

**TENNESSEE DEPARTMENT OF REVENUE
LETTER RULING #00-24**

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

Application of sales tax to business providing direct mail and related services.

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 provides a number of services to its customers, which are generally described as direct mail services. Further descriptions of these services are provided in connection with specific questions of taxability for sales tax purposes.

(1)

In certain instances, the taxpayer may provide a mixture of taxable and nontaxable services for a customer.

(2)

Customers may engage the taxpayer to mail monthly statements for them. These customers are brokers or financial institutions that provide monthly statements to their account holders. The customer provides the paper for the statements as well as the envelopes. These items already have the customer's company logo printed on them when they are provided to the taxpayer. The taxpayer prints the financial data for each account holder onto the paper provided by the customers. The financial data for each account holder is provided to the taxpayer in a number of ways, including diskettes, tapes, or electronic transfer. Once printed, the statements are folded, stuffed into envelopes, and mailed.

(3)

The taxpayer charges its customers for the use of various databases used to target persons by zip code, industry, income group, etc. The databases used can be an in-house database that the taxpayer has purchased, paying no sales tax on the purchase, or the taxpayer may pay a fee for a single use of another company's database, in which case it also pays no sales tax.

(4)

There are customers for which sorting, folding, envelope stuffing, and mailing are performed. The customer provides all materials. The only printing involves the printing of address labels or printing the address directly onto the envelope. In some instances, the customer provides all materials for sorting, folding, stuffing, and mailing. In other instances, the addresses are printed on address labels that are not provided by customer, but rather by the taxpayer.

(5)

For other customers, sorting, folding, stuffing, and mailing services are performed as in heading (4) above, however the mailing involves some or all of the following items: catalogues, catalogue inserts, magazines, magazine inserts.

(6)

The taxpayer also provides customers with data processing services and mail shop services.

The ruling request lists the following as examples of data processing services: (a) Processing customer databases to produce an output document which could range anywhere from a lasered, personalized letter with many variables to simply addressing an envelope. (b) Postal processing of customer databases to produce address labels or files for direct addressing onto envelopes or cards. (c) Postal processing of customer databases to provide a hard copy lists. (d) Postal processing a customer database to meet Postal Service CASS (Coding Accuracy Support System) requirements.

The ruling request lists the following as examples of mail shop services: (a) Placing inserts into envelopes either by machine or by hand. (b) Machine or hand tabbing self-mailing pieces. (c) Affixing address labels by machine or by hand. (d) Affixing postage by machine or by hand. (e) Metering mail for proper postage. (f) Sealing envelopes. (g) Sorting mail into trays. (h) Delivering mail to the post office.

(7)

In conjunction with addressing an envelope, the taxpayer may attach or print a delivery point barcode on a customer's envelope.

(8)

The taxpayer provides photocopying services. In some instances, the customer may supply the paper used. The taxpayer may use laser printing rather than photocopying if it determines that the laser printing can be more efficiently performed.

QUESTIONS

1. When a mixture of services is performed for a customer, and not all of those services are subject to sales tax, must a separate billing be done in order to avoid subjecting the nontaxable services to sales tax?
2. Must separate invoices be sent for those services subject to sales tax and those that are not subject to sales tax, or may one invoice be sent with an itemized sale price for each service; charging sales tax only on those items subject to the tax?
3. If all services, both taxable and nontaxable, are lumped together on one invoice, listing only one total "package" price, does this type of billing cause the entire invoice subjected to sales tax?
4. If the various services described under heading (2) above are itemized and billed to the customer separately, which services are taxable and which are not?
5. Should the taxpayer's customer be charged sales tax for the use of a database as described under heading (3) above, when a charge is made for the use of an in-house database?
6. Should the taxpayer's customer be charged sales tax for the use of a database as described under heading (3) above, when a charge is made for the use of a database obtained from others for a single use?
7. When the customer provides all materials for the services described under heading (4) above, is the printing of addresses directly on the envelopes subject to sales tax?

8. When the customer provides all materials for the services described under heading (4) above, is the printing of addresses on address labels not provided by customer (but rather by the taxpayer) subject to sales tax?
9. Are these services described under heading (5) above subject to sales tax?
10. Are data processing services and mail shop services, such as those described under heading (6) above subject to sales tax?
11. Is attaching or printing a delivery point barcode as described under heading (7) above subject to sales tax?
12. Are photocopying services subject to sales tax?
13. If the customer supplies his own paper for photocopying services, are the services subject to sales tax?
14. If laser printing is used rather than photocopying to provide copies to the customer, is the charge subject to sales tax?
15. What is the proper application of the maximum local option sales tax on a single article to the taxpayer's sales? Does the single article apply to a total invoice greater than \$1,600, or must each item be billed on the invoice be considered separately?

RULINGS

1. Taxable and nontaxable services must be separately billed if the nontaxable services are not to be taxed.
2. Separate invoices are not required. An itemized sale price for each item, on a single invoice for multiple items, is sufficient.
3. If a "package" price for both taxable and nontaxable items is charged, assuming both the taxable and nontaxable items are essential (that is, one is not merely incidental to the other), the entire package price is subject to tax.¹
4. None of the services described under heading (2) above are subject to sales tax.
5. The charge to the customer for the use of the database is not subject to sales tax.
6. The charge to the customer for the use of the database is not subject to sales tax.

¹ In a case where an ordinarily taxable item is provided incidental to the sale of a nontaxable item, the nontaxable item does not become taxable. Rather, the taxpayer is the user and consumer, and owes tax on its cost, of the incidental item. On the other hand, the provision of a nontaxable item incident to an essential, taxable item would not exempt any portion of the total charge for the taxable item.

7. When the customer provides all the materials, none of the services described under heading (4) above are subject to sales tax.
8. When the customer provides all the materials, except for an address label that is furnished by the taxpayer, none of the services described under heading (4) above are subject to sales tax. The taxpayer is liable for sales or use tax on its cost of the address labels.
9. The addition of catalogues, inserts, and magazines does not cause any of the services performed by the taxpayer to be subject to sales tax.²
10. The services described under heading (6) above are not subject to sales tax.
11. The affixing of a barcode to a customer's envelope as described under heading (7) above is not subject to sales tax.
12. Photocopying services are subject to sales tax, as a sale of tangible personal property.
13. Photocopying services, in instances where the customer furnishes the paper, are subject to sales tax.
14. Laser printing performed in lieu of photocopying is subject to sales tax.
15. For any taxable services performed by the taxpayer, the single article provisions of the local option sales tax are not applicable. For sales of tangible personal property, including sales of tangible personal property that the taxpayer describes as services (e.g., photocopying services) the single article provisions do not appear to apply to this particular taxpayer. The unit of measure would be each printed piece, and it appears the price of any one single piece is less than the \$1,600 base for the maximum local tax.

ANALYSIS

Separate Billing of Taxable and Non-Taxable Items

When a combination of taxable and nontaxable items are sold together, as a practical matter, it is necessary for the seller to bill the taxable and nontaxable components separately, otherwise, the entire charge is subject to sales tax. The definition of "sale price," T.C.A. Sec. 67-6-102(26) is inclusive and does not permit deductions other than those specifically allowed in the definition. See also Saverio v. Carson, 186 Tenn. 166,

² While the ruling request does not specify who furnishes these items, it is assumed they are provided by the customer along with the other materials for the mailing. If the catalogues, inserts, and magazines are furnished by the taxpayer, only the price charged for the catalogues, inserts, and magazines would be subject to sales tax, if the price for the items is separately stated. If the price of the catalogues, inserts, and magazines furnished by the taxpayer is not separately stated, tax would apply in accordance with rulings numbers 1 through 3 above.

208 S.W.2d 1018 (1948). Therefore, if the taxpayer uses a “package” price, rather than separately billing the taxable and nontaxable items, the entire package is considered taxable. However, the use of two or more separate invoices or other billing documents is not required. So long as a separate price is charged for each component of the billing, and the customer has the option to pick and chose among the various components, there is a sufficient separate billing. See Penske Truck Leasing Co., L.P. v. Huddleston, 795 S.W.2d 669 (Tenn. 1990), Tri-City Rentals, Inc. v. Huddleston, S/C No. 84 (Tenn. Sup. Ct., slip opinion, July 1, 1991).

Services, Tangible Personal Property, and Sales Involving
Both Services and Tangible Personal Property

Under the sales tax statutes, the sale of tangible personal property at retail is subject to tax unless such sale is specifically exempted by statute. Cape Fear Paging Co. v. Huddleston, 937 S.W.2d 787 (Tenn. 1990).

Even if the customer provides some or all of the materials used in fabricating tangible personal property, under the provisions of TENN. COMP. R. & REGS. 1320-5-1-.41, the transaction is a sale of tangible personal property, not a sale of services, and any charges for labor or services are not deductible from the sale price.

With respect to services, however, a different rule of what is subject to tax prevails. The sales tax does not apply to all services; it applies only to those services specifically enumerated by the statute. Ryder Truck Rental, Inc. v. Huddleston, 1994 Tenn. App. LEXIS 444. The taxable services are listed in the definition of “retail sale,” T.C.A. Sec. 67-6-102(24)(F).

It should be noted, however, that naming or characterizing a sale as a service does not cause the transaction to escape taxation when the transaction is essentially a transfer of tangible personal property. If the tangible personal property is a “crucial element” of the total transaction, the transaction is a sale of tangible personal property. See Thomas Nelson, Inc. v. Olsen, 723 S.W.2d 621 (Tenn. 1987), Creasy Sys. Consultants v. Olsen, 716 S.W.2d 35 (Tenn. 1986).

Some transactions are essentially sales of services, and the courts have recognized that although property may be transferred to the customer incidental to the sale of nontaxable items, such incidental property does not transform the sale into a taxable sale of tangible personal property. Commerce Union Bank v. Tidwell, 583 S.W.2d 405 (Tenn. 1976). With respect to such “incidental” tangible personal property, the Tennessee Supreme Court has held “when the primary function and purpose of the taxpayer is to provide services, the ownership, use and maintenance of certain types of personal property and equipment are necessary in order to enable it to furnish the services, so that the taxpayer, not its customer, is the ultimate user or consumer within the meaning of sales and use tax statutes.” Nashville Mobilphone Co. v. Woods, 655 S.W.2d 934, 937 (Tenn. 1983).

Applying the above analysis, the taxpayer’s services involving the preparation of statements, envelope stuffing, addressing, affixing postage, sorting, mailing, and the like are essentially services not listed as taxable in the sales tax statute, and therefore are not

subject to sales tax. The taxpayer is the user and consumer of any tangible personal property used in the performance of these services³, and owes a sales or use tax on its purchase of that property.

The taxpayer inquires as to the taxability of charges made to its customers for the use of a database, which from the description given can be described as a targeted mailing list. This database in some cases may belong to the taxpayer, or in other cases may belong to another party for which the taxpayer pays a fee for its use. The charge to the customer is a part of the charge for the mailing services, and as such, is not subject to tax. The Department regards the taxpayer's use of such a database as nontaxable, since the database constitutes information, not tangible personal property. Therefore, no tax is due on the taxpayer's payments for these databases.

For the same reasons the mailing services are not subject to tax, data processing services are not taxable, and sales or use tax is owed on the tangible personal property used in performing the data processing service.

On the other hand, photocopying and laser printing constitute the sale of tangible personal property. This is true even in those cases involving paper provided by the taxpayer's customer.

Maximum Local Option Tax on a Single Article

T.C.A. Sec. 67-6-702(a)(1) provides for a local option sales tax that currently is levied by every county in the state. However, that tax "shall apply only to the first one thousand six hundred dollars (\$1,600) on the sale or use of any single article of personal property." (Emphasis supplied.) This provision applies only to the sale of personal property and does not apply to any taxable services sold by the taxpayer.⁴

The definition of "single article" is found in T.C.A. Sec. 67-6-702(d), which states:

(d) "Single article" means that which is regarded by common understanding as a separate unit exclusive of any accessories, extra parts, etc., and that which is capable of being sold as an independent unit or as a common unit of measure, a regular billing or other obligation. Such independent units sold in sets, lots, suites, etc., at a single price shall not be considered a single article. [Language specific to motor vehicles, boats, and manufactured homes omitted.]

Pursuant to the above-quoted definition, each unit in a job performed by the taxpayer (for example, a photocopying job involving many individual copies) is an independent unit. The proper measure for the maximum local tax base is each page or copy, not each invoice or each line item on the invoice. Therefore, it appears that the maximum local option sales tax does not apply to sales by this taxpayer.

³ For example, on the address labels provided by the taxpayer mentioned in heading (4) above.

⁴ As explained previously, those services sold by the taxpayer that are described in the ruling request do not appear to be taxable as taxable services.

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APPROVED: Ruth E. Johnson
Commissioner

DATE: 7/27/00