

**TENNESSEE DEPARTMENT OF REVENUE
LETTER RULING # 07-01**

WARNING

Revenue rulings are not binding on the Department. This presentation of the ruling in a redacted form is information only. Rulings are made in response to particular facts presented and are not intended necessarily as statements of Departmental policy.

SUBJECT

Application of the sales and use tax to an on site copy and fax center.

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 on 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 his detriment.

FACTS

Taxpayer will operate and manage on-site copy and fax centers for its clients. Based on client needs, the Taxpayer may provide personnel only, personnel and supplies, or personnel, supplies and equipment.

The services provided by the Taxpayer include the following:

On Site Copy and Fax Center

At the client's facility, the Taxpayer's personnel will make copies of original documents submitted by the client and provide related copy services (binding, stapling, numbering, etc.). The Taxpayer provides the personnel, supplies and equipment required to produce the copies.

At the client's facility, the Taxpayer's personnel will operate facsimile equipment for incoming and outgoing faxes and deliver the faxes as per the client's request.

All direct costs, administrative expenses and overhead are paid directly by the Taxpayer. All personnel provided by the Taxpayer will be part-time or full-time permanent employees of the Taxpayer, paid by the Taxpayer, and entitled to benefits under the Taxpayer's policies. Generally, it is expected that personnel involved in these operations will work primarily at the client's facility, but occasionally separate facilities are established.

Generally, the machinery and equipment used by the Taxpayer at the client's premises in the copy center is rented or owned by the Taxpayer. On occasion, the client will sell its equipment to the Taxpayer who will then use the equipment to perform the services.

Billing for services rendered

Under the contract, the client is billed for a "monthly management fee." Generally, clients are billed under a one to five year contract term at a monthly management fee for a defined level of services including:

- A. An allowance covering a stated number of copies and facsimiles, all rental and other charges for the equipment provided by the Taxpayer and all charges for related supplies.
- B. Fee for personnel, travel, staff support and other overhead costs.
- C. Management report and counseling to the clients.

For copies and facsimiles which exceed the monthly allowance, the client is charged a fixed price per copy/facsimile. The fixed price includes the cost of supplies.

The contract also provides for overtime billing at a specified rate should the Taxpayer's personnel work overtime on the site.

All amounts paid are treated under this contract as taxable gross receipts with no deduction taken for the cost of equipment, labor or service cost and other related materials used. The client is billed sales tax on the entire gross receipts as per the contract.

QUESTIONS

1. Would machinery or equipment purchased, rented or leased by the Taxpayer in connection with providing the services described above qualify for a sales and use tax exemption?
2. Would supplies and materials purchased by the Taxpayer and used in the various operations be exempt from sales tax?
3. Would all amounts paid under this contract be considered as taxable gross sales? If yes, can the Taxpayer take a deduction from the gross sales for the cost of equipment, labor or service cost and other related materials used in performing services under the contract? Should the client be billed for taxes on the entire amount as per the contract?

RULINGS

1. Machinery utilized in the pre-press and press operations and machinery or equipment utilized in the binding and stapling processes qualify for the industrial machinery exemption from sales and use tax. Machinery and equipment used for sending and receiving facsimiles are subject to tax.
2. Supplies and materials that become a component part in the machinery used for copying and the fluids and chemicals necessary for the operation of the copying machinery will be exempt from sales and use tax. In addition, the purchase of the paper used for making copies will also be exempt from sales and use tax as a sale for resale.
3. Yes. All amounts paid under the contract are taxable. The Taxpayer may not take a deduction from the gross sales for the cost of the equipment, labor or service cost or other related materials used in performing the contract. The client should be billed for sales tax on the entire amount of the contract.

ANALYSIS

1. Machinery utilized in the pre-press and press operations and machinery or equipment utilized in the binding and stapling processes qualify for the industrial machinery exemption from sales and use tax.

TENN. COMP. R. & REGS. 1320-5-1-.67(2) states that printing and binding are subject to sales and use tax unless the product is manufactured for resale:

The printing and binding of paper, books, forms, letters, and the like is a fabrication thereof, and is subject to the Sales or Use Tax unless the fabrication is a part of a manufacturing process for resale. It is immaterial whether the customer furnishes any or all the paper or other materials used in the fabrication work. . . .

Because printing and binding constitute the fabrication of tangible personal property, the industrial machinery and equipment used in the process may be exempt from sales and use tax as industrial machinery under Tenn. Code Ann. § 67-6-206(a). Industrial machinery is defined by Tenn. Code Ann. § 67-6-102(a)(19) as:

(A) Machinery, apparatus and equipment with all associated parts, appurtenances and accessories, including hydraulic fluids, lubricating oils, and greases necessary for operation and maintenance, repair parts and any necessary repair or taxable installation labor therefore, which is necessary to, and primarily for, the fabrication or processing of tangible personal property for resale and consumption off the premises . . . where the use of such machinery, equipment or facilities is by one who engages in such fabrication or processing as one's principal business. . . .

* * *

(C) Machinery utilized in the pre-press and press operations in the business of printing, including plates and cylinders and including the component parts and fluids or chemicals necessary for the specific mechanical or chemical actions or operations of such machinery, plates and cylinders, regardless of whether or not the operations occur at the point of retail sales.¹

Statutes granting exemptions from tax are strictly construed against the taxpayer. *AFG Indus., Inc. v. Cardwell*, 835 S.W.2d 583, 584-585 (Tenn. 1992). And exemptions from taxation will not be read into a taxing statute by implication. *Hamilton National Bank v. McCanless*, 144 S.W.2d 768 (Tenn. 1940).

¹ It should be noted that only part (A) of the definition of industrial machinery requires that fifty-one percent (51%) of the use of the machinery or equipment be for the purpose of the fabrication or processing of tangible personal property, whereby, part (C) does not share this requirement.

In order to qualify for the exemption, the Taxpayer must apply for an industrial machinery exemption. The rules for applying for the exemption are found in TENN. COMP. R. & REGS. 1320-5-1-.106, which reads as follows:

(1) Persons who wish to make purchases or leases of industrial machinery shall apply to the commissioner for authority to make such purchases exempt from tax. This application shall give such information as the commissioner may require. If the commissioner finds from such information that the applicant is entitled to make purchases or leases of industrial machinery, authority shall be permanent in nature and shall continue until such time as the business ceases operation or until such time as the business changes in character such that it is no longer operating within the scope of its original application. Any misrepresentation made on the application by the taxpayer will subject the taxpayer to any applicable tax, penalty and interest. . . .

According to the American Heritage Dictionary, Fourth Edition, a definition of printing is “to produce something in printed form by means of a printing press or other reproduction process.” Making copies is a reproduction process and thus is a form of printing. Since the Taxpayer is engaged in “the business of printing,” the machinery utilized in the conduct of the business of printing falls within the definition of “industrial machinery” in accordance with Tenn. Code Ann. § 67-6-102(a)(19)(C), and is eligible for the exemption; provided that, the appropriate documentation is filed and approved by the Commissioner. In addition, the machinery and equipment used in the binding and stapling process will be exempt from sales and use tax provided over fifty percent (50%) of gross sales are from the fabricating or processing of tangible personal property, i.e. booklets, brochures, etc. for resale. Tenn. Code Ann. § 67-6-102(a)(19)(A).

Printing, as the term is used in Tenn. Code Ann. § 67-6-102(a)(19)(C), does not include the sending and receiving of facsimiles. The exemption from sales and use tax for machinery, component parts and chemicals used in the “business of printing” must be read narrowly and cannot be expanded to include the machinery used for sending and receiving of facsimiles. The Taxpayer therefore, is not entitled to an exemption for the machinery used in the sending and receiving of facsimiles because the sending and receiving of facsimiles is a taxable telecom service. As a specifically taxable service, the sending and receiving of facsimiles does not constitute the processing or fabrication of tangible personal property for resale. *AT&T v. Johnson*, 2002 WL 3124708 (Tenn. Ct. App. 2002), *perm. app. denied* (Tenn. 2003). Therefore, the machinery also does not fall under Tenn. Code Ann. § 67-6-102(a)(19)(A) and is not exempt under this provision.

2. Supplies and materials that become a component part in the machinery used for copying and the fluids and chemicals necessary for the operation of the copying machinery would be exempt from sales and use tax. Paper used to make copies may be purchased on a resale certificate.

Supplies and Materials

Component parts and necessary fluids or chemicals are also included in the definition of industrial machinery under Tenn. Code Ann. § 67-6-102(a)(19)(C). Accordingly, any supplies and materials which become a component part of the machinery used for copying would be exempt from sales and use tax. In addition, any fluids or chemicals that are necessary for the mechanical and chemical actions and operations of the copy machines would also be exempt as industrial machinery.

Paper

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 WL 420911 (Tenn. Ct. App. 1994). The taxable services are listed in the definition of “retail sale.” Tenn. Code Ann. §67-6-102(a)(32)(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). *But see Prodigy Services Corp., Inc. v. Johnson*, 125 S.W.3d 413 (Tenn. Ct. App. 2003)(where the court more recently applied the “true object” test and found that telecommunications services were not the true object of the taxpayer’s computer information services; thus, the information services were not taxable).

Some transactions are essentially sales of services, and the courts have recognized that although property may be transferred to the client 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*, 538 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 client, 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 photocopying are essentially transfers of tangible personal property.² The photocopies generated are the crucial, not incidental, element of the Taxpayer’s transaction with its clients and, as such, constitute the sale of tangible personal property; therefore, sales tax must be collected and remitted by the Taxpayer. Because the Taxpayer is in the business of selling

² The facsimile services are taxable as telecommunications services under Tenn. Code Ann. § 67-6-102(a)(32)(F)(iii).

tangible personal property in the form of copies, it may purchase the paper it uses for making copies on a resale certificate.

3. The Taxpayer may not take a deduction from the gross sales for the cost of the equipment, labor or service cost or other related materials used in performing the contract.

The sales³ tax due is computed based on the sales price of the tangible personal property. “Sales price” is defined in Tenn. Code Ann. § 67-6-102(a)(35) as, “the total amount for which a taxable service or tangible personal property is sold, including any services that are a part of the sale of tangible personal property. . . .” Accordingly, the Taxpayer’s clients should be billed and the Taxpayer should remit sales tax on the total sales price of each contract.⁴

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Approved: Loren L. Chumley
Commissioner of Revenue

Date: 01/16/07

³ Although not specifically requested, the Taxpayer should note that Tenn. Code Ann. § 67-4-708(3)(C) of the Business Tax Act specifically makes services taxable: “making sales of services or engaging in the business of furnishing or rendering services” is a taxable privilege unless the services are specifically excluded. Services are defined by Tenn. Code Ann. § 67-4-702(a)(19) as, “every activity, function or work engaged in by a person for profit or monetary gain except as otherwise provided in this part.” The Taxpayer is providing management, copying and faxing services to its clients. These activities fall within the scope of Tenn. Code Ann. § 67-4-708(3)(C). The Taxpayer, therefore, also owes business tax on the services it provides.

The business tax has been described as a “gross receipts” tax. *Stalcup v. City of Gatlinburg*, 577 S.W.2d 439, 440 (Tenn.1978); *IBM Credit Corp. v. County of Hamilton*, 830 S.W.2d 77, 78 (Tenn. Ct. App. 1992). Thus, in order to determine the amount of taxes due, it is necessary to first determine the sales price of the services sold. Tenn. Code Ann. § 67-4-702(a)(17) defines “sales price” as “the total amount for which ... services rendered [are] sold ... without any deduction therefrom on account of the ... labor or service cost ... or any other expense whatsoever.”

The sales price for the Taxpayer’s services is the total amount paid by the client under the contract. The Taxpayer may not take a deduction for labor or service costs or any other costs of doing business. The Taxpayer should bill the client for tax on the total contract price for the services.

⁴ Legislation related to the Streamlined Sales and Use Tax Agreement, effective July 1, 2007, may result in changes regarding the application of sales and use tax sales of certain items of tangible personal property. The Department of Revenue encourages you to visit our website at www.tennessee.gov/revenue for updates.