

**TENNESSEE DEPARTMENT OF REVENUE
LETTER RULING #98-25**

WARNING

Letter rulings are binding on the Department only with respect to the individual taxpayer being addressed in the ruling. This presentation of the ruling in a redacted form is informational only. Rulings are made in response to particular facts presented and are not intended necessarily as statements of Department policy.

SUBJECT

Sales tax as applied to information consulting services and the provision of personnel.

SCOPE

This letter ruling is an interpretation and application of the tax law as it relates to a specific set of existing facts furnished to the department by the taxpayer. The rulings herein are binding upon the Department and are applicable only to the individual taxpayer being addressed.

This letter ruling may be revoked or modified by the Commissioner at any time.

Such revocation or modification shall be effective retroactively unless the following conditions are met, in which case the revocation shall be prospective only:

- (A) The taxpayer must not have misstated or omitted material facts involved in the transaction;
- (B) Facts that develop later must not be materially different from the facts upon which the ruling was based;
- (C) The applicable law must not have been changed or amended;
- (D) The ruling must have been issued originally with respect to a prospective or proposed transaction; and
- (E) The taxpayer directly involved must have acted in good faith in relying upon the ruling; and a retroactive revocation of the ruling must inure to the taxpayer's detriment.

FACTS

[THE TAXPAYER] is an information systems consulting firm. Clients enter into an initial contract with the Taxpayer for analysis and recommendations. The initial contract does not obligate a client to a second contract for the performance

of services. The contract describes the services rendered by the Taxpayer as “analysis for the design of an application.” A letter describing the specifics of the project is incorporated into the contract. The sample letter provided states that upon completion of the analysis, the Taxpayer is prepared to implement the recommendations.

Based on the Taxpayer’s recommendations, the client then determines whether to enter into a second contract with the Taxpayer to provide the recommended services. The scope of the second contract is based on the recommendations of the initial contract. The second contract may include software installation, hardware installation, software tuning, or writing custom software as well as project management, programming services, or systems design where needed. The contract lists a description of the services to be rendered, typically as described in an associated letter or memorandum, and states a flat price for the services.

Through a separate arrangement, the Taxpayer also contracts to provide personnel for clients. The contract provides that a client purchases a certain number of hours from the Taxpayer’s specialized personnel. The services to be rendered vary depending on the nature of the client’s needs. The client does not contract for a particular service, such as software installation or troubleshooting, but purchases, essentially, a number of hours of the Taxpayer’s time to be used as needed. The Taxpayer bills the client upon execution of the agreement, in advance of the services rendered. As the hours are used, the Taxpayer sends an invoice with a brief description of the type of work done and the amount of time spent. Invoices are sent as various tasks are performed. The clients determine the hours for the personnel and direct the work, which is done at the clients’ office.

ISSUES

1. Whether the services provided under the first and second contracts are subject to sales tax.
2. Whether the provision of personnel is subject to sales tax.

RULINGS

1. The services provided under the first contract are not subject to sales tax. The charge for the services to be rendered pursuant to the second contract are subject to sales tax.
2. The provision of personnel is not a taxable service, but the Taxpayer should collect tax for any taxable services rendered by the personnel.

ANALYSIS

Tenn. Code Ann. § 67-6-201 declares the business of selling tangible personal property at retail to be a taxable privilege. A “sale at retail” is defined by Tenn. Code Ann. § 67-6-102(23)(F) to include certain services.

1. The services provided by the Taxpayer in the first contract, Consulting/Integration Agreement, are not among those enumerated in Tenn. Code Ann. § 67-6-102(23)(F). These services are provided pursuant to a single contract which is not related to or incident to the creation of tangible personal property. A client who contracts with the Taxpayer for analysis and recommendations is not obligated to proceed to the next step of implementing the recommendations or any other services which could be subject to tax. Accordingly, the services performed pursuant to the first contract are not subject to tax.

The second contract, implementing the projects proposed in the first contract, may include software installation, hardware installation, software tuning, or writing custom software. Computer software is considered tangible personal property, the installation of which is subject to tax. Tenn. Code Ann. § 67-6-102(24)(B); Tenn. Code Ann. § 67-6-102(23)(F)(vi). Likewise, the installation of hardware is also subject to tax. The creation and sale of software, whether custom or generic, is subject to sales tax. Tenn. Code Ann. § 67-6-102(24)(B). Software tuning, or adjustment, constitutes either the fabrication or repair of tangible personal property and is subject to tax. Tenn. Code Ann. § 67-6-102(23)(F)(iv); Tenn. Code Ann. § 67-6-102(24)(B).

These taxable services and the taxable sale of tangible personal property in the form of software computer equipment and documentation are combined in a single charge to the client. This single charge is subject to sales tax. To the extent that any of the included services are not subject to tax, if incident to the sale of tangible personal property, they are also subject to tax whether combined with the taxable charges or separated out. Tenn. Code Ann. § 67-6-102(25).

2. The provision of personnel is not a taxable service. The clients purchase hours of time from the Taxpayer, to be used on an as needed basis for a variety of tasks. The client pays for the hours purchased in advance and may determine on a daily or other basis what type of personnel is needed for a particular problem or function. The Taxpayer invoices the clients after services are rendered to account for the number of hours used and the type of services rendered. If the personnel perform repair, programming, or other taxable services, the Taxpayer should then collect tax from the client. If it is not possible to determine when the contract is signed what type of work will be performed and accordingly whether any sales tax should be collected, the Taxpayer should collect any tax due when the work is performed.

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APPROVED: Ruth E. Johnson, Commissioner

DATE: 5-12-98