

**TENNESSEE DEPARTMENT OF REVENUE  
REVENUE RULING #12-25**

**WARNING**

**Revenue rulings are not binding on the Department. 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 various Internet-based services.

**SCOPE**

Revenue Rulings are statements regarding the substantive application of law and statements of procedure that affect the rights and duties of taxpayers and other members of the public. Revenue Rulings are advisory in nature and are not binding on the Department.

**FACTS**

The Taxpayer provides the various Internet-based services via remote computer access described in detail below (the “Web Services”). The Web Services are purchased or used by subscribers, participants invited by subscribers, and trial users. The Taxpayer does not sell, transfer, or license software or tangible personal property to its customers, although the customer must download the applet described below to access the Web Services. There is no charge for downloading the applet.

Customers may not access the Taxpayer’s software code or manipulate it in any way. Instead, the Taxpayer utilizes its proprietary system (comprised of hardware and software) to provide the Web Services and charges for these services on a per-user subscription basis. The Taxpayer’s proprietary software is maintained on the Taxpayer’s own equipment; the software and equipment remain at all times under the control of the Taxpayer. The Taxpayer’s Web Services infrastructure includes multiple data centers [REDACTED]; no data centers are located in Tennessee.

Customers access the Web Services via the Taxpayer’s websites by downloading an applet. These users are unable to alter or manipulate the applet at any time. Unless connected to the Web Services, the applet has no functionality; the applet is of no use to a person who does not subscribe to the Taxpayer’s services. There is no charge for the download or use of the applet.

The applet is a piece of Java script or code that is necessary for access to the Web Services; the main purpose of the applet is to enable a secure connection over the Internet. More specifically, the applet works with the Taxpayer’s proprietary system to navigate through computer firewalls and facilitate secure connections between the user and the user’s computer, when the user is at a

remote location. Once a connection is established, an encrypted data stream is passed through communication servers located in the Taxpayer's data centers. There are two points of encryption: 1) link security, which enables each endpoint to have a secure connection to the data center; and 2) end-to-end encryption, which allows encryption of the data stream between the endpoints.

The Taxpayer generally makes a [REDACTED] free trial of its Web Services available to potential customers. The free trial provides the same functionality as the paid subscription, and includes the applet. If the customer decides to cancel the trial without purchasing a subscription, the non-functional, unusable applet remains on the customer's computer. There is no charge for downloading the applet as part of the free trial, and the customer is not required to remove the applet at any time. To subscribe to the Web Services, a customer creates an account either by entering into a contract with the Taxpayer or by registering online and creating a username and password.

The Taxpayer is not an Internet service provider, nor does it provide or charge for telecommunications services to its customers. In order to utilize the Taxpayer's services, customers must independently obtain an Internet connection and/or telecommunications services from a third party.

The following is a description of each type of Web Service provided by the Taxpayer.

### **Web Service #1**

Web Service #1 allows a customer's designated customer service technicians and/or internal help desk to remotely assist and provide support to the customer's employees and/or own customers. This service provides subscribers with a functionality that allows the subscriber's own technicians to gain remote access to the employee or customer's computer in order to fix problems.

Customers subscribing to Web Service #1 download the applet. Web Service #1 works by allowing a customer's employee to access an Internet support portal and type in a URL to allow access to the employee's computer. The support request is then queued for the customer's next available technical support representative. With the employee's permission, the representative accesses the employee's computer through the Internet. The representative then begins a remote support session with the employee.

Alternatively, the employee can move directly from a phone call to a remote support session. To do so, the representative provides the employee with the web portal URL and a unique connection code to begin the remote support session. By utilizing this web-based service, the representative can immediately diagnose, troubleshoot, and resolve issues remotely. The Taxpayer charges its subscribers for this service on a per user basis. Subscribers may also purchase one or more "day passes" that allow usage over a 24-hour period.

Subscribers to Web Service #1 may also purchase a complimentary service that allows the subscriber to monitor its information technology networks, devices, and servers, maintain inventory management of such items, and perform associated analysis and reporting.

## **Web Service #2**

Web Service #2 deploys a technology similar to that of Web Service #1, except that it allows a subscriber to access his or her own computer remotely. Customers subscribing to Web Service #2 download the applet. Web Service #2 allows a user to access his or her own computer remotely from any other Internet-connected computer through a private, secure connection. To facilitate this ability, the service navigates through the user's firewalls to enable communication without compromising security. This service is predominantly used for home and office applications. It is sold primarily to individuals who wish to access an office computer from home, and vice-versa.

Web Service #2 encompasses four components: a remote (or client) computer, communication servers/brokers, firewalls, and permitted host computers. A subscriber can register and access up to a set number of host computers, depending upon the level of service purchased.

When a user attempts to access a host computer remotely from a client computer, the user visits the service website, enters a username and password, and clicks on a "connect" button for the desired host computer. The user is then authenticated through the web-based broker operated separately from the user's computer. This broker, located at Taxpayer's server site and part of the Taxpayer's proprietary system, acts as an authorizer/traffic controller and grants permission for the users to access the service/host computers. For network address and firewall independence, the remote user initiates all communication with the broker via a URL. All transmissions are encrypted and only those subscriber computers previously configured will be displayed and accessed remotely.

## **Web Service #3**

Web Service #3 utilizes a similar technical infrastructure to allow multiple users to view a presenter's computer screen. Customers subscribing to Web Service #3 download the applet, which runs on the customer's computer to initiate a secure transmission control protocol [hereinafter "TCP"] connection using ports open in most firewalls. The applet is used to create the quickest, most secure compatibility with existing network security. Once a connection is made, the service is provided by the Taxpayer through one of its data centers, none of which are located in Tennessee.

Web Service #3 enables subscribers to meet with others and present information securely online. Subscribers are able to conduct an unlimited number of Internet meetings for a flat monthly or annual fee. Up to [NUMBER of] meeting participants may attend and view the meeting materials displayed during the meeting. This service also enables subscribers to securely display information online to a broader audience. Subscribers may hold unlimited online seminars ("webinars") on the Internet with up to [NUMBER of] attendees. There is no charge to the meeting or webinar participants, who do not have to be registered users. The meeting or webinar organizer sends participants a URL, which enables the participants to download an applet to support the connection that allows them to view the organizer's computer.

The online presentation is viewed by the participant from the participant's computer. The content, and the application used to display the content, remain on the organizer's computer at all times. The Taxpayer does not provide or transmit any application software used by the organizer.

This service has a recording feature by which the organizer has sole authority to initiate recordings. The recording is saved to the organizer's computer desktop; the Taxpayer does not have access to recordings. The organizer can post the recording to a web server for viewing by participants.

#### **Web Service #4**

Web Service #4 enables subscribers to conduct online training sessions with their attendees. This service allows synchronous online training sessions, distribution of course materials, testing and assessments, publication of upcoming courses to a catalogue, and maintenance of a reusable content library. Customers subscribing to Web Service #4 download the applet.

All content is generated by the subscriber to the service. The subscriber may upload its materials to the Taxpayer's server; in that case, the data is maintained in the Taxpayer's data centers. The trainee will download the subscriber's training content for use during the session. Alternatively, the subscriber can maintain the content elsewhere and distribute a URL to access the materials.

Subscribers to this service may also access and use the Web Service #3 online meeting application to conduct online meetings. The primary difference between Web Service #3 and Web Service #4 is that Web Service #3 allows the subscriber to hold a webinar with up to [NUMBER of] participants, while Web Service #4 allows the subscriber to hold a training session with up to [NUMBER of] participants. Additionally, Web Service #4 allows the subscriber to make training materials and tests available online in advance of the training session.

#### **RULINGS**

Are the Taxpayer's Web Services subject to the Tennessee sales and use tax?

Rulings:

1. *Web Service #1.* No. The provision of Web Service #1 is not subject to the Tennessee sales and use tax.
2. *Web Service #2.* No. The provision of Web Service #2 is not subject to the Tennessee sales and use tax.
3. *Web Service #3.* Yes. The provision of Web Service #3 is subject to the Tennessee sales and use tax.
4. *Web Service #4.* Yes. The provision of Web Service #4 is subject to the Tennessee sales and use tax.

## ANALYSIS

Under the Retailers' Sales Tax Act, TENN. CODE ANN. §§ 67-6-101 to -907 (2011), the retail sale in Tennessee of tangible personal property and specifically enumerated items and services is subject to the sales and use tax, unless otherwise exempted.

TENN. CODE ANN. § 67-6-102(80)(A) (2011) defines the term "sale" in pertinent part to mean "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."

Tangible personal property, as defined in the Retailers' Sales Tax Act, means "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(91)(A). Tangible personal property also includes "prewritten computer software."<sup>1</sup> TENN. CODE ANN. § 67-6-102(91)(A). Conversely, the sale or use of intangible intellectual property is generally not subject to Tennessee sales and use tax.<sup>2</sup>

In addition to the transfer of tangible personal property, the term "sale" also includes "the furnishing of any of the things or services taxable" under the Retailers' Sales Tax Act. *See* TENN. CODE ANN. § 67-6-102(80)(C). One of the "things" the Retailers' Sales Tax Act specifically imposes sales and use taxation on is

[t]he retail sale, lease, licensing or use of computer software in this state, including prewritten and custom computer software<sup>3</sup> . . . regardless of whether the software is delivered electronically, delivered by use of tangible storage media, loaded or programmed into a computer, created on the premises of the consumer or otherwise provided.

TENN. CODE ANN. § 67-6-231(a) (2011) (footnote added). Computer software is defined as "a set of coded instructions designed to cause a computer . . . to perform a task." TENN. CODE ANN. § 67-6-102(20).

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<sup>1</sup> TENN. CODE ANN. § 67-6-102(70) defines the term "prewritten computer software" in pertinent part as "computer software, including prewritten upgrades, that is not designed and developed by the author or other creator to the specifications of a specific purchaser." TENN. CODE ANN. § 67-6-102(70) further provides that "[p]rewritten computer software" or a prewritten portion of the computer software that is modified or enhanced to any degree, where the modification or enhancement is designed and developed to the specifications of a specific purchaser, remains prewritten computer software." Note, however, that where there is a "reasonable, separately stated charge or an invoice or other statement of the price given to the purchaser for the modification or enhancement, the modification or enhancement shall not constitute prewritten computer software." TENN. CODE ANN. § 67-6-102(70).

<sup>2</sup> If intangible intellectual property is stored on tangible storage media that is sold or used in Tennessee, however, then it does become subject to the sales and use tax, *see Crescent Amusement Co. v. Carson*, 213 S.W.2d 27, 29 (Tenn. 1948) (holding that rental films are tangible personal property), unless the tangible method of data transfer is "merely incidental" to the underlying transaction. *Commerce Union Bank v. Tidwell*, 538 S.W.2d 405, 407 (Tenn. 1976).

<sup>3</sup> As explained above, "prewritten computer software" is also subject to sales and use taxation as tangible personal property. *See* TENN. CODE ANN. § 67-6-102(91)(A).

Services are also taxable under the Retailers' Sales Tax Act. *See* TENN. CODE ANN. § 67-6-102(80)(C). But the sales tax does not apply to all services; rather, it only applies to retail sales of those services specifically enumerated by the statute. *See Covington Pike Toyota, Inc. v. Cardwell*, 829 S.W.2d 132, 135 (Tenn. 1992); *Ryder Truck Rental, Inc. v. Huddleston*, No. 91-3382-III, 1994 WL 420911, at \*3 (Tenn. Ct. App. Aug. 12, 1994). One of the services subject to the sales and use tax is the furnishing of “intrastate, interstate or international telecommunication services” for consideration, pursuant to TENN. CODE ANN. § 67-6-205(c)(3) (2011). The term “telecommunications service” is defined under TENN. CODE ANN. § 67-6-102(92)(A) as the “electronic transmission, conveyance, or routing of voice, data, audio, video, or any other information or signals to a point, or between or among points.” TENN. CODE ANN. § 67-6-102(92)(B)(i) excludes from the definition of “telecommunications service,” however, “[d]ata processing and information services that allow data to be generated, acquired, stored, processed, or retrieved and delivered by electronic transmission to a purchaser, where such purchaser’s primary purpose for the underlying transaction is the processed data or information.”

Another service subject to the sales and use tax is “[t]he furnishing, for a consideration, of ancillary services.” TENN. CODE ANN. § 67-6-205(c)(9). Ancillary services are “services that are associated with, or incidental to, the provision of telecommunication services.” TENN. CODE ANN. § 67-6-102(7). One particular form of ancillary service is a “conference bridging service,” which “links two (2) or more participants of an audio or video conference call.” TENN. CODE ANN. § 67-6-102(7)(A). Conference bridging services do not, however, include “the telecommunications services used to reach the conference bridge.”<sup>4</sup> *Id.*

Finally, a nontaxable service or item may be subject to taxation when charges for the nontaxable service or item are included in the sales price of a taxable good or service. Specifically, TENN. CODE ANN. § 67-6-102(81)(A) provides that the sales price of a good or service equals the “total amount of consideration . . . for which personal property or services are sold,” with no deduction for the seller’s costs or charges by the seller for services necessary to complete the sale. Thus, if taxable goods or services and nontaxable goods or services are sold together for a single charge, the entire charge is generally subject to taxation. *See Tomkats Catering, Inc. v. Johnson*, No. M2000-03107-COA-R3-CV, 2001 WL 1090516, at \*2 (Tenn. Ct. App. Sept. 19, 2001).

Accordingly, the Web Services described herein will be subject to the Tennessee sales and use tax if the charges relate to the 1) the retail sale or use of computer software in Tennessee, whether prewritten or custom; 2) the furnishing at retail of a telecommunications service; 3) the furnishing at retail of an ancillary service; and/or 4) the furnishing of an otherwise nontaxable good or service that is bundled with a taxable good or service.

## **WEB SERVICES #1 AND 2**

The Taxpayer’s Web Services #1 and 2 are not subject to the Tennessee sales and use tax.

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<sup>4</sup> The Taxpayer’s services cannot be characterized as any other type of service that is taxable under the Retailers’ Sales Tax Act. This revenue ruling therefore does not discuss any specifically enumerated services other than telecommunications services and ancillary services.

First, a transfer or use of computer software occurs in Tennessee when the Taxpayer provides Web Services #1 or 2 to its customers, but the transfer is not the true object of the transaction. To access Web Services #1 and 2, the subscribers are required to download a Java applet composed of script or code. The applet functions to establish a secure connection over the Internet to the Taxpayer's proprietary system. Consequently, the applet is "computer software" because it is "a set of coded instructions designed to cause a computer . . . to perform a task." TENN. CODE ANN. § 67-6-102(20). Moreover, the applet is "prewritten computer software" because it is a generic set of code not designed for any particular customer's specifications. *See* TENN. CODE ANN. § 67-6-102(70). The applet is thus considered tangible personal property.

Although the applet is tangible personal property, this does not cause the transaction to be subject to sales and use taxation. Tennessee's courts "have developed a method whereby judicial inquiry is made into the 'primary purpose' or 'true object' of the activity or business at issue." *Qualcomm Inc. v. Chumley*, No. M2006-01398-COA-R3-CV, 2007 WL 2827513, at \*4 (Tenn. Ct. App. Sept. 26, 2007). The applet, while necessary to securely access the Web Services, is not the "true object" of the transaction. Customers purchase Web Service #1 so that they can allow technical support agents to access their computer. Likewise, customers purchase Web Service #2 so that they can remotely access their home or office computer. In the absence of such services, nobody would download or use the applet. Consequently, the applet itself is not the true object of the Taxpayer's Web Services, and is not subject to sales and use taxation.

Second, the provision of the Taxpayer's Web Services #1 and 2 does not constitute a taxable service for Tennessee sales and use tax purposes because the Web Services are not a telecommunications service.

As noted above, a "telecommunications service" involves "the electronic transmission, conveyance, or routing of voice, data, audio, video, or any other information or signals to a point, or between or among points." TENN. CODE ANN. § 67-6-102(92)(A). All of the data involved with the use of Web Services #1 and 2, however, remains on the subscriber's computer. Web Services #1 and 2 merely allow the subscriber or a technical support agent to remotely view and manipulate the data at that single point, akin to attaching a second monitor to the subscriber's hard drive. Moreover, the "true object" of purchasing Web Services #1 and #2 is not to convey data from the subscriber's hard drive to another point. Rather, the true object of purchasing Web Services #1 and #2 is to manipulate data at a single point, on the subscriber's hard drive.

Third, the provision of the Taxpayer's Web Services #1 and 2 do not involve ancillary services. The Taxpayer has indicated that it does not provide any Internet access, but rather supplies the website functionality that allows its subscribers to access their home or office computers. Such service is not "incidental to . . . the provision of telecommunication services." *See* TENN. CODE ANN. § 67-6-102(7). Nor do Web Services #1 and 2 involve any "audio or video conference call[ing]," so they cannot be considered a "conference bridging service." *See* TENN. CODE ANN. § 67-6-102(7)(A). Therefore, providing Web Services #1 and 2 does not constitute a taxable service for purposes of the Tennessee sales and use tax.

Finally, because providing Web Services #1 and 2 does not implicate the Tennessee sales and use tax for the sale of computer software or for the sale of a taxable service, there is no way that

the Taxpayer can furnish an otherwise nontaxable good or service that is bundled with a taxable good or service.

Consequently, the Taxpayer's Web Services #1 and 2 are not subject to the Tennessee sales and use tax.

#### **WEB SERVICES #3 AND 4**

The Taxpayer's Web Services #3 and 4 are subject to the Tennessee sales and use tax.

For the reasons discussed above, Web Services #3 and 4 are not subject to taxation as a sale of computer software.

Web Services #3 and 4 do, however, involve unique functions not offered with Web Services #1 and 2 that are considered "ancillary services." As discussed above, ancillary services are "services that are associated with, or incidental to, the provision of telecommunication services."<sup>5</sup> The Taxpayer's Web Service #3 allows subscribers to meet with others and present information securely online from remote locations using a combination of audio and visual communication. Similarly, Web Service #4 allows subscribers to conduct synchronous online training sessions using a combination of audio and visual communication, in addition to the meeting capabilities offered with Web Service #3. Because these two Web Services "link[] two (2) or more participants of an audio or video conference call,"<sup>6</sup> they are properly considered "conference bridging services" that come under the umbrella of "ancillary services."<sup>7</sup> It is immaterial that the Taxpayer does not actually provide the Internet access services necessary to access the Web Services. Web Services #3 and 4 are thus taxable ancillary services under TENN. CODE ANN. § 67-6-205(c)(9).

As a result, Web Services #3 and 4 are subject to Tennessee sales and use tax.

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APPROVED:

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DATE:

10/31/12

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<sup>5</sup> TENN. CODE ANN. § 67-6-102(7).

<sup>6</sup> TENN. CODE ANN. § 67-6-102(7)(A).

<sup>7</sup> See TENN. CODE ANN. § 67-6-102(7).