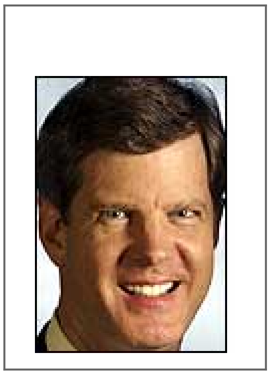
Does RFID Spell TAX?

A looming sales-tax case could spell trouble for the emerging RFID industry in Ontario, and potentially in four other Canadian provinces as well. Ontario’s government has assessed a large transportation company for failure to pay retail sales tax on the fair value of telecommunications produced for its own use. The assessment has been appealed, and will likely be heard in court in early 2008.



The issue relates to the company’s use of radio equipment to communicate between vehicles and dispatchers. Ontario’s sales-tax legislation includes provisions designed to capture tax on the fair value of property and services produced for a person’s or company’s own use. Telecommunication services are taxable in Ontario, as they are in all Canadian provinces and most U.S. states. The “own use” provisions are generally designed to capture tax revenue where a telecommunications carrier uses its own network for internal traffic. That use of the network requires a carrier to remit monthly tax payments based on a discounted value, expressed in relation to the market value of similar telecommunications.

The current law is written broadly, with the result that “telecommunications” includes all radio communications, including those produced by RFID devices. Some types of telecommunications, such as those pertaining to hotels and taxi companies, are exempt. The province has taken issue with radio dispatch activities, asserting that the use of the telecommunications equipment to generate communications between operators and the base station amounts to the creation of taxable telecommunications, despite the fact that a tax has already been paid on the equipment.

If the case succeeds, the result could be troubling for the RFID industry because it could possibly add to the cost of operating an RFID system. Any company employing an RFID system—including retailers such as Wal-Mart and Staples Business Depot, as well as manufacturers of consumer packaged goods—could be required to remit an 8 percent tax on some value derived from the depreciated cost of the equipment, tags, labels, related software and overhead costs, even if tax has already been paid on those properties.

The case comes on the heels of recent sales-tax rules for software that apply an 8 percent tax to most software contracts and related services. As a result, the issue bears watching closely—both in Ontario, where the case will be heard, and potentially in the four other Canadian provinces that impose similar sales taxes.

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