

**TENNESSEE DEPARTMENT OF REVENUE  
LETTER RULING # 12-19**

**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**

The application of the Tennessee sales and use tax to certain information technology staffing 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**

[TAXPAYER] (the "Taxpayer") provides staff augmentation services to a variety of client companies located throughout the United States and the State of Tennessee. The workers provided by the Taxpayer's staff augmentation business supplement a client company's existing information technology ("IT") and related needs workforce by providing services such as software development, help desk operation, data base administration, and business analysis. The Taxpayer's staff augmentation business enables its client companies to add or remove workers to their existing staffs as needed, thereby avoiding the costs associated with recruiting, training, and hiring new employees with the specialized skill sets needed for a particular task, especially when

the need for such supplemental IT staff is relatively short-term. To avoid those costs, the Taxpayer's staff augmentation business allows its client companies to supplement or augment their existing IT and related workforces with temporary contract employees who work side-by-side with and under the direction, supervision, and control of the client company's own IT managers and employees. On occasion, the Taxpayer's contract employees will incur expenses such as meal and travel costs that the client companies will reimburse to the Taxpayer.

Typically, a client company's staff augmentation needs arise as a result of (i) scheduling demands with respect to a specific, ongoing, long-term IT function, project, or support activity with fluctuating human resource demands, (ii) insufficient in-house expertise when the current project team of a client company's internal employees would benefit from the assistance of an individual who has been trained in some new information technology application or discipline, or (iii) an intensive, short-term IT project requiring supplemental IT and related services staff. In each of these circumstances, the hiring of internal employees for such relatively short-term or temporary assignments with the client companies (with all the complexity associated with the hiring and terminating of those individuals) is simply too costly, burdensome and inefficient for the client companies. As a result, the client companies utilize the contract employees provided by the Taxpayer's staff augmentation business to fill their temporary IT and related needs.

Once contract employees provided by the Taxpayer's staff augmentation business are assigned to a client company, the day-to-day activities, the projects to be completed, the deadlines for such projects, and other relevant information concerning the actual work to be performed by the contract employees is controlled and directed solely by employees of the client companies, typically a client company's IT manager. The Taxpayer, on the other hand, has no involvement in defining the scope of such activities or the manner in which such activities are carried out on a day-to-day basis. The only contact the Taxpayer has with contract employees while they are assigned to client companies is delivering the individuals a paycheck on a weekly basis and casual and very general inquiries into how everything is going for the contract employee.

The staffing of a particular task or assignment is controlled entirely by the client companies. In most instances, the client companies choose to rely on a team concept pursuant to which an individual provided by the Taxpayer becomes part of a larger team of individuals working on a specific IT or related project or task, at all times under the direction and control of one of the client companies' IT managers. The client company teams frequently consist of a combination of client company internal employees and contract employees (some of whom may have been provided by the Taxpayer and some of whom may have been provided by a competitor of the Taxpayer). These client company project teams generally consist of no fewer than two individuals and up to as many as forty individuals. In all cases, these project teams are under the direction, supervision, and control of a client company's IT manager who is responsible for carrying out the specific IT or related project or task performed by the teams. The client companies also provide contract employees with all of the hardware, software, materials, and supplies needed to perform the various tasks and assignments the client companies' IT project managers assign to the contract employees.

Client company employees also oversee the contract employees' work schedules. The contract employees provided by the Taxpayer are required to maintain time records that are turned into a client company's IT manager for approval before being sent to the Taxpayer on Monday of each

week. Vacation days, sick days, and personal days are typically worked out between a contract employee and the client company's IT manager to whom they are assigned, with notification provided to the Taxpayer after the fact.

The length of a contract employee's assignment with a client company is also controlled by the client company to whom the individual has been assigned. Typically, the individuals are contracted to be assigned to a client company for an estimated period of time, usually [TERM], but those initial terms are commonly increased or extended at the request of the client company for one or more additional estimated [TERMS]. Consequently, it is quite common to have contract employees placed with a single client company for periods of eighteen months or longer, depending on the scope and nature of a particular assignment, all as determined by the client company.

To conduct its temporary staffing or staff augmentation business, the Taxpayer has, in addition to its corporate offices in [CITY, STATE], more than [REDACTED] branch offices located in [COUNTRIES]. The Taxpayer has full-time internal employees working in each of these offices dedicated to the operation of its staff augmentation business. These employees are responsible for locating contract employees to place with client companies and for meeting with the client companies to discuss their needs for contract employees.

The Taxpayer's internal employees are also responsible for the payment of the contract employees' hourly wages and for all tax reporting, workers compensation, and employee benefits associated with those contract employees. The Taxpayer's internal employees at no time direct, supervise or control the contract employees in the performance of their day-to-day activities. All such day-to-day direction, supervision and control is exercised exclusively by the client companies' IT managers.

## **RULINGS**

1. Apart from the fabrication of software, are any other services performed for a client company by the Taxpayer's contract employees subject to the Tennessee sales and use tax?

Ruling: Yes. In addition to the fabrication of software for a client company, all repair and installation of tangible personal property or computer software performed by the Taxpayer's contract employees for a client company are subject to the Tennessee sales and use tax.

2. When a contract employee of the Taxpayer fabricates software and performs nontaxable services for a client company, must the Taxpayer separately itemize on invoices the taxable fabrication of software and the nontaxable services in order for the amounts paid for the nontaxable services to be exempt from sales and use taxes?

Ruling: Yes. If a contract employee of the Taxpayer fabricates software or performs a taxable service and also performs nontaxable services for a client company, the Taxpayer must separately itemize on invoices the taxable fabrication of software or taxable service

and the nontaxable services in order for the amounts paid for the nontaxable services to be exempt from sales and use taxes.

3. Are the amounts paid for computer software fabrication by the Taxpayer's contract employees, when performed for an exempt entity, exempt from Tennessee sales and use taxes?

Ruling: Yes. Amounts paid for computer software fabrication by the Taxpayer's contract employees, when performed for an exempt entity, are exempt from Tennessee sales and use taxes. However, such sales must be accompanied by the appropriate exemption certificate.

4. If the Taxpayer uses a passthrough or intermediary staff augmentation company, commonly referred to in the industry as a vendor manager or workforce management company, to provide a client company with contract employees, which charges will be taxable?

Ruling: The retail sale of tangible personal property, including the fabrication of computer software, and the retail sale of taxable services are subject to the Tennessee sales and use tax, regardless of whether sold or performed by the Taxpayer or a vendor manager.

5. Are travel costs, meal costs and other similar reimbursable expenses that are paid by a client company with respect to a contract employee subject to the Tennessee sales and use taxes?

Ruling: Travel costs, meal costs and other similar expenses incurred by the Taxpayer's contract employees in the course of providing services to the client company and reimbursed to the Taxpayer by the client company, are part of the total sales price. Thus, if the sale is taxable, the reimbursements are taxable as part of the sales price, and if the sale is nontaxable, the reimbursements are nontaxable.

## ANALYSIS

Under the Retailers' Sales Tax Act, TENN. CODE ANN. §§ 67-6-101 to -907 (2011), retail sales of tangible personal property in Tennessee are subject to sales and use tax. TENN. CODE ANN. § 67-6-102(78) (2011) defines a "retail sale" as a "sale, lease, or rental for any purpose other than for resale, sublease, or subrent." The term "sale" is defined under the Tennessee sales and use tax laws in pertinent part as "any transfer of title or possession, or both, lease or licensing, in any manner or by any means whatsoever of computer software for consideration, and includes the creation of computer software on the premises of the consumer and any programming, transferring or loading of computer software into a computer." TENN. CODE ANN. § 67-6-102(80)(K). TENN. CODE ANN. § 67-6-231(a) (2011) specifically provides that the retail sale of computer software is subject to the Tennessee sales and use tax "regardless of whether the software is ... created on the premises of the consumer."

However, "the fabrication of computer software by a person, or its direct employee, for the person's own use and consumption" is exempt from the Tennessee use tax. TENN. CODE ANN.

§ 67-6-387 (2011). TENN. CODE ANN. §67-6-387 provides that the exemption does not apply if the computer software “is fabricated by any agent of the person using the computer software unless the agent is also a direct employee of the person.”<sup>1</sup>

The Retailers’ Sales Tax Act also imposes the sales tax on certain services. The sales tax does not apply to all services; rather, it only applies to retail sales of those services specifically enumerated by the statute. *Ryder Truck Rental, Inc. v. Huddleston*, No. 91-3382-III, 1994 WL 420911 (Tenn. Ct. App. Aug. 12, 1994). These specifically taxable services include the installation and repair of tangible personal property, including computer software. TENN. CODE ANN. § 67-6-205(c)(4)&(6) (2011).

Even if a service is not specifically enumerated by the statute, the service may be subject to the sales tax where charges for the service are included in the sales price of a taxable good or service. Specifically, TENN. CODE ANN. § 67-6-102(81)(A) (2011) provides that the sales price of a good or service equals the “total amount of consideration . . . for which personal property or services are sold,” without any deduction for such things as the seller’s cost of the property, the cost of the materials, the seller’s travel costs, and other such expenses of the seller. Thus, when the sale of a non-enumerated service is part of the sale of a taxable good or service, the charges for the non-enumerated service are included in the sales price of the taxable good or service and as such are subject to taxation.

#### *1. Computer software fabrication and staffing service sales*

In addition to the fabrication of software for a client company, all repair and installation of tangible personal property or computer software performed by the Taxpayer’s contract employees for a client company are subject to the Tennessee sales and use tax.

In general, the retail sale or use of computer software, regardless of whether it is created on the premises of the consumer, is subject to the Tennessee sales and use tax. TENN. CODE ANN. § 67-6-231(a) (2011). A retail sale is any sale that is not for resale. TENN. CODE ANN. § 67-6-102(78) (2011). A sale is defined in pertinent part as “any transfer of title or possession, or both, lease or licensing, *in any manner or by any means whatsoever* of computer software for consideration, and *includes the creation of computer software on the premises of the consumer* and any programming, transferring or loading of computer software into a computer.” TENN. CODE ANN. § 67-6-102(80)(K). (Emphasis added.) Thus, if the Taxpayer creates computer software on the premises of its customers and receives a consideration, then such creation is subject to the Tennessee sales tax as a retail sale of computer software.

The contract employees of the Taxpayer work on the premises of the Taxpayer’s client companies. Many of these contract employees create software for the client companies. This creation of software is considered a retail sale of software and is subject to the Tennessee sales tax, and the Taxpayer must collect the tax from its customers. The taxable creation of software

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<sup>1</sup> TENN. CODE ANN. § 67-6-387 provides that for purposes of this exemption, “direct employee” is defined as “an employee to whom the person is obligated to issue a federal form W-2, wage and tax statement, and with respect to whom the person has responsibility for withholding taxes under the Federal Insurance Contributions Act, compiled in 26 U.S.C. §§ 3101-3126, or such other entity or affiliate that upon petition to the commissioner has been approved as having that responsibility under this section.”

also includes any programming software and any transferring or loading of computer software onto the client companies' computers.

However, some of the Taxpayer's contract employees provide services other than the creation or programming of computer software or the loading of such software onto computers. Such services include but are not limited to telephone assistance services, technical services, installation services, and repair services. In Tennessee, generally, the provision of services for a consideration is not subject to the sales tax unless specifically enumerated in the statute. TENN. CODE ANN. § 67-6-205(c)(1)-(10) (2011).

Retail sales of "[t]he performing, for a consideration, of any repair services with respect to any kind of tangible personal property or computer software" and "[t]he installing of tangible personal property that remains tangible personal property after installation and the installing of computer software, where a charge is made for the installation" are subject to sales tax. TENN. CODE ANN. § 67-6-205(c)(4)&(6). Thus, the installing and repairing of tangible personal property, including computer software, by the Taxpayer's contract employees is taxable.

However, according to the facts provided by the Taxpayer, none of the additional services provided by the Taxpayer's contract employees for its client companies are specifically enumerated by the statute and thus generally are not subject to the Tennessee sales tax. If, however, the charges for the nontaxable services are included in the sales price of the creation or programming of computer software, the loading of such software onto computers, or the repair or installation of any tangible personal property or software, then the entire sales price will be subject to the sales tax. *See* TENN. CODE ANN. § 67-6-102(81)(A).

## 2. *Separate itemization on invoices*

If a contract employee of the Taxpayer fabricates software or performs a taxable service and also performs nontaxable services for a client company, the Taxpayer must separately itemize on invoices the taxable fabrication of software or taxable service and the nontaxable services in order for the amounts paid for the nontaxable services to be exempt from sales and use tax.

As stated previously, if the sale for a nontaxable service is included in the sale of a taxable good or service, then the entire sales price will be subject to the Tennessee sales tax. TENN. CODE ANN. § 67-6-102(81)(A) (2011). Thus, when the sale of a service that is not enumerated by the statute is part of the sale of a taxable good or service, the charges for the non-enumerated service are included in the sales price of the taxable good or service and as such are subject to taxation.

However, if the nontaxable service is separate and optional from sale of the taxable good or service, and the two are separately itemized on the invoice, then the nontaxable service will not be subject to the Tennessee sales tax. *See Penske Truck Leasing Co. v. Huddleston*, 795 S.W.2d 669, 671 (Tenn. 1990); *TomKats Catering, Inc. v. Johnson*, No. M2000-03107-COA-R3-CV, 2001WL 1090516, at \*2-3 (Tenn. Ct. App. Sept. 19, 2001).

## 3. *Sales to exempt entities*

Amounts paid for computer software fabrication by the Taxpayer's contract employees, when performed for an exempt entity, are exempt from Tennessee sales and use taxes.

As explained in the analysis to Ruling #1, the retail sale of computer software generally is subject to the Tennessee sales and use tax. TENN. CODE ANN. § 67-6-231(a). However, certain entities are exempt from paying the Tennessee sales and use tax. See TENN. CODE ANN. § 67-6-322 (2011). If the Taxpayer fabricates and sells computer software to an exempt entity, such sale will not be subject to the Tennessee sales and use tax. However, such sales must be accompanied by the appropriate exemption certificate. TENN. COMP. R. & REGS. 1320-5-1-.78(1) (1974) (“Rule 78”) provides that dealers making otherwise taxable sales to purchasers on a tax-exempt basis must obtain and keep appropriate exemption certificates. Rule 78(2) states that “all sales where an exemption has been claimed, but which are not supported by exemption certificates, will be deemed retail sales, and the dealer will be held liable” for any sales and use tax due.

#### *4. Use of a vendor manager*

The retail sale of tangible personal property, including the fabrication of computer software, and the retail sale of taxable services are subject to the Tennessee sales and use tax, regardless of whether sold or performed by the Taxpayer or a vendor manager.

Generally, the taxability of a sale is not determined by what entity is making that sale. Therefore, if a vendor manager is selling the same tangible personal property or performing the same services as the Taxpayer’s contract employees, then the same analysis for Ruling #1 will apply to the sales of the vendor manager.

#### *5. Reimbursed expenses*

Travel costs, meal costs and other similar expenses incurred by the Taxpayer’s contract employees in the course of providing services to the client company, and reimbursed to the Taxpayer by the client company, are part of the total sales price. Thus, if the sale is taxable, the reimbursements are taxable as part of the sales price, and if the sale is nontaxable, the reimbursements are nontaxable.

When a taxable sale is made, the sales tax is imposed upon the sales price. TENN. CODE ANN. §67-6-202. “Sales price” is defined in pertinent part as “the total amount of consideration..., for which personal property or services are sold,” with no deduction for expenses of the seller in making the sale, including labor costs. TENN. CODE ANN. §67-6-102(81)(A). Thus, if a taxable sale is made, the total amount paid to the seller, including amounts covering any expenses incurred by the seller in making the sale, is subject to the sales tax. This is true even if the different amounts are separately stated on the invoice. However, if a sale is not a taxable sale, then the amount charged for reimbursable expenses also would not be taxable.

As discussed previously, the Taxpayer’s taxable services include the fabrication of software as well as the repair and installation of tangible personal property. The reimbursed expenses incurred in making these sales are included in the sales price and are subject to the sales tax. However, the reimbursed expenses incurred in making sales of the Taxpayer’s nontaxable services are not subject to the sales tax.

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