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Directive 94-2: Promotional Telephones used by Carriers

I. Facts

Cellular telephone carriers ("Carriers") frequently use cellular telephones as promotional items in their efforts to solicit new subscribers. In a typical transaction, a Carrier will offer to provide a cellular telephone to a customer at no additional charge or for a nominal consideration, if the customer agrees to become and remain a subscriber for a set minimum period, usually one or two years.¹

These transactions may be illustrated by the following example. Teleco is a cellular telephone service carrier. Under a month long promotional program, it offers to sell a new cellular phone for \$19.95 to any customer who agrees to become a new subscriber for a period of one year. A customer who accepts this promotion pays the same price for cellular service as customers who do not. The telephone itself has a wholesale cost of \$200.00.

II. Issue

What are the sales or use tax liabilities of Carriers with respect to cellular telephones that they use as promotional items?

III. Discussion of Law

Massachusetts imposes an excise upon sales at retail of tangible personal property, measured by a vendor's gross receipts from such sales. G.L. c. 64H, § 2. A "sale at retail" is defined in pertinent part as a "sale of . . . tangible personal property for any purpose other than resale in the regular course of business." *Id.* at § 1.

All gross receipts of a vendor from the sale of tangible personal property are presumed to be from sales subject to tax until the contrary is established. G.L. c. 64H, § 8(a). The burden of proving that a sale is not a sale at retail is upon the vendor unless the vendor takes a resale certificate from the purchaser. *Id.* If a purchaser (reselling vendor) who gives a certificate makes any use of the property other than retention, demonstration or display while holding it for sale in the regular course of business, such use is deemed to be a retail sale as of the time the property is first so used. *Id.* at § 8(d). The cost of the property to the purchaser, in turn, is deemed to be the gross receipts from that deemed retail sale. *Id.*

Massachusetts also imposes a complementary use tax on the storage, use or other consumption in the Commonwealth of tangible personal property purchased for storage, use or consumption here. G.L. c. 64I, § 2. This tax is measured by the sales price of the property. *Id.*

Where property is transferred by a vendor to a customer for no additional consideration, or for a nominal consideration, or for an amount substantially below cost, the property constitutes a promotional item for sales and use tax purposes, and the vendor is considered its consumer. See Letter Ruling 84-48; see generally *Parfums-Corday, Inc. v. State Board of Equalization*, 187 Cal. App. 3d 630 (1986); *Wallace Berrie & Co. v. State Board of Equalization*, 40 Cal. 3d 60 (1985); *The Drackett Products Co. v. Limbach*, Ohio Board of Tax Appeals, No. 87-C-975 (1992). Thus, for example, if a vendor gives a customer an item free of charge upon the presentation of a coupon, and the vendor receives no reimbursement from any source for the coupon, the vendor is considered the consumer of that item and is responsible for the payment of a sales or use tax based upon the amount the vendor paid for it. 830 CMR 64H.1.4(2). If a purchaser (reselling vendor) purchases

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property with a resale certificate and subsequently uses that property as a promotional item, that use is deemed to be a retail sale and the cost of the property must be included in the purchaser's gross receipts for that period. G.L. c. 64H, § 8(d).

IV. Directive

Cellular telephone service carriers that use cellular telephones as promotional items are liable for a sales or use tax based upon the cost of those items. In the event that the Carriers collect a sales or use tax from their customers based upon the amount of any nominal consideration charged for the telephones, they may claim an offsetting credit for those amounts.

/s/Mitchell Adams
Mitchell Adams
Commissioner of Revenue

February 4, 1994

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Footnotes:

¹The Carrier may also impose various penalties for the breach of this minimum service agreement, including so-called deactivation fees or the forfeiture of the telephone plus a substantial restocking penalty.