**Opinion Letter**

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| **Letter Number:** | **O-2015-002** |

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| **Tax Type:** | **Kansas Retailers' Sales Tax** |
| **Brief Description:** | **Direct Mail** |
| **Keywords:** |  |
| **Effective Date:** | **12/21/2015** |
| **Approval Date:** | **12/21/2015** |

**Body:**

December 21, 2015

XXXXX  
XXXXX  
XXXXX

RE: Your e-mail received on  
July 16, 2015

Dear XXXX:  
  
Thank you for your e-mail. You represent a Kansas business that solicits retail businesses to buy direct mail advertising. The advertising may consist of fliers, coupons, samples, or other promotional material that sent to potential customers identified on a mailing list supplied by the business. Most mailing lists contain proprietary information that belongs to the business and may not be used or retained by anyone else.  
  
Your client contracts with a direct mail provider in another state to design the advertising for the direct mailing. Your client provides the direct mail provider with a description of what the business want including in the direct mailing, along with any business logos or pictures the business wants to be incorporated in the advertising flyers. Once the business approves the design of the advertisements, the provider prints the them, inserts them into envelopes, and mails them to the addressees on the mailing list. Delivery and distribution of direct mail typically requires provider to palletize the direct mail in accordance with requirements fixed by the United States Postal Service or the private delivery service being used. All of the steps that the direct mail provider takes to fulfill its obligations under its contract with your client, including the printing, addressing and filling of envelopes, palletizing, and mailing, are performed outside Kansas.  
  
You ask how Kansas sales tax is applied to this direct mail advertising. K.S.A. 79-3602(j) defines "direct mail" for purposed of the Kansas sales tax act:

(j) “Direct mail” means printed material delivered or distributed by United States mail or other delivery services to a mass audience or to addressees on a mailing list provided by the purchaser or at the direction of the purchaser when the cost of the items are not billed directly to the recipients. Direct mail includes tangible personal property supplied directly or indirectly by the purchaser to the direct mail seller for inclusion in the package containing the printed material. Direct mail does not include multiple items of printed material delivered to a single address.

K.S.A. 79-3602(i) defines "Delivery charges," which are normally part of the "sales or selling price" defined at K.S.A. 79-3602(ll), to mean:

charges by the seller of personal property or services for preparation and delivery to a location designated by the purchaser of personal property or services including, but not limited to, transportation, shipping, postage, handling, crating and packing. Delivery charges shall not include charges for delivery of direct mail if the charges are separately stated on an invoice or similar billing document given to the purchaser***.***

The sale of direct mail delivered to a Kansas address is taxed as the taxable sale of tangible personal property. *K.S.A. 79-3603(a) ("For the privilege of engaging in the business of selling tangible personal property at retail in this state . . . there is hereby levied and there shall be collected and paid a tax . . . (a) The gross receipts received from the sale of tangible personal property at retail within this state. . . ").*  
  
Sales of direct mail are sourced pursuant to K.S.A. 79-3672. It provides, in parts that are relevant here:

(a) Notwithstanding the provisions of K.S.A. 79-3670, and amendments thereto, the following provisions apply to sales of “advertising and promotional direct mail”:  
(1) A purchaser of “advertising and promotional direct mail” may provide the seller with either:  
(A) A direct pay permit;  
(B) an exemption certificate, or other statement approved, authorized or accepted by the secretary, claiming “direct mail”; or  
(C) information showing the jurisdictions to which the “advertising and promotional direct mail” is to be delivered to recipients.  
(2) If the purchaser provides the permit, certificate or statement referred to in subsections (a)(1)(A) or (a)(1)(B), the seller, in the absence of bad faith, is relieved of all obligations to collect, pay or remit any tax on any transaction involving “advertising and promotional direct mail” to which the permit, certificate or statement applies. The purchaser shall source the sale to the jurisdictions to which the “advertising and promotional direct mail” is to be delivered to the recipients and shall report and pay any applicable tax due.  
(3) If the purchaser provides the seller information showing the jurisdictions to which the “advertising and promotional direct mail” is to be delivered to recipients, the seller shall source the sale to the jurisdictions to which the “advertising and promotional direct mail” is to be delivered and shall collect and remit the applicable tax. In the absence of bad faith, the seller is relieved of any further obligation to collect any additional tax on the sale of “advertising and promotional direct mail” where the seller has sourced the sale according to the delivery information provided by the purchaser.  
(4) If the purchaser does not provide the seller with any of the items listed in subsections (a)(1)(A), (a)(1)(B) or (a)(1)(C), the sale shall be sourced according to subsection (a)(5) of K.S.A. 79-3670, and amendments thereto.

These requirements mean the purchaser paying for direct mail has two options:

1. The purchaser paying for the direct mail (your client) may provide the direct mail provider with a fully completed ST-31, *Direct Mail Sourcing Certificate,* claiming either the direct mail exemption or that the purchaser has a direct-pay permit. When a certificate is issued, the direct mail provider does not charge any Kansas state or local sales tax, and it is the purchaser’s responsibility to pay tax to the appropriate Kansas tax jurisdictions.*(Note: If the purchaser has secured a direct-pay permit from the department, it should list its direct-pay permit number on the ST-31. Direct pay permits generally are only issued to large utilities and manufacturers.)*

or

2. The purchaser paying for the direct mail service (your client) provides delivery information to the direct mail provider showing the taxing jurisdictions where the direct mail will be delivered. This information must be in addition to the mailing list that normally contains proprietary information of the business that can only be used to address the direct mail. The provider must retain this information in their business records. However, if the direct mail provider is not registered to Kansas sales or use tax, the purchaser (your client) becomes the responsible for paying the tax to Kansas.

You ask which costs are subject to sales tax. The tax base used for taxable direct mail charges is the total amount billed to the purchaser (your client) for direct mail less the separately stated charges for the delivery that are excluded from the tax base by K.S.A. 79-3602(i), with tax base apportioned to Kansas based on ratio of the number of letters addressed to Kansas to the total number mailed. Delivery charges for direct mail that are not include in the tax base are separately-stated charges for postage, the packing and palletizing of the direct mail, and delivery of the pallets to the post office or private delivery company,  
  
As mentioned, charges for direct mail are taxed as charges the sale of tangible personal property delivered in Kansas. Under the step-transaction doctrine the taxable charge for direct mail is the total amount billed to your client, less any separately stated delivery charges. This is the tax base the Kansas legislature determined is appropriate for direct mail delivered to a Kansas address. The step transaction doctrine prohibits a contract for direct mail to be broken into a series of taxable and nontaxable steps that the direct mail is required to take to fulfill its contract, such as printing the advertising material, addressing the envelopes, inserting the material into the envelopes, palletizing them, delivering them to the postal services, and so forth.  
  
The step transaction doctrine establishes that when sales or use tax is imposed on a transaction, the transaction is required to be treated as a unified whole for purposes for determining how the tax imposition applies. See *C.I.R. v. Clark,* 489 U.S. 726, 737 (1989). "[A]n integrated transaction may not be separated into its components for the purposes of taxation by either the [taxing authority] or the taxpayer.") *Redwing Carriers, Inc. v. Tomlinson,* 399 F.2d 652, 658 (C.A. Fla. 1968); *Roebling Securities Corp. v. U.S.,* 176 F.Supp. 844, 847-48 (D.C.N.J. 1959); *Helvering v. New Haven & Shore Line R. Co.,* 121 F.2d 985 (2 Cir. 1941). The step transaction doctrine provides that “interrelated yet formally distinct steps in an integrated transaction may not be considered independently of the overall transaction.” *Commissioner v. Clark,* supra at 738; *see also Security Indus. Ins. Co. v. United States,* 702 F.2d 1234, 1244 (5th Cir. 1983)*(“The step transaction doctrine is a corollary of the general tax principle that ... taxation depends on the substance of a transaction rather than its form.”).* The step transaction doctrine requires that "rather than [being taken] ... in isolation,” “all interdependent steps with legal or business significance" are to be linked together so the “tax liability may be based on a realistic view of the entire transaction.” 1 B. Bittker,*Federal Taxation of Income, Estates and Gifts* ¶ 4.3.5, p. 4-52 (1981)."*C.I.R. v. Clark,*id at 738; *Clark,*489 U.S. at 738.  
  
The step transaction doctrine prohibits a sales transaction from being "deconstructed" into a series of hypothetical steps, with each one being treated as a separate taxable event in order to reduce the amount of tax that is paid on the transaction. The Supreme Court of Michigan cautioned against judicial attempts to "deconstruct" a taxable retail transaction into its individual steps and then determining how the tax imposition applies to each step required for contract performance. The Michigan Supreme Court observed that such "deconstruction" of a transaction made taxable by the legislature violates Constitutional separation of powers principles:

The legislative power of the State ... is vested in a senate and a house of representatives." Simply put, legislative power is the power to make laws. In accordance with the constitution's separation of powers, this Court "cannot revise, amend, deconstruct, or ignore [the Legislature's] product and still be true to our responsibilities that give our branch only the judicial power. *In re Complaint of Roves Against SBC Michigan,* 482 Mich. 90, 98, 754 N.W.2d 259, 264 (2008). *(Underlining added)*

"[W]here the essential nature of a transaction is the acquisition of property, it will be viewed as a whole, and closely related steps will not be separated either at the instance of the taxpayer or the taxing authority." *Kimbell-Diamond Mill. Co. v. C.I.R., 14 T.C. 74, 80* (1950). This "deconstruction" is what K.S.A. 79-3602(ll)(1)(A) and (B) were intended to prevent, but that *Cessna ECU* has declared is a lawful construction of a Kansas tax statute.  
  
The step transaction doctrine shows that you framed your question inaccurately, by asking "which of their costs would be subject to Kansas use tax?". The question is not what individual steps taken to fulfill a direct mail contract are taxable. The more precise question is what is the tax base for the sale of direct mail that was fixed by the Kansas legislature. As has been discussed the correct tax base is arrived at by deducting the delivery costs from the total amount that was billed to purchaser paying for the direct mail, less the separately stated delivery charges, when that amount is apportioned to Kansas based on the ratio of the direct mail delivered to Kansas addresses to the total number of letter mailed under the contract.  
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Sincerely,  
  
  
  
Thomas E. Hatten

Attorney/Policy & Research  
  
  
**Date Composed: 12/21/2015 Date Modified: 12/21/2015**