

**TENNESSEE DEPARTMENT OF REVENUE
LETTER RULING # 13-25**

Letter rulings are binding on the Department only with respect to the individual taxpayer being addressed in the ruling. This ruling is based on the particular facts and circumstances presented, and is an interpretation of the law at a specific point in time. The law may have changed since this ruling was issued, possibly rendering it obsolete. The presentation of this ruling in a redacted form is provided solely for informational purposes, and is not intended as a statement of Departmental policy. Taxpayers should consult with a tax professional before relying on any aspect of this ruling.

SUBJECT

The application of the Tennessee business tax to a service provider.

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

[TAXPAYER] (the "Taxpayer") is a [COMPANY] with its principal place of business in [CITY], Tennessee. The Taxpayer provides central reservation services and other management services to independent hotels and small chains (the "Clients") in the lodging industry with properties located throughout the United States as well as in international locations.

The Taxpayer provides four basic services to its Clients: [REDACTED] ("Primary Services"). In conjunction with several of its Primary Services, as applicable, the Taxpayer charges its Clients additional fees for transaction costs, connectivity, and account setup ("Additional Fees"). The

Taxpayer also offers to its Clients that purchase any of its Primary Services a variety of optional, supplementary services (“Elective Services”). The Primary Services, Additional Fees, and Elective Services are described more fully below.

[ALL OF THE TAXPAYER’S PRIMARY SERVICES ASSIST ITS CLIENTS IN RECEIVING ROOM RESERVATIONS FROM TRAVELERS AND TRAVEL AGENTS].

A Client that utilizes one or more of the Taxpayer’s Primary Services may request that the Taxpayer perform any number of elective services (“Elective Services”) for supplementary charges. The Taxpayer’s Elective Services include sending fax confirmations, making manual room rate change requests, providing a software interface between the Taxpayer’s system and a property management system utilized by a Client, providing revenue management consulting, allowing a hotel to forward its front desk calls to the Taxpayer’s call center, and providing a competitive rate shopping service to a Client. The Taxpayer estimates that its Elective Services generate less than 10% of its total revenue.

RULINGS

1. Are the Taxpayer’s Primary Services and Elective Services taxable under the Tennessee Business Tax Act?

Ruling: Yes.

2. Are the Additional Fees that the Taxpayer charges its Clients in conjunction with its services subject to the Tennessee business tax?

Ruling: Yes.

3. For purposes of the Tennessee business tax, is the Taxpayer allowed a deduction from gross receipts for services performed for its Clients that are located outside of Tennessee?

Ruling: For tax periods beginning on or after January 1, 2014, the Taxpayer may deduct from its gross receipts any fees, commissions, and charges associated with services that it performs that a customer receives at a location outside of Tennessee. Any fees, commissions, and charges associated with services received by a customer at a location inside of Tennessee remain part of the tax base subject to the Tennessee business tax.

ANALYSIS

- 1-2. Primary Services and Elective Services; Additional Fees

The Taxpayer’s Primary Services and Elective Services are subject to the Tennessee business tax. The Additional Fees that the Taxpayer charges its Clients in conjunction with its services are also subject to the Tennessee business tax.

The Tennessee Business Tax Act¹ is one component of Tennessee’s broader privilege and excise taxation statutes. The Act imposes, in certain instances, a tax on the privilege of making sales by engaging in any business activity described in TENN. CODE ANN. § 67-4-708(1)-(4) (2013).

The Act was modified in several respects by the Uniformity and Small Business Relief Act of 2013,² which is effective for tax periods beginning on or after January 1, 2014.³ This ruling will address the issues by applying the law as applicable under the Uniformity and Small Business Relief Act of 2013.⁴

A taxpayer is classified under TENN. CODE ANN. § 67-4-708 according to its “dominant business activity,” and this classification determines the rate of the business tax.⁵ The term “dominant business activity” is defined for business tax purposes under TENN. CODE ANN. § 67-4-702(a)(5) (2013) as “the business activity that is the major and principal source of taxable gross sales of the business.” The Department has issued guidance interpreting “dominant business activity” to mean “[t]he item comprising the largest proportion of gross sales of the business when compared with other items sold.”⁶

“Persons”⁷ whose dominant business activity is “making sales of services or engaging in the business of furnishing or rendering services” are included within Classification 3.⁸

¹ Tennessee Business Tax Act, ch. 387, §§ 1-27, 1971 Tenn. Pub. Acts 994, 994-1019 (codified as amended at TENN. CODE ANN. §§ 67-4-701 to -730 (2013)).

² Uniformity and Small Business Relief Act of 2013, ch. 313, §§ 1-23, 2013 Tenn. Pub. Acts (codified in various sections of Part 7 of Chapter 4 of Title 67).

³ *Id.* at § 23.

⁴ More information about the Uniformity and Small Business Relief Act of 2013 may be found on the Department’s website, available at <http://tn.gov/revenue/legsumm/2013legsumm.shtml#bizpc313> (last visited Oct. 23, 2013).

⁵ TENN. CODE ANN. § 67-4-709 (2013).

⁶ TENN. COMP. R. & REGS. 1320-4-5-.15 (1974). When a business engages in taxable activities enumerated in TENN. CODE ANN. § 67-4-708(1)-(4) (2013), yet the item comprising the largest proportion of gross sales does not fall within any of those classifications, the business is not exempt. *Hermitage Memorial Gardens Mausoleum & Memorial Chapel v. Dunn*, 541 S.W.2d 147 (Tenn. 1976). Applying a previous version of the Tennessee Business Tax Act, the Tennessee Supreme Court ruled that “[a]ll entities who make sales by engaging in any of the business activities enumerated in § 67-5805 [now codified, as amended, at TENN. CODE ANN. § 67-4-708 (2013)] are subject to the tax,” and that “[t]he dominant business activity of a taxpayer is relevant only in determining which of the classifications in § 67-5805 applies to him.” *Id.* at 149.

⁷ “Person” is broadly defined to include “any individual, firm, partnership, joint venture, association, corporation, estate, trust, business trust, receiver, syndicate, or other group or combination acting as a unit, and the plural as well as the singular number.” TENN. CODE ANN. § 67-4-702(a)(12) (2013).

⁸ TENN. CODE ANN. § 67-4-708(3)(C) (2013). The Taxpayer’s Primary Services and Elective Services, which can be summarily described as reservation and management services, do not fall within any of the sixteen enumerated exceptions from Classification 3 set forth in TENN. CODE ANN. § 67-4-708(3)(C)(i)-(xvi).

The Taxpayer offers four Primary Services to its Clients. It also offers a variety of Elective Services that Clients may add to their Primary Services depending upon their needs. As such, the Taxpayer is exercising the taxable privilege of making sales by engaging in a business activity described in TENN. CODE ANN. § 67-4-708. More specifically, TENN. CODE ANN. § 67-4-708(3)(C) places the Taxpayer under Classification 3 because the Taxpayer's dominant business activity is making sales of services.

Accordingly, the Taxpayer is subject to the business tax with respect to its gross sales under Classification 3. The Taxpayer's gross sales will include receipts from sales of the Primary Services and the Elective Services, and the Additional Fees. The Taxpayer's Primary Services and Elective Services, and the Additional Fees, are thus subject to the Tennessee business tax.

3. Deduction for services received by a customer outside of Tennessee

For tax periods beginning on or after January 1, 2014, to compute the business tax, the Taxpayer may deduct from its gross sales any receipts for services received by a customer at a location outside of Tennessee.

The business tax applies to the gross sales of entities engaging in activities subject to the tax.⁹ "Gross sales" is defined as "the sum total of all sales . . . without any deduction whatsoever of any kind or character, except as provided in [the Business Tax Act]."¹⁰ The actual computation of the gross sales, however, depends on the total sales price of property or services sold.¹¹ TENN. CODE ANN. § 67-4-702(a)(18) defines "sales price" as "the total amount for which tangible personal property or services rendered is sold . . . without any deduction from the price on account of the cost of the property sold, the cost of materials used, labor or service cost, losses, or any other expense whatsoever."¹² TENN. COMP. R. & REGS. 1320-4-5-.08(2) (1974) clarifies that the business tax "is based upon actual consideration passed, or agreed to be passed between the purchaser and the vendor."

For purposes of computing the business tax, TENN. CODE ANN. § 67-4-711(a) (2013) allows for the deduction of certain items from the tax base. Effective January 1, 2014, one such deduction is for "[s]ales of services that are received by customers located outside the state."¹³ Thus, the appropriate inquiry concerns the receipt of the service and the location of the taxpayer.

The Taxpayer's Clients are single independent hotels and small hotel chains. Determination of deductibility involves little analysis if the Taxpayer's Client is located wholly inside or outside

⁹ *Aabakus*, 1996 WL 548148, at *5 (citing TENN. CODE ANN. § 67-4-709(b)(3) (1994); TENN. COMP. R. & REGS. § 1320-4-5-.08(2) (1984)).

¹⁰ TENN. CODE ANN. § 67-4-702(a)(7).

¹¹ TENN. COMP. R. & REGS. 1320-4-5-.08(2); *see also Aabakus*, at *5.

¹² *See also* TENN. COMP. R. & REGS. 1320-4-5-.08(1) (defining "sales price" similarly).

¹³ TENN. CODE ANN. § 67-4-711(a)(6) (2013) (effective January 1, 2014).

of Tennessee. When the Taxpayer's Client is an independent hotel located outside of Tennessee, the Taxpayer may deduct from gross sales its receipts from services rendered to that hotel. Moreover, when the Taxpayer's Client is a small hotel chain with both its base of operations and all of its hotels located outside of Tennessee, the Taxpayer may deduct from gross sales its receipts from services provided. On the other hand, when the Taxpayer's Client is an independent hotel located in Tennessee or a small hotel chain both with a Tennessee base of operations and all hotels within the chain located in Tennessee, the Taxpayer is not entitled to a deduction for the sale of any services it provides.

Further examination, however, is necessary when the Taxpayer's Client is located both inside and outside of Tennessee. In those situations where a small hotel chain has its base of operations in Tennessee and at least one hotel located outside of Tennessee, or vice versa, it is necessary to determine whether the service provided is received at the location of a particular hotel. If the service is received at a particular hotel location, the Taxpayer must look at that hotel's location to determine deductibility for purposes of the business tax. If the service is not received at a particular hotel location but rather by the hotel chain as a whole, the Taxpayer must look to the location of the chain's base of operations to determine deductibility.¹⁴

For example, if a taxpayer provides hotel room cleaning services to a hotel located in Nashville, Tennessee, but which is part of a hotel chain based in Houston, Texas, the service is clearly provided to the customer at its location in this state. Such sales would not be deductible. Much like hotel room cleaning services, which are specifically received at a particular hotel location, services that make reservations at a particular hotel are likewise received by that specific hotel. With regard to the Taxpayer's sale of Primary Services, which are billed as either a flat fee per completed reservation or a percentage of the actual room reservation, a deduction from gross sales is appropriate if the hotel associated with a reservation is located outside of Tennessee, regardless of the location of the chain's base of operations.

With regard to Elective Services, a deduction is appropriate if the services are provided to a specific hotel location outside of Tennessee. Such Elective Services include: sending fax confirmations; making manual room rate change requests; and allowing a hotel to forward its front desk calls to the Taxpayer's call center.

For Elective Services that are not specifically provided to any particular hotel, but rather are provided generally to the Client, the Taxpayer should look to the location of the chain's base of operations to determine deductibility. If the chain's base of operations is outside Tennessee, a deduction is appropriate. Such Elective Services include: providing a software interface between the Taxpayer's system and a property management system utilized by a Client; providing revenue management consulting; and providing a competitive rate shopping service to a Client.

The Additional Fees at issue are not specifically provided to any particular hotel, and, as such, a deduction from gross sales is appropriate if the chain's base of operations is located outside of Tennessee.

¹⁴ Note that the location of the servers on which the Taxpayer's services are electronically transmitted and the locations of travelers making reservations have no impact on this determination.

Accordingly, for business tax periods beginning on or after January 1, 2014, the Taxpayer may deduct from its gross sales any fees, commissions, and charges associated with services that a customer receives at a location outside of Tennessee.¹⁵ Any fees, commissions, and charges associated with services received by a customer at a location inside Tennessee remain part of the tax base subject to the business tax.

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APPROVED: Richard H. Roberts
Commissioner of Revenue

DATE: December 20, 2013

¹⁵ The Taxpayer, properly falling within Classification 3 according to its dominant business activity, may begin to deduct the sale of services received by customers outside Tennessee from the business tax base for the tax period that begins July 1, 2014. *See* TENN. CODE ANN. § 67-4-715(a)(3) (2013).