

**TENNESSEE DEPARTMENT OF REVENUE  
LETTER RULING # 13-09**

**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 sales and use tax to services and licensing rendered to [LESSEES OF TANGIBLE PERSONAL PROPERTY].

**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 Tennessee [BUSINESS] that operates a [REDACTED] company. As part of its operations, the Taxpayer utilizes independent [CONTRACTING PARTIES] that are not employees of the Taxpayer.

The Taxpayer enters into a contract (the “Contract”)<sup>1</sup> with each independent [CONTRACTING PARTY]. This Contract includes the Taxpayer’s agreements with the [CONTRACTING PARTIES] regarding the lease of [TANGIBLE PERSONAL PROPERTY] and [REDACTED] equipment to [CONTRACTING PARTIES] in Tennessee, found in a portion of the Contract labeled “LEASE OF [TANGIBLE PERSONAL PROPERTY].” The Contract also provides for certain services and other benefits for the [CONTRACTING PARTIES] under the heading [REDACTED] (the “Services and the License”). The Taxpayer states that it does not require a [CONTRACTING PARTY] to lease the Taxpayer’s [TANGIBLE PERSONAL PROPERTY], and will furnish the Services and License to individuals owning their own [TANGIBLE PERSONAL PROPERTY].

The Services, found in section [REDACTED] of the Contract titled [REDACTED], include training, [REDACTED], [REDACTED], bookkeeping, record keeping,<sup>2</sup> and accounting services. The Taxpayer also provides “marketing” and “advertising” services.<sup>3</sup> The Taxpayer has stated that although it handles the advertising, the [CONTRACTING PARTIES] are allowed to advertise on their own and are allowed to customize some of the materials provided by the Taxpayer. In addition, the Taxpayer has stated that it provides “coupons or promotions” to the [CONTRACTING PARTIES] as part of its advertising efforts.

The License includes the use of the Taxpayer’s “goodwill and trade name.” Towards this end, section [REDACTED] of the Contract permits the [CONTRACTING PARTIES] to use the Taxpayer’s name on business cards. [CONTRACTING PARTIES] are restricted, however, from infringing on the Taxpayer’s trademark, despite sometimes being allowed to customize the advertising materials.

## RULING

Is the Taxpayer’s sale of Services and the License subject to Tennessee sales and use tax?

Ruling: Yes. The Taxpayer’s sale of Services and the License is subject to the Tennessee sales and use tax when provided with [TANGIBLE PERSONAL PROPERTY] and/or [REDACTED] equipment.

## ANALYSIS

When the Retailers’ Sales Tax Act was first passed in 1947, it proclaimed that the legislative intent was “that every person is exercising a taxable privilege who . . . rents or furnishes any of

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<sup>1</sup> [REDACTED]

<sup>2</sup> [REDACTED]

<sup>3</sup> Section [REDACTED] of the Contract states: “[REDACTED].”

the things or services taxable under this Act.”<sup>4</sup> One of the things taxable under the Act was the “lease or rental of tangible personal property” by or incidental to an established business.<sup>5</sup>

Shortly after the Act’s passage, the Tennessee Supreme Court had occasion to review the application of the lease provisions of the act to a business’s rental of diapers. The plaintiff in *Saverio v. Carson* operated a laundry service business that also rented cloth diapers.<sup>6</sup> According to the plaintiff, a significant portion of the cost associated with such rentals was actually for the service of “collecting, delivering and laundering diapers, rather than the rental return upon the original purchase price.”<sup>7</sup>

The Court nevertheless rejected the plaintiff’s contention that such rentals should not be subject to tax, holding that “[t]he measure of the tax is the gross proceeds of the rental paid by the lessee to the lessor without any deduction for service charges, regardless of how small may be the percentage of the return on the property rented.”<sup>8</sup> The Court also stated that the “statute is plain in that the tax must be paid on the final rental or selling price, even though this price includes service charges.”<sup>9</sup>

Although the sales tax statutes have changed over the years, much has remained the same. It is still the legislative intent to impose the sales and use tax on the “sales price of all leases and rentals of tangible personal property . . . in this state”<sup>10</sup> by or incidental to an established business.<sup>11</sup> And like the original definition of sales price, the current statute defines “sales price” as “the total amount of consideration, including cash, credit, property, and services, for which personal property or services are sold, leased, or rented, value in money,” but without any deduction for “service cost[s]” or “[c]harges by the seller for any services necessary to complete the sale.”<sup>12</sup>

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<sup>4</sup> Tennessee Retailers’ Sales Tax Act, ch. 3, § 3, 1947 Tenn. Pub. Acts 22, 26.

<sup>5</sup> Tennessee Retailers’ Sales Tax Act, ch. 3, § 3(c), 1947 Tenn. Pub. Acts at 27; *see also* Tennessee Retailers’ Sales Tax Act, ch. 3, § 3(d), 1947 Tenn. Pub. Acts at 27 (imposing the tax on the monthly lease or rental price paid by the lessee).

<sup>6</sup> 208 S.W.2d 1018, 1018 (Tenn. 1948).

<sup>7</sup> *Id.* at 1018-19.

<sup>8</sup> *Id.* at 1019.

<sup>9</sup> *Id.* (citing Tennessee Retailers’ Sales Tax Act, ch. 3, § 2(d), 1947 Tenn. Pub. Acts at 24 (including “any services that are a part of a sale” as part of the “sales price” definition)).

<sup>10</sup> “Tangible personal property” is defined as “personal property that can be seen, weighed, measured, felt, or touched, or that is in any other manner perceptible to the senses.” Tenn. Code Ann. § 67-6-102(89)(A) (Supp. 2012).

<sup>11</sup> *See* TENN. CODE ANN. § 67-6-204(a) (2011); *see also* TENN. CODE ANN. § 67-6-102(78)(A) (Supp. 2012) (defining “sale” in pertinent part as “any transfer of title or possession, or both, exchange, barter, *lease or rental*, conditional or otherwise, in any manner or by any means whatsoever of tangible personal property for a consideration.” (emphasis added)).

<sup>12</sup> TENN. CODE ANN. § 67-6-102(79)(A)(ii)-(iii) (Supp. 2012).

In other words, the general rule remains that leases or rentals that also involve services are taxed on the entire amount of the lease. Practically, the tax is levied on the “sales price derived from the lease or rental of tangible personal property.”<sup>13</sup> But if the lessee or renter pays on an installment basis, rather than in a lump sum, TENN. CODE ANN. § 67-6-204(a)(2) imposes the tax on each installment payment when due, rather than on the entire lease at the beginning of the lease term.<sup>14</sup> As further explained in TENN. COMP. R. & REGS. 1320-5-1-.32(2) (2008), the terms of the contract establish the basis for computing the tax, be it a lump sum or periodic payment.

Notwithstanding the general rule, however, there is one unique circumstance where Tennessee courts have disallowed the taxation of certain goods or services accompanying the transfer of tangible personal property pursuant to a lease: where two separate and divisible agreements are embodied in a single contract.

The seminal case to invoke this standard, *Penske Truck Leasing Co. v. Huddleston* involved a taxpayer that leased vehicles to customers under a “lease and service” agreement.<sup>15</sup> In addition to providing the terms relating to the lease of the vehicle, the agreement also provided the lessee with the option of purchasing fuel for the leased vehicles from the taxpayer, or of purchasing fuel from other vendors.<sup>16</sup>

To decide whether the fuel purchase portion of the contract should be included in the “gross proceeds”<sup>17</sup> of the lease and would therefore be subject to tax, the Court looked to whether the terms of the agreement related to the purchase of fuel were separate and divisible from the rest of the lease.<sup>18</sup> The Court determined that it was.<sup>19</sup>

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<sup>13</sup> TENN. CODE ANN. § 67-6-204(a)(1); *see also* TENN. COMP. R. & REGS. 1320-5-1-.32(1) (2008) (“The tax shall be computed on the gross receipts, gross proceeds, or rental payable without any deduction whatsoever for expense incident to the conduct of business.”)

<sup>14</sup> This approach accords with the original imposition of the tax in 1947 by the Tennessee Retailer’s Sales Tax Act, ch. 3, § 3(c)-(d), 1947 Tenn. Pub. Acts at 27. The Taxpayer suggests that the amount “contracted or agreed to be paid by lessee or renter,” *see* TENN. CODE ANN. § 67-6-204(a)(2), should establish the tax base such that taxpayers can control whether a transaction is taxed by careful drafting. As the *Saverio* Court warned, however, such “an attempted division or separation of the charge for services rendered would result in confusion in the administration of the Act and render the law unworkable.” *Saverio*, 208 S.W.2d at 1018.

<sup>15</sup> 795 S.W.2d 669, 670 (Tenn. 1990).

<sup>16</sup> *Id.* at 670.

<sup>17</sup> The Court’s analysis is derived from the imposition of the tax on the “gross proceeds” of a lease under the then-current TENN. CODE ANN. § 67-6-204(a). The term “gross proceeds” has since been replaced by the term “sales price.” *Compare* TENN. CODE ANN. § 67-6-204(a) (1989) (“gross proceeds”), *with* TENN. CODE ANN. § 67-6-204(a) (2011) (“sales price”). The analytical framework remains valid, however.

<sup>18</sup> *Id.* at 671.

<sup>19</sup> *Id.*

Importantly, the Court based its holding on the fact that the parties to the lease and service agreement intended and understood that the lease of equipment was separate and apart from fuel sales, though the terms of both transactions were embodied in the same document.<sup>20</sup> The Court gave considerable weight to the fact that the lease portion of the contract was “readily distinguishable” from the portion covering fuel sales, and that neither portion of the contract was dependent upon the other.<sup>21</sup> The Court also emphasized that the fuel agreement could be terminated independently, without causing termination of the lease agreement.<sup>22</sup> Because the fuel agreement was separate and divisible from the lease agreement, receipts from sales of fuel (which were not subject to the sales and use tax) were not properly included in the gross proceeds<sup>23</sup> from the leasing of vehicles (which was subject to the sales and use tax).<sup>24</sup>

The Taxpayer’s Contract here involves, in part, the transfer of [TANGIBLE PERSONAL PROPERTY] and other equipment. There is no question that these items are tangible personal property, and are consequently subject to sales or use tax under TENN. CODE ANN. § 67-6-204(a).

Whether the Taxpayer’s sale of Services and the License is subject to Tennessee sales and use tax, therefore, depends upon whether the terms of the Taxpayer’s Contract relating to the Services and License are separate, divisible, and “readily distinguishable” from the portion of the contract relating to the provision of the [TANGIBLE PERSONAL PROPERTY] and equipment. A review of the provided Contract reveals that the terms are not separate, divisible, or “readily distinguishable.”

First, there is no option in the Contract for a party to choose only to lease [TANGIBLE PERSONAL PROPERTY] and equipment or to receive the Services and License, notwithstanding the word “option” included in the [REDACTED] price schedule. The first provision under the “[REDACTED]” heading states that:

[REDACTED].

This language does not contemplate an option to [USE] independently owned [TANGIBLE PERSONAL PROPERTY].

Moreover, it is seemingly impossible for a party to lease only [TANGIBLE PERSONAL PROPERTY] from the Taxpayer without also acquiring the Taxpayer’s services, as many of the Services and the License are tied to the use of [REDACTED] leased [TANGIBLE PERSONAL PROPERTY]. [MOST] provisions listed under [THE SERVICES AND LICENSE SECTION] refer to the contracting party as a “LESSEE,” and also reference either [REDACTED] leased

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<sup>20</sup> *Id.*

<sup>21</sup> *Id.*

<sup>22</sup> *Id.*

<sup>23</sup> Note that the tax on the lease or rental of property is no longer based on “gross proceeds,” but is instead based on the “sales price.” See TENN. CODE ANN. § 67-6-204(a) (2011).

<sup>24</sup> *Penske Truck Leasing Co.*, 795 S.W.2d at 671.

[TANGIBLE PERSONAL PROPERTY] or leased equipment. [REDACTED].<sup>25</sup> The provisions regarding Services are mostly dependent upon the lease of [TANGIBLE PERSONAL PROPERTY], and are not “readily distinguishable.”<sup>26</sup>

Second, [REDACTED].

Third, [REDACTED].<sup>27</sup>

Fourth, unlike the separately terminable agreements in *Penske Truck Leasing Co.*, the Contract at issue here contains one cancellation clause [REDACTED] allowing either party to cancel “at the end of any lease term.” The Taxpayer is further allowed to cancel the Contract if the lessee breaches the Contract or “fails to [USE] the [TANGIBLE PERSONAL PROPERTY] in a safe and prudent manner.” This provision makes no distinction between a lease of [TANGIBLE PERSONAL PROPERTY] and equipment and the provision of Services and a License. If the Contract is cancelled for any reason, the entire agreement is cancelled, and [ANOTHER] provision allows the Taxpayer to repossess the leased [TANGIBLE PERSONAL PROPERTY] if necessary.

Finally, although the Taxpayer represents that it “does expressly provide [its Services and License] to [CONTRACTING PARTIES] who own their own [TANGIBLE PERSONAL PROPERTY] and equipment and to whom the Taxpayer leases no tangible personal property,” the Taxpayer has not represented that it would ever lease [TANGIBLE PERSONAL PROPERTY] to a [CONTRACTING PARTY] without requiring the [CONTRACTING PARTY] to use the Taxpayer’s Services and License. This omission accords with a plain reading of the contract and common sense, as it is unlikely that the Taxpayer would allow its brand name and image to rest on [CONTRACTING PARTIES] that have not had its own training, that do not use its [REDACTED], and may or may not be insured. Clearly the leasing of [TANGIBLE PERSONAL PROPERTY] is intertwined with the provision of the Taxpayer’s Services and License.

The lease agreement for the Services and License is therefore not separate from the lease agreement for the [TANGIBLE PERSONAL PROPERTY] and Equipment. Having found the agreements to be indivisible, the Taxpayer’s non-enumerated Services and the License are necessarily bundled with a taxable sale of tangible personal property. Consequently, the Taxpayer’s Services and License are subject to Tennessee sales and use tax.

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<sup>25</sup> (Emphases added).

<sup>26</sup> See *Penske Truck Leasing Co.*, 795 S.W.2d at 671.

<sup>27</sup> (Emphasis added).

APPROVED: Richard H. Roberts  
Commissioner of Revenue

DATE: August 16, 2013