

# STATE OF COLORADO

**DEPARTMENT OF REVENUE**  
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GIL-2008-8

Bill Ritter, Jr.  
Governor

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Executive Director

XXXXXXXXXXXXXXXXXX  
Attn: XXXXXXXXXXXXX  
XXXXXXXXXXXXXXXXXX  
XXXXXXXXXXXXXXXXXX

February 28, 2008

Re: taxability of video format conversion

Dear XXXXXXXXXXXXX,

This letter is in response to your letter to the Colorado Department of Revenue, dated January 9, 2008, re: the taxability of DVDs converted from VHS tapes.

## Issues

1. Should the company charge sales tax to customers for the DVDs?
2. Should the company provide a resale certificate to a third-party that provides the company with a service and DVD?

## Background

You provide the following facts. Customers come to the company to have their VHS tapes converted to DVDs. The company contracts with a third-party which converts the VHS to DVD. The third-party bills the company for the conversion and transfers to the company the DVD. In turn, the company transfers the DVD to its customer and charges a fee.

## Discussion

Colorado imposes sales and use tax on the sale, use, storage, or consumption of tangible personal property. §39-26-104(1)(a), C.R.S. There are two sales in the circumstances you describe. The first is the sale of DVDs by the third-party to the [company]. However, Colorado exempts sales where the purchaser intends to resell the property to another (i.e., wholesale sales). See, §39-26-104(1)(a) (tax on retail sales) and 102(9) (retail sales do not include wholesale sales), C.R.S. Therefore, the sales from the third-party to [company] are exempt because [company] resells the DVDs to customers.

The second sale is the sale of DVDs by the [company] to its customers. This sale is a retail sale of the DVD and, therefore, is taxable.

I note that, in some cases, the transfer of tangible personal property is not taxable if the “true object” of the transaction is the performance of a service and the transfer of tangible personal property is only incidental to the sale. See, Department Special Regulation Sales 40. This exception, however, does not apply here. In this case, the true object of the transaction is the DVD itself. In such cases, the transfer of the property is taxable even though labor is used to produce the property. Other states that have addressed this issue have reached similar conclusions. See, e.g., California Sales Tax Counsel Rulings No. 435.0595; California Sales Tax Counsel Rulings No. 120.1220; Missouri Private Letter Ruling No. LR 4151, 10/01/2007.

You ask whether the charge by the third-party for the service of making the conversion from VHS to DVD is taxable. As noted above, the sale between the third-party and the [Company] is an exempt sale. Therefore, it does not matter whether there is a separate charge for the service of converting the VHS tape into a DVD. However, the sale between the [Company] and its customer is taxable, so it is important to address whether the [Company] can separately state that service charge on its own invoice to the customer and not collect tax on that amount. In general, the purchase price upon which sales or use tax is calculated must include the cost of services incurred in producing the tangible personal property. See, §39-26-102(10), C.R.S. (“Except as otherwise provided in this subsection (12), the sales price is the gross value of all materials, labor, and service, and the profit thereon, included in the price charged to the user or consumer.”). The services provided by the third-party are a necessary and inseparable part of the process to produce the DVDs. *A.D. Stores v Department of Revenue*, 19 P3d 680 (Colo. 2001). Therefore, the sales tax collected from the customer must include the third-party’s service charge, regardless of whether the [Company] separately states the service charge on the customer’s invoice.

I also note that you are located out-of-state. An out-of-state retailer must collect Colorado sales or use tax if it is “doing business in this state.” §39-26-102(3), C.R.S. You have not submitted an inquiry on whether your activities constitute doing business in this state and there is not sufficient information in the letter to allow me to provide guidance on that issue. However, the department has a number of tax publications and other resources available on its web site regarding what constitutes doing business in this state and other tax issues. Visit us on-line at: [www.revenue.state.co.us](http://www.revenue.state.co.us) and go to Taxation > FYIs > Sales Tax > FYI Sales 5 (Sales Tax Information for Out-of-state Businesses). See, also, FYI Sales 1 (Documenting sales to retailers).

Finally, the Department makes a good faith effort to provide accurate and complete answers to questions posed to it by taxpayers. However, the information and answers provided here are not binding on the Colorado Department of Revenue, nor do they replace, alter, or supersede Colorado law and regulations. The Executive Director, who by statute is the only person having authority to bind the Department, has not formally reviewed and/or approved this response.

Respectfully,

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