



Private Letter Ruling 05-003

Redacted Version

Sales Tax

March 24, 2005

Sales Tax Treatment of Electronic Discovery Services

This private letter ruling describes the sales and use tax treatment of electronic discovery services and applies only to the facts presented here.

Facts

A company provides electronic discovery services for litigation teams around the country. The company gives legal teams and investigatory agencies the ability to electronically search through potentially relevant data needed to supply information requested in a legal discovery. The company's services can be divided into four phases:

1. Evidence Collection—The company works with the client's management and technology team to identify areas of critical interest to the litigation team. After the company's employees acquire an understanding of the client's business objectives, document management systems, document retention policies, and the quantity and variety of the data, the company prepares a document discovery strategy to extract relevant data. The information is then collected from the client's systems. This function may be performed solely by the client's employees or with the assistance of the company's employees.
2. Data Preparation—After the data has been collected, the company loads the information into its "data preparation center" where the electronic records are inventoried. Each file is assigned a unique number and scanned for viruses. Duplicate and irrelevant records are culled from the inventory.

The data preparation phase also includes creating a metadata file (data about the data). The metadata file supplies additional information to the litigators that may be important to the client's case. For example, a metadata file stores information about when a document was created, who created it, the document's topic, and to whom the document was sent and when. The company creates the metadata file from the client's original records after they are organized and serialized. While clients may use the metadata file to locate records for discovery, they may not sell or distribute the information because the metadata file remains the property of the company.

3. Data Review—After preparation for use, the files described above are made available for the client or litigation team to review it in one of the following formats:
 1. web-based application;
 2. File Transfer Protocol (FTP) server; or
 3. a tangible format (printed material, tapes, compact discs, or a hard drive).

If the data is made available through a web-based application, the data is stored on the company's computer server located outside of Louisiana and clients are allowed access

remotely via the Internet. If the data must be delivered in some other form, clients can download the data from an FTP server or have the information delivered in the form of printed material, tapes, compact discs, or hard drive to their office.

4. Data Production—Once the documents have been reviewed, the relevant, non-privileged data set is delivered to the appropriate parties. A crucial aspect of production is to accurately and reliably track the documents reviewed so that litigation teams and clients know what documents went to which recipients and when. Each recipient's requests are tracked and a history of these requests is made available to the client in the same manner as the documents were delivered.

The "production file" tracks what documents are requested by the litigating parties and when. For example, if Attorney "A" from Law Firm "XYZ" requests a copy of a particular document, the production file will list when that attorney requested and received the document and any other pertinent information. The production files also belong to company and cannot be sold or distributed by the client.

The company charges for its services based upon the volume, either data size or page count; by the hour for professional consulting or programming services; and by media, where media-related services are performed. The media used to deliver the files determine the charges as follows:

1. When access to the information is provided via the company's server located outside of Louisiana, customers are billed for two charges. The first is for processing and publishing the information to the company's website. The second charge is for a monthly "access fee" to view the data online, which is roughly equivalent to a charge for hosting the client's data on their website.
2. If the customer desires to receive the information in a printed format, the files are transmitted to an outside company for printing, which is billed separate from the charges for processing and publishing the data.
3. On very rare occasions the information is loaded onto a hard drive for installation on the client's computer. In these rare instances, the cost of the hard drive is billed separately.

If the information is delivered to the client on a compact disk, there is no additional charge since the cost of the CD is insignificant. Expenses incurred, such as travel and shipping, are billed as separate line items.

Issue

Is the company required to collect and remit sales tax on sales made into the State of Louisiana?

Discussion

La. Rev. Stat. Ann. §§ 47:302, 321, 331, and Section 2 of the Louisiana Tourism Promotion District Ordinance levy sales and use tax on three categories of transactions: the sale at retail or use of tangible personal property; the lease or rental of tangible personal property; and the eight taxable services. As described below, the transactions occurring between the company and its customers do not fall into any of the three categories and thus are not taxable.

The first category of taxable transactions is the sale at retail or use of tangible personal property. Although items transmitted electronically like songs, books, videos, and computer software are tangible personal property under Louisiana law¹, the primary purpose of the company's transactions is the providing of technical or professional services. La. Admin. Code tit. 61, § 4301.C. *Tangible Personal Property* explains that work products presented in tangible form that have worth because of the technical or professional skills of the seller are considered non-taxable technical or professional services because the tangible personal property delivered to the client is insignificant in comparison to the services performed. The files produced by the company fall into this category. The primary purpose of these transactions is to provide a non-taxable service even when the results are available to the customer in the form of tangible personal property. However, the company would owe use tax on tangible personal property or taxable services acquired to provide these services.

The transaction is also not a fabrication under La. Rev. Stat. Ann. § 47:301(12), which defines a sale as the transfer of title or possession of tangible personal property for a consideration and includes, "the fabrication of tangible personal property for consumers who furnish, either directly or indirectly, the materials used in fabrication work...." A fabrication for purposes of Louisiana sales and use tax "means to make, build, create, produce, or assemble components of tangible personal property, or to make tangible personal property work in a new or different manner."² The records serve their intended purpose in their original state and are not components of a new and distinct product. Loading, inventorying, searching, and sorting the records does not create new records; they are merely organized for legal discovery by litigation teams. This does not rise to the level of a fabrication where a new and distinct product is created from its component parts.

Similarly, the transfer of the metadata and production files is not a sale at retail or use of tangible personal property. Although the files remain the property of the company and the client is allowed unrestricted access to the records, the underlying transaction remains a non-taxable technical or professional service involving compiling data about the use and distribution of the records.

The second category of taxable transactions is the lease or rental of tangible personal property. La. Rev. Stat. Ann. § 47:301(7)(a) defines "lease or rental" as "the leasing or renting of tangible personal property and the possession or use thereof by the lessee or renter, for a consideration, without transfer of title of such property." For a rental or lease to occur, the renter or lessee must temporarily use or possess tangible personal property for consideration, and there must be no transfer of title of the rented or leased tangible personal property. No phase of the services provided by the company qualifies as a lease or rental transaction for Louisiana sales and use tax.

¹ In *South Central Bell Telephone Co. v. Sidney J. Barthelemy, et al.*, 94-0499 (La. 12/15/94), 643 So.2d 1240, the court held that canned and custom software constitutes tangible personal property as defined in La. Rev. Stat. Ann. § 47:301(16). However, Acts 2002, 1st Ex.Sess., No. 7, § 1 amended La. R.S. 47:301(16) to provide that tangible personal property shall not include "custom software" although the exclusion is being implemented in 25 percent increments between July 1, 2002, and June 30, 2005.

² La. Admin. Code tit. 61, § 4301.C. *Sale* b.

In the “evidence collection” phase of the service, the customer retains title to the records and no temporary possession or use of the reorganized records is at issue. In the “data preparation” and “data production” phases of the service, the files produced remain with the company and ownership does not pass to the client. Instead, the client is granted the perpetual right to access the files, similar to the manner in which most software is transferred to customers in the form of perpetual license agreements. Perpetual access to a product would be classified as a sale under § 47:301(12) (any transfer of title or possession, or both, of tangible personal property for a consideration) were it not for the fact that the underlying transaction is for technical or professional services. Thus, the “data preparation” and “data production” phase of the service does not fit under the category of taxable leases or rentals of tangible personal property.

The third category of taxable transactions is the provision of a taxable service listed in La. Rev. Stat. Ann. § 47:301(14). None of the eight enumerated services listed in § 47:301(14) match the services provided by the company. Additionally, § 47:301(14)(i)(iii)(ff) specifically states that telecommunications services do not include “[i]nformation and data services, including storage of data or information for subsequent retrieval, the retrieval of data or information, or the processing, or reception and processing, of data or information intended to change its form or content.” In the instances where the company provides remote access to the files via the Internet through the company’s computer server located outside of Louisiana, any storage of data or information for the customers’ subsequent retrieval falls into this exclusion. In the instances where the customer receives the files through a download, compact disc, or hard copy, the providing of evidence collection, data preparation, and data production are services not specifically enumerated in § 47:301(14) and thus, are not taxable.

Conclusion

The services provided by the company are not subject to sales or use tax as sales of tangible personal property, fabrication of tangible personal property, or services. Therefore, the company is not required to collect and remit sales tax on sales made into the State of Louisiana.

Cynthia Bridges
Secretary
Louisiana Department of Revenue

By: _____
J. A. Cline, Jr., CPA
Revenue Tax Research Analyst
Policy Services Division

This correspondence constitutes a private letter ruling (PLR) by the Louisiana Department of Revenue, as provided for by section 61:III.101 of the Louisiana Administrative Code. A PLR provides guidance to a specific taxpayer at the taxpayer's request. It is a written statement that applies principles of law to a specific set of facts or a particular tax situation. A PLR does not have the force and effect of law, and is not binding on the person who requested it or on any other taxpayer. This PLR is binding on the department only as to the taxpayer to whom it is addressed, and only if the facts presented were truthful and complete and the transaction was carried out as proposed. It continues as authority for the department's position unless a subsequent declaratory ruling, rule, court case, or statute supersedes it.