempt entities (like a church or school);
 - 2. Purchases of exempt items like certain grocery items or medications; and
 - 3. Purchases of items that will be resold.
 - ii. **Note.** If you engage in a transaction that is subject to an exemption, the Comptroller has special paperwork that you must complete. Please ask an attorney or CPA to help you determine whether your transaction is exempt, and if so, what paperwork is necessary to prove the exemption.
- f. **Amusement Services.** Amusement services and places that offer amusement services include:
- 1. live or recorded performances, whether by individual ticket or by season tickets;
 - 2. musical concerts;
 - 3. motion pictures;
 - 4. theatres (movies and plays);
 - 5. arts and crafts and art shows;
 - 6. museums;
 - 7. sports;
 - 8. bars (cover charge);
 - 9. and more.
- ii. **Ten (10) or Fewer Exemption.**
- 1. There is an occasional sale exemption for the sale of ten (10) or fewer admissions for amusement services during a 12-month period by a person who does not hold himself out as engaging, or does not habitually engage, in the sale of amusement services would qualify. *See* 34 Tex. Admin. Code 3.316 (occasional sales); 34 Tex. Admin. Code § 3.298(a)(3).
 - a. For example, a ticket scalper is unlikely to qualify for the occasional sale exemption because he likely holds himself out as engaging, or habitually engaging in the sale of amusement services.

2. Yellow Submarine is a professional concert venue holding itself out as engaging in the sale of amusement services. Its ticket sales would not qualify for the occasional sale exemption.

g. Tax Rate:

- i. The state rate is 6.25% for both sales and use tax.
- ii. **Local Sales Taxes:** Various local sales taxes may be imposed in addition to this tax. The maximum combined tax rate for local taxes may not exceed 2% at any location. Therefore, the maximum possible sales tax rate is 8.25%.
 1. Generally, the same exemptions, reporting and payment requirements under the state sales and use tax laws apply to local sales and use taxes.

2. Internet Sales & Multi-State Issues

- a. **Question:** Ground Control opens a guitar shop in Tulsa, Oklahoma and sells unique guitars out of its local store front. Their business has become so popular that they want to expand and offer online sales as well. They hire Major Tom, a website developer based in Austin, TX to build a website. Major Tom hosts the site on his server in Texas once the site is complete. Is Ground Control required to collect and remit Texas sales tax from sales made through the website?
 - i. **Answer:** The answer depends on whether Ground Control has “**taxing nexus**” with Texas.
- b. **Nexus:** A taxpayer is “engaged in business” when it has some contact or physical connection with a taxing jurisdiction.
 - i. Whether a taxpayer has nexus with a state determines the taxpayer’s collection responsibilities in that state.
 - ii. In *Quill Corp. v. North Dakota*, the United States Supreme Court announced the following nexus standards:
 1. “The Due Process Clause requires some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax and the income attributed to the State for tax purposes must be rationally related to values connected

with the taxing State.” *Quill Corp. v. North Dakota*, 54 U.S. 298, 306 (1992).

2. So, a remote seller that takes advantage of the economic markets of the taxing state (*i.e.*, sells products into that state) may have nexus.
 3. The Commerce Clause, however, requires the remote seller to have a **physical presence** within the taxing state. *See Quill* at 315. Economic presence alone is not sufficient under *Quill*.
- iii. The Texas Legislature has undermined the physical presence requirement:
1. Like many states, Texas has implemented creative legislation that pushes the boundaries of *Quill* in order to keep up with the changing technology and the increase in Internet and remote sales.
 - a. One example is affiliate nexus laws. Texas has enacted an affiliate nexus provision.
 - i. These laws attribute nexus to remote sellers that are related to or affiliated with businesses that have nexus in the taxing state. A state may find nexus where a remote seller is related to an in-state entity that accepts returns, maintains a warehouse used by the remote seller, or provides any other services to the remote seller’s customers (performing repairs, maintenance, or training).
 - b. Another example is “click-through” nexus. Texas does not impose click-through nexus.
 - i. This creates taxing nexus when a remote seller enters into an agreement with the owner of an in-state website to refer customers to the remote seller’s website for a commission (*e.g.*, via a link on the in-state website).

- iv. Every state employs different sales tax laws, so businesses have to navigate a patchwork of sales tax laws to engage in multi-state commerce.
 1. There have been many legislative attempts to impose or implement unified sales tax provisions that would be applicable to all states. However, these attempts have not been successful at this point in time.
 2. *Note.* If you are touring and/or selling merchandise online in multiple states, please ask an attorney or CPA to help you determine whether you are subject to taxing nexus in each state.
- c. **Question:** Does Ground Control's website on a Texas server create nexus?
 - i. **Answer:** If Ground Control's website is static and serves as a brochure, then it is unlikely to create nexus if Ground Control does not otherwise have a presence in Texas. But, if Ground Control's website processes credit card payments it could be considered a presence in Texas and create nexus.
 - ii. **Website on a Texas Server:** Storing a static webpage on a server in Texas that is owned and maintained by a third-party does not create nexus with Texas. *See Texas Tax Code § 151.108.*
 - iii. **Using a Texas Server and Soliciting in Texas:** Storing a static webpage on a server in Texas maintained by a third-party and soliciting sales via telephone, print and direct mail advertising will not result in nexus with Texas.
- d. **Question:** Major Tom is close friends with Hanson and tells the band about the incredible guitars made in Tulsa. Hanson goes to the store and loves the guitars so much that they purchase 20 to take on their next tour. Hanson asks Ground Control to ship the guitars to Austin, Texas where one of the band members lives. Ground Control has no guitars in stock in Tulsa. Ground Control contacts its supplier in Louisiana and orders 20 guitars. It asks the supplier to ship the guitars directly to Austin, Texas.
 - i. **Answer:** Ground Control does not have any employees, offices, or property in Texas. It does not have to collect Texas sales tax on its transaction with Hanson.

- a. The drop-shipper is not located in Texas and does not have any employees, officer, or property in Texas. It does not have to collect Texas sales tax on its transaction with Ground Control.
 - b. Hanson may be required to pay use tax to the Texas Comptroller because it purchased tangible personal property for storage, use, or consumption in Texas.
- ii. **Drop Shipment.** In general, sellers or third-party drop shippers are not required to collect tax or obtain exemption or resale documents from a retailer in a state where the seller or shipper is not engaged in business.
1. A seller's obligation to collect and remit sales or use tax depends on whether the seller has nexus with the taxing jurisdiction.
 2. Drop shipments of TPP are generally taxable in Texas if the customer is located in Texas.

3. Audio & Video Recordings

- a. Jake Blues and Elwood Blues are tired of life on the road. They form a business entity called "Penguin Productions" and purchase a building that they plan to convert into a recording studio. They want to offer a variety of audio and video recording services, as well as offer the occasional live concert located at the studio. They purchase a stage, backline, lighting, computer equipment, and software. They renovate the building to include a craft services area.

Aretha Franklin hires Penguin Productions to record a new album of James Brown cover songs.

b. Production of Musical Content

- i. **Question:** Penguin Productions produces an audio master as well as a music video master for the new song. Are these charges subject to sales tax?
 1. **Answer:** No, Penguin Productions' charges to produce an audio master likely qualify for the exemptions in Texas Tax Code § 151.3185.

2. Producing an audio or video master, a copy of which is sold or offered for ultimate sale, licensed, distributed, broadcast, or otherwise exhibited, is exempt from sales tax. *See* Tax Code § 151.3185(a).
3. The exemption does not include requirements that music or video be recorded in a specific medium. If you record music, whether to a master tape reel, to a laptop, or to a digital audio tape → you can qualify for this exemption. You can even qualify if you record music on an iPhone.
4. The production must be intended to be broadcast to either the general public or to a cable television service subscriber or paid customers. *See* Tex. Tax Code § 151.3185(d).
5. The producer must give the seller a properly-completed exemption certificate for his records.
6. Both Penguin Productions and the artist or vendor bear the burden of proof. The standard to prove exemptions is clear & convincing evidence.

ii. Items used in production are exempt.

1. **Question:** Is Penguin Productions required to pay sales tax on cameras, lights, audio recording equipment, and audio routing switches that it purchased for use in its production studio?
 - a. **Answer:** Penguin Productions is not required to pay sales tax on cameras, lights, audio recording equipment, and audio routing switches that it purchased if the items are necessary and essential to and used or consumed directly in the production process.
 - b. Producers of audio/visual masters are considered manufacturers and are eligible to claim exemptions for qualifying items used in the production of motion pictures or video or audio recordings. The items must be *necessary and essential* to and *used or consumed directly* in the production process.

- c. Examples include: (*See* Tax Code § 151.3185(b))
 - i. Cameras, film, and film developing chemicals;
 - ii. Lights, props, sets, teleprompters, microphones, digital equipment, and special effects equipment and supplies; and
 - iii. Audio or video routing switches that are necessary and essential to the production.

- d. Items that *do not* qualify include: (*See* Tax Code § 151.3185(c))
 - i. Office equipment supplies
 - ii. Maintenance or janitorial supplies
 - iii. Machinery, equipment, or supplies used in sales, transmission, or transportation activities
 - iv. Machinery, equipment or supplies used in distribution activities
 - v. Taxable items used incidentally in production
 - vi. The following taxable items (regardless of how used):
 - 1. Telecommunications equipment;
 - 2. Transmission equipment;
 - 3. Security services;
 - 4. Motor vehicle parking services; and
 - 5. Food ready for immediate consumption.

iii. Editing.

1. **Question:** Is Penguin Productions required to pay sales tax on charges to edit Aretha's audio master and music video master?
 - a. **Answer:** Penguin Productions can claim an exemption because the editing is performed in connection with producing an audio or video master.
 - b. Editing audio for video, and/or multimedia, presentations is taxable unless an exemption is claimed.

iv. Selling Copies of Masters.

1. **Question:** Aretha Franklin sells the master recording to Sony. Is this transaction subject to sales tax?
 - a. **Answer:** Aretha may accept a properly completed resale certificate in lieu of collecting sales tax from a purchaser who will be reselling the copies.
 - b. In general, sales of TPP including audio and video recordings transferred on a format of any kind (CD, DVD, Downloads) are subject to SUT. *See STAR 200207261L (July 17, 2002).*
 - i. But, there is an exemption for the sale of a motion picture, video or audio master. *See Tax Code § 151.3185(e).*
2. **Question:** Aretha Franklin sells three copies of the master to an affiliate of Sony. Is this transaction subject to sales tax?
 - a. **Answer:** Yes. The exemption does not apply to duplicates.
 - b. Sale of duplicates of an audio/ video master are taxable if sold to an individual in Texas. *See STAR 200207261L (July 17, 2002).*
 - c. If duplicates are shipped out-of-state, they are exempt from Texas sales and use tax.

c. Stocking the Craft Services Bar

- i. **Question:** Are the Blues Brothers' purchases of food to stock craft services in the artist lounge subject to sales tax?
 1. **Answer:** Yes, the purchases of most snack items or prepared food items that would be used to stock the craft services bar would be taxable. Grocery items like water, bread, fruits, and vegetables would not be subject to sales tax.

- a. Since the Blues Brothers are reselling the prepared food and drinks and will charge tax to Aretha Franklin, the Blues Brothers can give a resale certificate to the vendors instead of paying sales tax on purchases of prepared food and snack items.
2. Food products are generally exempt from sales tax if they are not ready to eat when they are sold. *See generally* Tex. Tax Code § 151.314; 34 Tex. Admin. Code § 3.293(c).
3. **Nontaxable Food Items:** Items such as water, flour, sugar, bread, milk, eggs, fruit, vegetables and other groceries are generally not taxable.
4. **Taxable Food Items:** Prepared foods, flavored water, soft drinks, ice, and snack items like candy and individual sized chips are taxable.
5. Separately stated charges for serving, picking up, and or delivering prepared food items is taxable.
6. **Caterers:** Food prepared, sold, or served by caterers is taxable. *See* STAR 200703903L (Mar. 1, 2007).
 - a. A caterer is defined as anyone who prepares and serves meals, drinks, or other food products at a location designated by the customer. *See* 34 Tex. Admin. Code § 3.293(a)(4).
 - b. A caterer must collect tax from the customer on the total price for preparing and serving the catered meal, including all separately stated expenses billed in connection with the meal. Examples include separately-stated charges for delivery or providing servers. *See* STAR 200703903L (Mar. 1, 2007).

4. Painting Canvas and Murals.

- a. Major Tom's web developing services are in high demand, so he purchases a lot in downtown Austin and begins to construct a new office building. He hires Daniel Johnston to paint a large mural on the side of the office building, and also hires him to paint a large canvas with his company logo to hang in the entryway of the new office.

b. Purchasing Materials, Supplies, and Equipment.

- i. **Question:** Daniel Johnston goes to an art supplies store and buys items like paints, brushes, rulers, tape, markers, and a drop cloth. Is Daniel Johnston required to pay tax on these items?
 1. **Answer:** Purchases of items like paint and markers that will become a component part of the finished mural are not subject to sales tax. Daniel may give an exemption certificate at the time of purchase.
 - a. Items like tape, brushes, and a drop cloth will not become a component part of the finished mural. Daniel must pay sales tax on purchases of these items.
- ii. The artist is responsible for paying tax on supplies and equipment at the time of purchase.
 1. However, if the supplies (*i.e.*, paint) become an ingredient or component part of the finished item held for sale, the artist may qualify for the manufacturing exemption. If so, the artist can give an exemption certificate to the supplier at the time of purchase.

c. Painting.

i. Items of Tangible Personal Property.

1. **Question:** Daniel Johnston's contract with Major Tom includes a separately-stated charge for the service of painting the canvas. Is this charge subject to sales tax?
 - a. **Answer:** Yes, Daniel's charge to paint the canvas is subject to sales tax.

- b. Painting or restoring items of tangible personal property is a taxable service.
- c. Painting a canvas is considered painting of tangible personal property, and is subject to sales tax. *See* STAR 200002086L (Feb. 7, 2000) (superseded on the issue of local tax).

ii. Other examples:

1. Painting or restoring furniture is taxable remodeling.
2. Painting vehicles (even if you perform design work like pinstriping) is taxable because you are painting TPP.

iii. **Artwork on Buildings.**

1. **Question:** Daniel Johnston's contract with Major Tom includes a separately-stated charge for the service of painting the mural. Is this charge subject to sales tax?
 - a. **Answer:** Daniel's mural is painted on the side of Major Tom's office building, so the commercial property rules will apply. The office building is new construction, so the new construction exception will apply. Charges for labor to paint the new building will not be subject to tax.

Daniel's contract with Major Tom includes a separately-stated charge for materials. Daniel should not pay tax on his purchase of the materials. Instead, Daniel should charge sales tax on the separately-stated charge for the materials.

If the contract had been lump-sum, Daniel should pay tax to vendors at the time he purchases the materials.

- b. Painting a mural on the side of a building implicates the real property rules.
- c. Painting murals or designs on walls is considered remodeling, so regular construction rules apply.

d. Residential:

- i. Labor charges incurred for residential real property repair, remodeling, and restoration is a nontaxable service.
- ii. If the contract is lump-sum, meaning the charges for labor and materials are not separated, then the artist is considered the consumer of all materials and must pay tax to vendors at the time the materials are purchased. The artist would not collect sales tax from the customer.
- iii. If the contract provides separate charges for materials and labor, the artist must collect tax on the charge for materials.

e. Commercial:

- i. Materials and labor charges incurred for commercial real property repair, remodeling and restoration are taxable regardless of the contract type. *See* 34 Tex. Admin. Code § 3.357.
- ii. Regardless of the contract pricing terms, the artist would not pay tax on the materials, but instead would give a resale exemption to the vendor.
- iii. **New Construction Exception:** “New construction,” as contrasted with “repair and remodeling,” is not a taxable service.
- iv. New construction is defined as all new improvements to real property including initial finish out work to the interior or exterior of the improvement that has never been occupied for any reason. New construction is also the addition of new footage to an existing structure.
 1. If the mural is painted on a building a building as part of new construction or the addition of new footage to an existing structure, then the labor charges to paint the mural are not subject to sales tax.

5. Photography & Video.

- a. Ray Benson retires from the music business and opens a small business in Austin called “Asleep at Your Wedding.” He offers a variety of photography, film, and printing services. He photographs and films weddings, graduations, and family events. Recently, he was hired as a freelance videographer to film a small portion of a major film.

b. Film Services.

- i. **Question:** Are Ray Benson’s charges for filming weddings and graduations subject to sales tax?
 1. **Answer:** Yes, Ray’s charges for filming family events are subject to sales tax unless an exemption applies.
 2. In general, a video photographer must collect tax on total charge for videotaping services.
 - a. Filming events like weddings and birthdays is subject to sales tax.
 - b. A special exemption exists for videotaping depositions prepared for use in litigation.
- ii. **Question:** Are Ray Benson’s charges for filming a small portion of a major film subject to sales tax?
 1. **Answer:** Ray’s charges will not be subject to sales tax if the video becomes a component part of a major motion picture master.
 2. Filming a video that will become a component of a motion picture master is not taxable
 - a. Writing narration scripts for video and/or multimedia presentations is not taxable.

6. Graphic Design & Internet Advertising.

- a. Ray expands his company to provide an advertising package to his clients, which includes the following services:
 - i. Designing corporate logos and letterhead
 - ii. Printing letterhead, brochures, and envelopes
 - iii. Drafting press releases to be distributed via social media

Ray is hired to design and print a brochure for a start-up tech company.

b. Graphic Design Services.

- i. **Question:** Are charges to design the brochure subject to sales tax?
 1. **Answer:** Yes, charges to design a brochure are taxable as graphic arts services.
 2. Graphic arts is considered production of TPP and is subject to tax, unless the customer issues a resale or exemption certificate. *See* Comptroller Hearing No. 47,841 (STAR 200904347H) (Apr. 16, 2009).
 - a. For example, charges to design logos, business stationary, display items, marketing materials, and miscellaneous corporate items are considered taxable graphic arts and are subject to tax. *Id.*
 - b. Another example- a charge by a caricaturist or cartoonist for drawings is the taxable sale of graphic arts.

c. Printing.

- i. **Question:** Are charges to print the brochure subject to sales tax?
 1. **Answer:** Yes, charges to print the brochure are taxable. But, Ray some of Ray's purchases of printing equipment for his company may be subject to an exemption.
 2. Charges for printing brochures, letterhead, and envelopes are subject to sales tax.

3. Purchases of the printing equipment may be subject to an exemption for printing equipment. The 1999 Legislature reinstated the manufacturing exemption for pre-press machinery, equipment and supplies, including computers, cameras, film, film developing chemicals, veloxes, plate-making machinery, plate metal, litho negatives, color separation negatives, proofs of color negatives, production art work and typesetting or composition proofs, that are necessary and essential to and used in connection with the printing process.
4. To qualify, the items must be purchased by a person engaged in
 - a. Printing or imprinting tangible personal property for sale; or
 - b. Producing a publication for the dissemination of news of a general character and of a general interest that is printed on newsprint and distributed to the general public free of charge at a daily, weekly or other short interval.

d. **Advertising Services.**

- i. **Question:** Are charges to write copy for the brochure subject to sales tax?
 1. **Answer:** Ray's charges for writing the copy included in the brochure, alone, would not be subject to sales tax. However, Ray also prints the brochure as part of the same transaction. Because the copywriting charge is combined with a taxable service as part of the transaction, the entire transaction is subject to sales tax.
 2. Advertising charges are not exempt from sales tax if the advertising company performs a taxable service (like printing) or provides employee-fabricated property (like a brochure) as part of the transaction.
 3. But, if they are solely performing 'nontangible' services like writing copy, then the advertising charges are nontaxable.

4. If a client is charged for preliminary art, but the preliminary art does *not* become part of the finished art for any reason (for example- if the art was rejected by the client), then the Comptroller will consider the charge for the preliminary art as the purchase of a nontaxable design service, not the creation and sale of TPP. *See* Comptroller Hearing No. 47,841 (STAR 200904347H) (Apr. 16, 2009).